FUNDS INSIDER

November 2022

Distressed M&A in the UK

SPAC developments in Luxembourg

Amendments to the Luxembourg Financial Collateral Law

New and proposed regulatory changes in the UK

The new Italian insolvency code

read more

ashurst

Contents

Foreword

Welcome to the autumn edition of Funds Insider, our quarterly publication focusing on hot topics across a wide range of practices areas of particular interest to private capital clients.

This edition will cover:

- What to watch out for in distressed M&A in the UK
- Recent SPAC developments in Luxembourg
- The new creditor-friendly features with amendments to the Luxembourg Financial Collateral Law
- A regulatory update for UK fund managers
- An overview of the new Italian insolvency code

In terms of global outlook, central banks around the world are raising interest rates in an effort to curb high rates of inflation and, as public markets begin to correct, we are now seeing this filter through to private markets and in the nature of the work that is currently keeping us busy. We are increasingly observing a flight to quality assets by investors and riskier deals being put on hold or becoming subject to much greater scrutiny.

COP27 also reiterated the market focus on ESG related matters as well as the opportunities that are arising from it and we are continuing to intensively engage with our clients on those issues.

We hope you enjoy reading this edition of Funds Insider. Please do get in touch if you have any feedback or if there are any topics you would like us to cover in future editions.

Funds Insider

FundsInsiderEMEA@ashurst.com

Distressed M&A in the UK

What to watch out for and what looks different this time around

By Molly Woods, Richard Bulmore and Liam Stoneley

Since the initial outbreak of coronavirus in 2020 and the resultant economic impact, the investor world has been poised for an abundance of distressed M&A opportunities. Thus far no such abundance has materialised. However, as we look ahead to the predicted 'winter of despair' it is difficult to see how governmental policy or alternative capital can continue to stem the tide. UK businesses across all industries continue to suffer the effects of supply chain and labour shortages, rising interest rates and rampant currency inflation. Consumer-facing businesses, including retail and hospitality, are still likely to be the most vulnerable, joined and are now by energy companies and other players in the energy sector impacted by the sector's volatility.

Such conditions of course present the need for solutions and mechanisms for realising the value in such businesses and assets, but investing in businesses operating in (or around) the zone of financial distress requires careful consideration, expert advice and guidance to avoid potential pitfalls.

This article:

- provides a reminder of why distressed M&A transactions should be treated differently to traditional M&A, and discusses the key considerations for both prospective sellers and purchasers; and
- explores recent law reform, and its impact, worth bearing in mind when contemplating distressed M&A opportunities in the current economic climate.

When a target business in stress or distress is the subject of an acquisition, there is a financial and regulatory backdrop which cannot be ignored and which will influence the valuation assessment and parties' priorities. The solvency status of the relevant entities involved, and the cashflow runway for the business, must be understood and closely monitored by all interested parties because this could dictate: who the economic owner is and therefore who a purchaser needs to negotiate with, the format the transaction can take (whether a formal insolvency process is required to effect a sale), the specific structuring of the transaction (share vs asset sale), the urgency of a completion and the potential (or lack thereof) for purchaser contractual value protections. Of course the situation is likely to evolve as the parties negotiate and, as such, remaining flexible is key.

We unpack these considerations further below.

Seller considerations

1. **Are the directors OK?**

   The directors of a company operating in the zone of insolvency will need to remain cognisant of the potential for the subjects of their Companies Act 2006 directors' duties to flip from being the members of the company to its creditors. This will happen gradually from the moment that the company is on the verge of insolvency or where insolvency (administration or liquidation) is 'probable', until those creditors' interests become paramount when an insolvent administration or liquidation is inevitable. Once the interests of the creditors are paramount, a director – regardless of whether they have been appointed by an existing shareholder – has a statutory and fiduciary duty to ensure those interests are protected and therefore to guide the board's decision-making in the context of any M&A process.

   The directors must ensure their actions do not fall foul of the wrongful trading rules (for example, by trading when they knew, or ought to have concluded, that there was no reasonable prospect the company would avoid an insolvency process), nor constitute fraudulent trading (for example, where directors knowingly allow the business to be carried on with the intent to defraud creditors, or for any other fraudulent purpose). Wrongful or fraudulent trading carries personal and potentially criminal liability for the directors and, accordingly, must be avoided.

   It may be prudent to consider at the outset of a proposed M&A process involving a company in the zone of insolvency whether the directors should receive their own separate advice, or whether the board should be supplemented (or advised) by someone with insolvency and/or restructuring experience. An easy, but important, defence tool for directors in such processes is the accurate and fulsome record-keeping of board decisions, reflecting due consideration by directors of the discharge of their duties and the solvency status of the company.

   It is worth keeping in mind (and remaining open to) whether the risk of insolvency dictates using an insolvency process to effect the disposal, for example an administration sale or a Company Voluntary Liquidation, where the buyer transacts with an appointed officeholder and not the directors. However, as mentioned below, this could have value implications.

2. **Director conflicts?**

   Where the business involves multiple operating entities, focus should be on the discharge of directors' duties, and compliance by directors with the legal framework needs to be carried out at each entity within the structure – not solely focused solely on the 'topco' or 'holdco'. Accordingly, another key consideration for directors of multiple target

companies within a group is the possibility for conflicts arising from wearing multiple governance hats. Each corporate entity and each board of directors must separately make determinations as to the solvency status and discharge of duties to the appropriate stakeholders (who may not be the same across the group, especially where layered or restricted security structures are in place). It may be appropriate for board sub-committees to be formed to the exclusion of directors with such active conflicts, in order to remove any concerns about tainting the M&A process.

3. **Valuation questions**

   Maximising value will be the key focus of the seller and its financial advisers. In this regard the usual rules apply: maintaining leverage through competitive tension is critical and a seller should ensure as much preparedness as possible, with a spotlight on risk and cost mitigation. It is likely that the speed of the transaction will result in little or no due diligence time for prospective buyers and, as such, the extent to which the seller team can provide ready information and solutions to liability exposure will make all the difference. To this end, questions of management (key personnel) transaction incentivisation should be considered and resolved early on to ensure the necessary effort and resources are applied to the process. This is of particular importance in approaching distressed M&A, as the role of management going forward and their ordinary course incentivisation may not be as certain as with traditional M&A processes.

   The directors of a seller entity also need to approach questions of valuation with an eye on solvency. If the disposal realises less value than the liabilities of the seller, questions of the seller's solvency and any post-completion obligations of the seller need to be carefully considered. Further, if the realised proceeds net of the costs of running the M&A process are forecasted to be lower than the likely proceeds from an insolvency process, directors may be required to pursue such means instead.

4. **Increased importance of speed and certainty**

   In a distressed process, speed and certainty for the seller are usually high on its list of priorities, driven by the cashflow runway and upcoming liability/cost milestones. While frustrating, the urgency of reaching a deal that avoids a value-destructive insolvency can (and often should) take precedence over other factors such as a higher bid price. Accordingly, a prospective buyer that can deliver a transaction in short order is likely to be preferred to a conditional, but higher value, bid if the bid cannot be delivered in time to avoid the sale being subsumed by an insolvency process. It would be prudent to discuss with the M&A financial adviser the benefit (in the context of the relevant transaction) of apprising prospective buyers of important cashflow milestones.

Purchaser considerations

1. **Expect an accelerated process**

   The biggest consideration for a purchaser will likely be the seller's accelerated timeframe for a completion, and the consequences of this on the purchaser's ability to meet its internal decision-making requirements. As a result, the due diligence portion of the transaction is often truncated. Purchasers should therefore focus their due diligence on the key areas of the business: a purchaser will be well advised to have a clear understanding of its own 'bottom lines' in terms of the diligence it must carry out before a transaction is realistic, ie is it financial only; are any legal issues critical; does that answer depend on the industry/sector; what about issues such as anti-bribery and corruption and ESG matters?

   A purchaser should expect that a seller will be unlikely to have vendor diligence reports and that a seller may not be able to facilitate a full-scale buyer diligence process (or may not have compiled a virtual data room). On the plus side, a well-advised seller will anticipate that a purchaser will need to 'price in' the level of risk it takes in accelerating these traditional phases of M&A processes.

   Certainty of financing will be paramount for the seller. Further, a purchaser should expect the seller to resist conditionality and deferred consideration mechanisms. Should regulatory or third party processes require a conditional process and split signing and completion, the purchaser should prepare a solution for funding (or bridging the funding) of the business during that period.

2. **What is the best transaction structure?**

   Where the target business has atypical liabilities that are immediately identifiable as undesirable, it is worth considering transaction structures other than a share sale to maximise the value for the seller (by removing the need for a price deduction to accommodate the acceptance of such risk). Sellers will likely be more amenable to business or asset sales in a distressed context, as their planning has likely involved consideration of solvent or insolvent winding-up of one or more group entities post-completion in any event. However, this will need to be balanced against the risks to the seller's directors if the seller's remaining business cannot support itself and enters an insolvency process and, from the purchaser's perspective, potential loss of any tax relief that may otherwise be available should the target corporate have available tax losses and/or should the group structure provide tax benefits. It is critical to engage a tax and accounting adviser early on in the process.

   Consideration should also be given from the purchaser's perspective as to whether an insolvency process, and therefore contracting with an officeholder, may provide a more beneficial route to a purchase. Should the contracting entity go into an insolvency process after it has sold assets to the purchaser, there is a risk that the transaction itself may later be examined by the appointed officeholder for the purposes of claw-back, for example if the officeholder has cause to consider the transaction was made at an undervalue. Should the purchaser contract directly with the officeholder, for example as part of a pre-pack transaction, this risk is significantly reduced.

3. **What contractual valuation protection will be possible?**

   Depending on the state of the seller and its group (or related entities) after completion of a sale, there may be no ability (or appetite) for the seller to offer the purchaser warranty and/or indemnity protections in the sale agreement. The W&I insurance market is still worth exploring even in a distressed situation, and since the coronavirus outbreak synthetic policies have become more readily available. However, W&I insurance will add to the complexity (and potential length) of the process, as insurers will likely need to be able to review a legal diligence report and/or include key exclusions to coverage.

   Further, if the sale is made directly with an officeholder, for example as part of a pre-packaged transaction, it is very common not to offer a purchaser any warranties or indemnities at all.

What's new – reform worth bearing in mind

1. **Impact of sanctions**

   It is worth both sellers and purchasers being cognisant of the potential impact of economic sanctions against Russia on transaction processes. It is important to pre-empt questions of transaction structuring particularly where the opportunity presents itself as a result of a sanctioned entity, individual or counterparty featuring in the corporate or commercial structure of the business.

   Such considerations are always fact-specific, but, in our experience, it is more likely (for example) that a purchaser will be protected from the risk of transacting with a sanctioned person if the transaction is effected through an insolvency process (such as a pre-pack administration) and therefore executed by an officeholder. Early assessment of such considerations can assist in ensuring the transaction is as efficient as possible and should also feed into the purchaser's valuation and risk analysis.

2. **Pension Schemes Act 2021 (and guidance)**

   In October 2021, the controversial Pension Schemes Act 2021 introduced new criminal offences for certain actions which affect defined benefit schemes. Where a target business operates a defined benefit scheme, these offences should trigger a red flag and both sellers and purchasers should seek specific advice. The offences are:

   (a) doing an act or engaging in a course of conduct without reasonable excuse that detrimentally affects in a material way the likelihood of accrued pension benefits being received, where the person knew or ought to have known that the act or course of conduct would have that effect; and

   (b) avoiding or compromising a debt under section 75 of the Pensions Act 1995 (which an employer owes to the trustees of an underfunded defined benefit scheme in specified circumstances), without reasonable excuse.

   Broadly, if a transaction leaves the pension scheme in an unfavourable position compared with other stakeholders, or if the scheme would have fared better if certain corporate actions had not been taken, an offence may have been committed. Importantly, any person involved with the activity in question (other than an insolvency practitioner acting in that capacity) can potentially commit such an offence. This includes sellers, purchasers and lenders, and any individuals involved with the transaction. The Pensions Regulator has produced guidance that suggests that both sellers and purchasers should consider the position of the pension scheme at an early stage, that they should carefully document all decisions in relation to the scheme, and that they should engage with the scheme trustees as soon as possible to ensure that any detriment to the scheme is appropriately mitigated. The Pensions Regulator is likely to monitor any transaction which involves a sizeable defined benefit scheme whose sponsor is in distress. Accordingly, the presence of a defined benefit scheme in the transaction scope of the transaction should be placed high on the agenda in early transaction structuring discussions.

   The Government plans to strengthen the regulatory regime even further later this year by requiring sellers and purchasers to engage with trustees and the Pensions Regulator at an early stage in transactions which involve a defined benefit pension scheme.

3. **Building Safety Act 2022**

   More recently (and perhaps even more controversially) law reform impacting the house-building sector has come into force, and it is also worth paying careful attention to whether the reform is relevant to the proposed distressed opportunity. The key provisions in the Building Safety Act came into force in June and July of this year. These provisions make retrospective changes to the law that both expand existing liability and create new liabilities for developers and other parties involved in the construction of residential buildings (including product manufacturers and suppliers) in relation to historical building safety defects. The Act creates scope for developers to be ordered to contribute to the costs of remedying building safety defects, even where the developer is no longer the owner of the development, and also extends the limitation period for a developer (or other relevant party) to be pursued under the Defective Premises Act 1972 from six to thirty years.

   Arguably most remarkable is the extension of liability to "associated persons" of a liable party. That is, a party that controls a liable party (Party L) through either:

   (a) ownership of at least half of the shares in the capital of Party L;

   (b) possessing the right to acquire at least half of the voting rights exercisable in general meetings of Party L;

   (c) being economically entitled to at least half of the assets of Party L on a winding-up or distribution of 100% of the income of Party L; or

   (d) possessing the power (either directly or indirectly) to ensure that the affairs of Party L are conducted in accordance with its wishes.

   This extension of the liability framework is a material lever for prospective claimants and enables a claimant to pursue the party with the deepest pockets. It is clear that the intent behind this feature of the legislation is anti-avoidance; it is designed to pierce the corporate veil if necessary to find a home for the liabilities.

   This creates a novel problem for structuring distressed M&A transactions involving businesses impacted by these liabilities, one which is only made more difficult by the fact that the legislation is brand new and remains untested. We recommend that you seek specialist advice in respect of opportunities developing in this sector.

Molly Woods
Partner
T +44 20 7859 2253
M +44 7823 341 265
molly.woods@ashurst.com

Richard Bulmore
Partner
T +44 20 7859 1036
M +44 7823 341 125
richard.bulmore@ashurst.com

Liam Stoneley
Associate
T +44 20 7859 2925
M +44 7876 246 352
liam.stoneley@ashurst.com

SPAC developments in Luxembourg

An attractive legal framework for the set-up of business mergers

By Isabelle Lentz, Markus Waitschies and Katia Fettes

Since 2020 all across the United States and Europe special purpose acquisition companies (SPACs) have become a considerable alternative to traditional IPOs, gaining much interest from investors and market participants alike. Luxembourg is not an exception to this trend and recently several SPACs have been set up and successfully listed. The first SPAC to be set up was Lakestar SPAC 1 SE in February 2021. Other SPACs that followed were 468 SPAC I SE and OboTech Acquisition SE. More recently, a business combination between Alvotech Holding S.A. and Oaktree Acquisition Corp. II SPAC was achieved. Furthermore, on 16 August 2022 the *Commission de Surveillance du Secteur Financier* (CSSF) granted a derogation from the requirement to launch a takeover bid for the shares of Odyssey Acquisition S.A. as a result of the subscription for newly issued shares on 22 April 2022 in the context of the business consummation between Odyssey Acquisition S.A. and BenevolentAI Limited.[1]

Luxembourg's attractive regulatory corporate and listing law frameworks have turned the country into a major potential hub, which is likely to become one of Europe's preferred destinations for such projects.

1 ISIN: LU2355630455, Euronext Amsterdam regulated market listing.

What exactly is a SPAC and how is it structured?

Generally speaking, SPACs are blank-cheque companies which are set up in order to raise the necessary funding with respect to the acquisition of a future, not yet identified, target company in a reverse merger. They provide private companies with a means to access public markets and offer investors an opportunity to embark on joint investments with more experienced sponsors and market participants.

Usually, a SPAC can use only a restricted timeframe during which the target company is identified and its acquisition is completed (in many instances such timeframe is between 18 and 24 months). If the SPAC is unable to complete the acquisition of an appropriate target company by the applicable deadline, the funds that have been raised from investors must be returned to the investors. Typically, the investors also have the right to redeem the shares they acquired in the preceding IPO and have their original investments paid back to them prior to the acquisition taking place should they not approve of the target company selected, but rather prefer to exit the structure.

Although SPACs are often structured similarly to private equity funds, they do not fall under the scope of Directive 2011/61/EU on alternative investment fund managers as they have been set up with the aim to become a fully operating company or at least a holding company of a group that includes the target company once the acquisition of the target company has been fully consummated. Given that they do not impose any limitations and requirements on the profiles of the investors in most instances, any individual or legal entity can buy shares.

Furthermore, often target companies can negotiate specific fixed lock-in prices of their stock with the sponsors of the SPAC. Thus, target companies may succeed in avoiding possible value decreases that a classic IPO can cause, in particular in times of market uncertainty. Also, there is often the possibility to negotiate the sale price of the target company in a sale to a SPAC. In this respect investors can decide whether or not to exit the structure and withdraw their capital before the acquisition occurs. If such a situation arises, the sponsors of the SPAC may nonetheless agree to fund any cash shortfalls at closing so that the acquisition can still go ahead. This makes SPAC investments considerably investor-friendly.

Given that the SPAC, despite being a shell company, is a corporate entity with legal personality, it is generally allowed to have its shares or units admitted to trading on a public stock exchange, thus enabling investors to benefit from all the advantages in terms of trading and information disclosure which are available to listed companies.

Which corporate law framework applies to SPACs?

Luxembourg corporate law allows SPACs to adopt various legal forms such as a European company (*société européenne*), a public limited company (*société anonyme*) or a limited stock partnership (*société en commandite par actions*). In this respect it is fair to say that the legal form of the public limited company (*société anonyme*) has proven particularly popular as it has relatively low incorporation costs (the minimum share capital at the incorporation being EUR 30,000). Furthermore, it can relatively easily be merged with a target company which has been set up under the laws of another EU Member State and converted into a European company to be governed either by Luxembourg law or by the law of the target company subsequent to the acquisition of the target.

Another major advantage of Luxembourg law with respect to the set-up of SPACs is its flexibility to make adjustments based on the specific context of the project. Thus, it is generally possible to create different classes of shares such as ordinary, preferential and redeemable shares to which different financial and voting rights are attached. In this respect, voting and non-voting shares can be issued, which are to be held by different investor types. Along the same lines, the articles of association of a SPAC usually contain the possibility to issue redeemable shares allowing investors that do not wish to continue with their investments to redeem the shares they hold.

Likewise, the powers and tasks given to the management body of the SPAC can be adapted and restricted to specific decision-making topics with varying representation rules provided within the general Luxembourg corporate law framework, taking into account specific constraints and idiosyncrasies of the envisaged target company merger.

Are there specific issues that might occur in the context of the listing of a SPAC?

Since a SPAC is ultimately a legal entity which does not differ that much from other operating companies in terms of its corporate structure, no particular, ie SPAC-specific, listing and prospectus approval regime applies to it. Consequently, in order to obtain a listing on the Luxembourg Stock Exchange, a prospectus must be produced and approved by the relevant competent approval authority under general Luxembourg prospectus rules.

In this respect, two main market venues are offered by the Luxembourg Stock Exchange, ie the regulated market and the Euro MTF market. An admission to trading on the regulated market requires the prior approval by the CSSF of a prospectus compliant with Regulation (EU) 2017/1129 (the Prospectus Regulation) provided that Luxembourg is indeed the SPAC's home Member State for prospectus purposes. Once approved, such a prospectus can also be passported into another EEA Member State for the purposes of a listing on such EEA Member State's regulated market.

A listing on the Euro MTF, being a Luxembourg multilateral trading facility, only triggers the application of the Rules and Regulations of the Luxembourg Stock Exchange (the ROI). The competent approval authority for such a Euro MTF listing is the Luxembourg Stock Exchange and not the CSSF.

However, in the context of an IPO conducted by a SPAC, a prospectus under the Prospectus Regulation will have to be approved for the purposes of making a public offer in Luxembourg. The publication of such a public offer prospectus is required prior to the IPO taking place in non-exempt offer scenarios, ie in situations in which the offeror of the securities cannot benefit from an exemption from the obligation to publish an approved prospectus.[2] Such a public offer prospectus will need to set out the terms and conditions of the offer as well as the main characteristics of the securities which are to be offered to the public. Furthermore, the total amount of the offer, the number of securities offered, the price of each security or the minimum subscription amount per investor must be specifically referred to in the prospectus. Also the investment scope and all parameters to be applied with respect to the identification and acquisition process of the future target company must be sufficiently described.[3]

Once listed on a regulated market of the Luxembourg Stock Exchange, the SPAC will be subject to all applicable rules, in particular under Regulation (EU) No. 596/2014 on market abuse (the Market Abuse Regulation), the Luxembourg law of 11 January 2008 on transparency requirements (the Luxembourg Transparency Law)[4] and the ROI. With respect to a listing on the Euro MTF, in addition to the Market Abuse Regulation in terms of disclosure requirements, only the rules set out in the ROI will be applicable as such issuers are not subject to the Luxembourg Transparency Law.

If the intention is to list the target company and not the SPAC, once the reverse merger has been consummated, it is important to note that the question of the conditions under which such listing can be obtained will require a separate analysis given that the newly acquired company and not the SPAC would be the issuer in such case.

2 These exemptions are set out in article 1(4) of the Prospectus Regulation.

3 The main framework applicable with respect to the content of the prospectus is Commission Delegated Regulation (EU) 2019/980 of 14 March 2019.

4 The Luxembourg Transparency Law is applicable to issuers whose home Member State for transparency purposes is Luxembourg. Luxembourg-incorporated issuers of shares which have been admitted to trading on a regulated market (which need not necessarily be the one operated by the Luxembourg Stock Exchange) automatically have Luxembourg as transparency home Member State. Such issuers cannot choose from among the competent supervisory authorities of several EEA listing venues.

Does the Luxembourg Stock Exchange provide any specific guidance on the listing of SPACs?

In August 2021 the Luxembourg Stock Exchange published a framework with the objective to provide guidance to sponsors and other professional intermediaries in the context of a listing of securities issued by SPACs on its markets (the SPAC Guidelines).

The SPAC Guidelines are essentially recommendations that SPAC issuers should take into account when structuring their listing project and are therefore not obligatory. These recommendations are as follows:

1. Funds raised by SPACs should be placed in an escrow account with a regulated financial institution and issuers should document an order of priority for outgoing payments.
2. The issuer should grant redemption rights to the SPAC shareholders and describe the conditions under which the rights can be exercised.
3. The majority of the shareholders should approve the business combination with the target company in a general meeting (de-SPAC process) and the issuer should provide the shareholders with the information necessary to make an informed decision about the exercise of their redemption rights.
4. In the prospectus accompanying the admission to trading, the issuer should describe its business strategy to deliver insights on the target industries and geographies where it seeks acquisition opportunities.
5. The timeframe for the consummation of the business combination should be defined and limited in time.

The Luxembourg Stock Exchange emphasises that the SPAC Guidelines are not to be understood as an exhaustive or mandatory list of features that any SPAC would need to comply with in order to obtain a listing on the Luxembourg Stock Exchange. Deviations from these recommendations in specific cases might therefore be possible.

Consequently, as part of its general review and approval process, the Luxembourg Stock Exchange reserves the right to consider any other feature of a SPAC (eg management lock-up periods, sponsor commitments or remuneration mechanisms) when assessing a listing request or approving a Euro MTF prospectus.

Are there any issues that could arise under Luxembourg takeover rules where the SPAC has been admitted to trading on a regulated market?

An obligation to launch a takeover bid under the Luxembourg law of 19 May 2006 on takeover bids (the Luxembourg Takeover Law) can arise. Where the shares issued by the SPAC have been admitted to trading on a regulated market and provided that new shares are to be issued within the context of the merger of the target company which will be subscribed for by specific shareholders of the SPAC, such as the sponsors acting in concert.

The Luxembourg Takeover Law establishes a framework for both mandatory and voluntary takeover bids. Generally speaking, it is applicable to Luxembourg-incorporated issuers of securities carrying voting rights which have been admitted to trading on a regulated market. Consequently, listings on multilateral trading facilities such as the Luxembourg Euro MTF market are not sufficient. Furthermore, it is not applicable to open-ended funds (ie issuers which operate on the principle of risk-spreading and the units of which can be repurchased or redeemed at the holders' request).

a) Obligation to launch a bid

Pursuant to article 5(1) of the Luxembourg Takeover Law, a mandatory bid must be made whenever a natural or legal person (as a result of their acquisition or the acquisition by persons acting in concert with that person) obtains securities of a target company which, when added to any existing holdings of those securities, directly or indirectly provide a specific percentage of voting rights in the target company, thereby giving that person control of the target company.

Control over the target is obtained if the relevant person(s) hold(s) a percentage of 33⅓% of voting rights in the target company. Generally speaking, the acquisition of such a controlling holding needs to occur during the time of listing. Therefore, usually issuers that are already controlled by a certain shareholder or shareholders acting in concert at the time the relevant securities were first admitted to trading on a regulated market cannot become the target of a mandatory bid. The reason for this is that, in such a case, control had already been established before the admission to trading took place.

b) Persons acting in concert

Control is oftentimes not acquired alone but by persons acting in concert. Under the Luxembourg Takeover Law, persons acting in concert means natural or legal persons who cooperate with the offeror or the target company on the basis of an agreement, which is either express or tacit, oral or written, and which is aimed at acquiring control of the target company. Strictly speaking, any person acting in concert is also under the general obligation to launch a mandatory bid and therefore any derogation granted from the obligation by the CSSF must be addressed and granted to all persons involved (ie main offeror and persons acting in concert). In a SPAC context sponsors may qualify (depending on the features of the case) as such persons acting in concert.

c) Derogation from the obligation to launch a takeover bid

However, in specific contexts a derogation from the obligation to launch a takeover bid can be obtained from the CSSF.

Such a derogation was granted in March 2022 in the context of the acquisition of a company incorporated under German law[5] by a Luxembourg-incorporated special purpose acquisition company[6] and (as mentioned in the preamble to this article) in August 2022 in the context of the business combination between Odyssey Acquisition S.A. and BenevolentAI Limited.

5 HomeToGo GmbH.

6 Lakestar SPAC I SE (renamed HomeToGo SE) ISIN:LU2290523658).

The derogations were granted in accordance with article 4(5) of the Luxembourg Takeover Law to the persons subscribing for newly issued shares in the SPACs and acting in concert as they temporarily acquired control of the SPACs. The shares issued by the SPACs had been admitted to trading on the regulated market of the Frankfurt Stock Exchange and Euronext Amsterdam, respectively, and the CSSF was the competent authority with respect to the granting of any derogation under the Luxembourg Takeover Law in both cases pursuant to article 4(2)(e) of the Luxembourg Takeover Law.

In both contexts, the CSSF's decision was based on the argument that the shareholders of the SPAC during the process of the business acquisition and combination had the possibility to make an informed decision as to whether or not they should stay in the structure. According to the CSSF, this was in particular reflected by the fact that the business combination was submitted for approval in the context of the extraordinary general meeting of shareholders of the SPAC and the possibility of an unlimited exit for shareholders not approving the proposed acquisition of the target company. Thus the CSSF came to the conclusion that the interests of the minority shareholders had been sufficiently taken into account and protected, so the application of article 5(1) of the Luxembourg Takeover Law was not necessary.

Despite the listings having been obtained on the Frankfurt Stock Exchange and Euronext Amsterdam the CSSF was also the competent authority for the granting of such a derogation, as both contexts were a situation of shared supervision pursuant to article 4(4) of the Luxembourg Takeover Law.

Generally speaking this means that whenever the securities issued by a Luxembourg-incorporated target company have been admitted to trading on an EEA-regulated market other than the one operated by the Luxembourg Stock Exchange, the competent supervisory authority with respect to any takeover bid is not the CSSF but the supervisory authority of the EEA Member State where the regulated market is located. Consequently, the takeover framework applicable in that EEA Member State is the main legal framework under which any bid would have to be launched.

However, in such cross-border contexts according to article 4(2)(e) of the Luxembourg Takeover Law matters relating to the information to be provided to the employees of the target company and all matters relating to company law, in particular the percentage of voting rights which confers control and any derogation from the obligation to launch a bid, as well as any squeeze-out and sell-out procedures, among others, are governed by the Luxembourg Takeover Law. On the other hand, most procedural aspects of the takeover bid will, however, be governed by the laws of the EEA Member State where the listing has been obtained. This includes aspects such as the offer price, the contents of the offer document and the disclosure of the bid.

Favourable outlook for the future

Investment banks and sponsors but also retail investors looking for new investment opportunities will most likely welcome the increasing interest setting up SPACs in Luxembourg. In particular, the accessibility of the CSSF and it deal-specific experience, as referred to above, as well as the straightforward and investor-friendly listing framework provided by the Luxembourg Stock Exchange will undoubtedly prove to be a great asset to Luxembourg and should be likely to further increase its position as a major business centre in Europe.

Isabelle Lentz
Partner
T +352 28 133 222
M +352 621 798 357
isabelle.lentz@ashurst.com

Markus Waitschies
Senior Expertise Lawyer
T +352 28 133 228
M +352 621 469 639
markus.waitschies@ashurst.com

Katia Fettes
Senior Associate
T +352 28 133 243
M +352 621 964 910
katia.fettes@ashurst.com

Amendments to the Luxembourg Financial Collateral Law

An overview of its new creditor-friendly features

By Fabien Debroise, Katia Fettes, Anna Kozakiewicz

In July 2022, the Luxembourg Parliament (*Chambre des Députés*) adopted a bill proposing a reformof the Luxembourg law of 5 August 2005 on financial collateral arrangements, as amended (the Luxembourg Financial Collateral Law).[1] The reform reinforces the legal certainty of Luxembourg financial collateral arrangements by introducing a number of welcome clarifications to several frequently discussed notions and enforcement mechanisms in the law.

While the reform was primarily intended to align certain provisions of the Luxembourg law with Regulation (EU) 2021/23 of 16 December 2020 on a framework for the recovery and resolution of central counterparties (the Recovery and Resolution Regulation), the Luxembourg Parliament seized this opportunity to update the Luxembourg Financial Collateral Law and bring it in line with current market practice and case law. In particular and most importantly, clarifications have been added to the provisions regulating the enforcement of security interests by way of sale and the application of enforcement proceeds.

1 Projet de loi N°7933, 20.12.2021.

Recovery and Resolution Regulation

Article 2-1 of the Luxembourg Financial Collateral Law now includes a reference to the Recovery and Resolution Regulation in order to specify that the Luxembourg Financial Collateral Law applies without prejudice to the provisions of the Recovery and Resolution Regulation as well as to the provisions of Part I of the law of 18 December 2015 on the failure of credit institutions and certain investment firms, as amended, and Part IV of the Luxembourg law of 5 April 1993 on the financial sector, as amended, which include some derogations from the Luxemburg Financial Collateral Law in certain circumstances.

Additional clarifications about enforcement events of pledges

The Luxembourg Financial Collateral Law now contains useful clarifications with respect to the triggers for enforcement of pledges subject to that law.

The new version of the law stipulates that any event, irrespective of its nature, as agreed between the parties to a pledge agreement can serve as an enforcement event. In this respect, the law specifies that an enforcement event is a default or any other event 'whatsoever' which has been agreed between the parties by amending the definition of "Enforcement Event" in the law in order for it to explicitly refer to "any event

of default or any event whatsoever" (Fr. "*une défaillance ou tout autre événement quelconque convenu entre les parties*"). The introduction of this wording explicitly confirms that the agreed enforcement events entitling the collateral taker to enforce a pledge can also be events other than payment defaults, such as breaches of financial covenants or other events or circumstances which relate to either the general framework or to certain specific aspects of a transaction and irrespective of whether or not any payment obligations have become due and payable.

The Luxembourg legislator in the parliamentary works with respect to the new Luxembourg Financial Collateral Law had explicitly mentioned that the parties to the pledge should be entirely free to determine the circumstances that should lead to an enforcement event. In this respect reference was made to the non-compliance of certain financial ratios or any other elements relating to the general economy or to certain particular aspects of a given transaction.[2]

There had been discussions in the Luxembourg legal doctrine about the question whether any events other than typical enforcement events could indeed be agreed as constituting enforcement events of a pledge governed by the Luxembourg Financial Collateral Law. In line with the general creditor-friendly orientation of the Luxembourg Financial Collateral Law, the Luxembourg courts previously confirmed that security financial collateral arrangements can be enforced upon the occurrence of any contractually agreed enforcement trigger event (in the specific case, a breach of financial covenant), irrespective of whether a payment default occurred or any secured obligations are due and payable. In fact, in a court decision of 22 January 2020 the Luxembourg Court of Appeal took the view that the mere violation of a financial covenant could in itself constitute an agreed enforcement event of a pledge.

The amendment of the definition of enforcement event, however, also raised the question whether the enforcement proceeds should be applied immediately against the relevant secured obligations or whether the pledgee should be required to hold these proceeds as continuing security until the secured obligations become due and payable.

The Luxembourg Financial Collateral Law now clarifies this by providing that, unless otherwise agreed by the parties, enforcements will be immediately applied against the secured obligations on enforcement.[3] This clarification also cements a position previously adopted by legal practice into the Luxembourg Financial Collateral Law.

This provision is especially helpful in circumstances where an enforcement has occurred in situations where there has been no payment default (as mentioned above) or acceleration of the underlying secured liabilities, or no contractual prepayment features will be required.

This flexibility in the structuring of an enforcement clearly is a standout feature of the Luxembourg financial collateral regime for creditors compared with other European countries.

Amendments to the enforcement methods of pledges

Furthermore, the Luxembourg Financial Collateral Law has undergone a series of amendments with respect to the various enforcement methods of pledges. These amendments relate to five main topics:

(1) sale of pledged assets on trading venues;

(2) appropriation of financial instruments admitted to trading on a trading venue and of units or shares in a collective investment undertaking;

(3) enforcement of pledges over units or shares in collective investment undertakings;

(4) enforcement of pledges over claims arising under insurance contracts; and

(5) the public auction enforcement method for pledges.

However, it should be noted that parties may always agree on alternative methods of enforcement and the provisions of Luxembourg Financial Collateral Law apply only to the extent the pledgor and the pledgee have not agreed otherwise.

2 Comment to article 9, page 16 of bill of law N° 7933.

3 Article 11(5) of the Luxembourg Financial Collateral Law.

Sale of pledged assets on trading venues

In the past, the Luxembourg Financial Collateral Law provided the pledgee with the possibility to enforce pledged assets "by private sale on normal commercial conditions, by sale over a stock exchange or by public auction" and by default such a public auction was to be effected through the Luxembourg Stock Exchange.

In respect of the private sale of financial instruments admitted to trading, the reference to "stock exchange" has now been updated and clarifies that the sale of the pledged assets can generally happen on the platform on which the pledged assets have been admitted to trading, which does not necessarily need to be a regulated market only. Furthermore assets which have been admitted to trading on any unregulated market can be directly disposed of on the same market. Such markets now also include any Luxembourgish, European or third country regulated markets, multilateral trading facilities (MTF) or organised trading facilities (OTF).

Appropriation of financial instruments and of units or shares in a collective investment undertaking

Another additional new feature of the Luxembourg Financial Collateral Law is the introduction of provisions regarding the value at which financial instruments admitted to trading on a trading venue, and units or shares in collective investment undertakings, can be appropriated.

The Luxembourg Financial Collateral Law now clearly distinguishes between (i) an appropriation of financial instruments admitted to trading on a trading venue (which appropriation can, unless the parties have otherwise agreed, be made at the market price of such financial instruments), and (ii) an appropriation of units or shares in a collective investment undertaking, which can, unless the parties have otherwise agreed, be made either at their market price, provided that such units or shares are admitted to trading on

a trading venue, or at the price of the last net asset value published by, or for, that collective investment undertaking, provided that the latest publication of the net asset value is not older than one year.

This addition to the Luxembourg Financial Collateral Law follows an evolution in market practice where a similar approach on appropriation of fund units has become increasingly common.

Enforcement of pledges over units or shares in collective investment undertakings

The new version of the law also explicitly clarifies that with respect to units or shares in a collective investment undertaking the collateral taker can enforce the pledge by requesting the redemption of the pledged units or shares at their redemption price in accordance with the constitutional documents of the relevant collective investment undertaking.

Enforcement of pledges over claims arising under insurance contracts

Furthermore, an additional item covering insurance contracts and listing all accepted enforcement procedures[4] has been included in the relevant provision of the Luxembourg Financial Collateral Law. The Luxembourg Financial Collateral Law now offers a new, specific enforcement method for these types of claims by providing that a pledge over such insurance contracts can be enforced by requesting the repurchase of the contract or demanding the payment of all sums due under the insurance contract in satisfaction of the secured obligations.

This new rule on the enforcement of pledges over claims arising under insurance contracts should be likely to assuage the doubts that have been raised in the past by certain legal authors questioning the applicability of the Luxembourg Financial Collateral Law to pledges over insurance contracts. In this respect it is, however, important to note that a pledge over a Luxembourg life insurance contract still needs to comply with articles 116 and 117 of the Luxembourg law of 27 July 1997 on the insurance contract. This law has not been amended by the reform of the Luxembourg Financial Collateral Law. Specific rules in this respect provide that, among other things, a life insurance contract may be pledged only by an endorsement signed by the policyholder, the collateral taker and the insurer and, where the benefit of a life insurance contract has already been accepted, with the consent of the beneficiary.

New public auction enforcement regime

Finally, the Luxembourg public auction regime has been amended and updated and thus no longer refers to the Luxembourg Stock Exchange as the mandatory public auction entity. The public auction regime prior to the reform of the Luxembourg Financial Collateral Law was based on a law dated 1 June 1929 and stemmed from the fact that the Luxembourg Stock Exchange used to benefit from a specific governmental concession. However, as a result of the Luxembourg law of 13 July 2007 on markets in financial instruments, the Luxembourg Stock Exchange has become an ordinary professional body in the financial sector among many others and thus the Luxembourg legislator did not consider it appropriate to burden it any longer with the role of a national public auction entity.[5] Consequently, an entirely new procedure which involves the participation of a Luxembourg notary or bailiffs has been included in the new Luxembourg Financial Collateral Law and which applies unless parties agree otherwise. The new law also foresees specific rules with respect to situations in which any authorisations or lack of opposition from a particular public authority is required for the realisation of a tender in the auction process. If such approval cannot be obtained in a timely manner, the pledgee has the right to prolong the relevant period during which the approval can be achieved or, as the case maybe, to initiate a new public auction procedure.

Interestingly, the Luxembourg Financial Collateral Law now provides that assets can be acquired in a public auction through any payment method, including set-off against the obligations secured under the relevant security arrangement. Although this amendment to the law should be welcomed, it ought to be noted that the public auction procedure is not used very frequently as pledgees tend to prefer the shorter and less expensive appropriation and private sale mechanisms.

The changes introduced by the new Luxembourg Financial Collateral Law have brought about helpful clarifications and answers to the above discussed legal aspects, without changing the overall substance of the law. In this respect the reform has undoubtedly reinforced the law's strong creditor-friendly position and will further enhance Luxembourg's position as a prime financial centre for all types of financial transactions requiring collateral arrangements.

Fabien Debroise
Partner
T +352 28 133 249
M +352 621 674 957
fabien.debroise@ashurst.com

Katia Fettes
Senior Associate
T +352 28 133 243
M +352 621 964 910
katia.fettes@ashurst.com

Anna Kozakiewicz
Associate
T +352 28 133 232
M +352 621 648 405
anna.kozakiewicz@ashurst.com

4 Article 11(1)g) of the Luxembourg Financial Collateral Law.

5 Comment to article 10, page 18 of bill of law N° 7933.

New and proposed regulatory changes in the UK

An update for UK fund managers

By Jake Green and Greg Patton

UK fund managers will be well acquainted with the various changes to AIFMD and MiFID II over the past few years and it might, at first, come as a relief to hear about regulatory changes affecting fund managers that don't relate to either. However, there are a number of new or proposed regulatory changes in the UK that you might have missed over the summer that fund managers should consider carefully.

Consumer Duty

The Consumer Duty will apply to firms providing regulated activities to retail clients in the UK. It consists of three elements: a consumer principle; cross-cutting rules; and four customer outcomes. The Consumer Duty represents the biggest change to the retail market in a generation, probably not seen since the retail distribution review, and will lead to material changes in the way in which firms will have to think about conducting their business with retail customers.

If you are a retail fund manager reading this you should be well versed in these obligations already. However if you are an AIFM targeting professional investors you may find yourself inadvertently caught in the same way that you may have been caught by PRIIPS KID.

The Consumer Duty applies only to funds where you have investors who are not professional investors in the fund. However, as noted above, various sophisticated and high net worth individuals are still considered to be retail investors. If you target this semi-professional category you may be subject to the Consumer Duty.

It also is not clear how your obligation may apply where a fund has a mixture of retail and professional investors. It potentially cuts across other regulatory obligations in AIFMD to treat clients fairly and to disclose when an investor obtains preferential treatment.

One area of concern may be that your co-invest vehicles would be investments by relatively junior staff or middle and back office staff as well as friends and family. Technically all these investors are retail and the Consumer Duty applies to them.

Action points:

For retail fund managers you should be acting already. If you are not you need to move urgently. For wholesale fund managers you need to identify the circumstances where you have retail clients investing and start considering your approach.

Appointed Representative Regime

An appointed representative (AR) is an entity that effectively uses the regulatory permissions of a regulated entity, its principal, to provide arranging and advising services. The principal remains responsible for the activities of the appointed representative.

Many fund managers rely on the appointed representative regime. US-headquartered managers who are establishing a presence in the UK for the first time establish an AR in the UK, to 'test the waters', which in turn can become a fully authorised firm as who scale up. UK multi-strategy fund managers establish appointed representatives to manage their internal structures with a principal having different appointed representatives advising different strategies of the fund manager, therby allowing for easy identification.

The FCA has concerns that the AR regime leads to poor outcomes for clients and is therefore implementing additional requirements for principals and ARs. The FCA's requirements fall into two categories. The first is an obligation on principals to provide additional and ongoing data to the FCA in respect of the activities of their ARs. The second substantially increases the obligations on principals prior to, but also during, the ongoing appointment of any AR.

These obligations impose an additional burden on the principals to oversee their ARs. Additional oversight will be required including board discussions about arrangements. It will also mean amending the contracts in place between the AR and the principal to ensure the principal has necessary oversight. The additional data from the FCA will also allow the FCA to undertake additional proactive and reactive surveillance and we expect additional scrutiny of this in the next 12 months.

If you are an AR you are not subject to these rules directly but it is likely that your principal will be imposing additional obligations and restrictions on your activities. Expect additional oversight especially where you rely on a third party principal rather than an intragroup arrangement. For intragroup arrangements, more documentation, at the very least, will be required.

In some ways fund managers are collateral damage in terms of the FCA's concerns with financial advisors to retail investors. The AR model is used by these businesses and leads to a disproportionate number of complaints to the FCA. However, limited distinction is made in the rules as to the commercial reasons behind the model.

Increasingly the obligations on an AR will start to align with those of fully regulated firms without the benefits of being authorised. The cost-benefit analysis may therefore change for some ARs.

The FCA has indicated it will work with the Treasury to make further amendments, so it may not be the end of the road.

Action points:

If you are a principal you need to ensure that you implement the new oversight obligations, amend contracts and ensure you are able to implement this.

Overseas Persons Exclusion

Many UK fund managers rely on third parties to provide advice or portfolio management in respect of their funds. The UK, unlike the EEA, has a liberal regime that has allowed these services to be provided on a cross-border basis into the UK without authorisation or registration. Therefore there is a relatively frictionless provision of services into the UK (unlike services being provided from the UK into other jurisdictions).

This is done through a combination of the characteristic performance test. Essentially where an activity like portfolio management is performed in, for instance, the US or EEA, even on behalf of a UK client, the regulated activity is not deemed to occur in the UK. Where the characteristic performance test isn't available, the overseas persons exclusion states that where an activity, such as advising, is deemed to be carried out in the UK if it is not done from a place of permanent establishment it is excluded from the need to be authorised.

This is a well-trodden path in the provision of intragroup and third party services, not just for fund managers but for insurance and share trading, and is part of the financial ecosystem. The FCA however is concerned it is being used in a way that it was never designed for. It is therefore working with the Treasury to examine the extent of the OPE. The FCA has also indicated it may provide additional guidance on the use of the characteristic performance test, potentially expanding the activities that are occurring in the UK and are therefore subject to regulation.

A combination of the narrowing of the OPE and the expanding of activities deemed to occur in the UK would lead to a number of services being provided into the UK requiring an overseas affiliate to become authorised if they cannot rely on other exemptions.

Action points:

None at this stage. Keep a watching brief.

LTAF

The FCA has announced plans to relax financial promotion rules in relation to Long Term Asset Funds, with the result that these can now be marketed to a wider range of retail investors. Launched in 2021, the LTAF is a type of authorised open-ended fund designed to encourage investment in long-term assets such as private debt, private equity, infrastructure and property. Under current rules, the LTAF can be promoted only to professional clients, certified high net worth investors, certified sophisticated investors and self-certified sophisticated investors.

The FCA confirmed plans for broadening the retail distribution of the LTAF to more categories of retail investors. The move is in line with the FCA's broader strategy in relation to financial promotion rules for high-risk investments. LTAFs promoted to retail clients would need to comply with the following criteria: not contain any monetary or non-monetary incentive to invest; and include specified risk warning and risk summary. Further rules apply for non-advised customers receiving direct offer financial promotions. The FCA is expecting to publish a final policy statement and final Handbook rules early in 2023.

Action points: Some fund managers, who have seen a succession of vehicles designed to be marketed to 'semi-professional' investors – EuVECAs, EUSEFs, ELTIFs and FAIFs – all go largely unused might be sceptical about the benefits of the LTAF, but for managers of illiquid strategies LTAFs are worth considering.

Financial Promotions of High-Risk Investments

The FCA has published final rules on financial promotions of "high risk" investments. These rules are intended to increase protection for consumers by reducing the potential for harm from investing in "high-risk" assets, and therefore in practice are applicable to retail funds as opposed to funds typically targeted at large institutional investors.

The FCA has developed product categories for Restricted Mass Market Investments (RMMIs) and Non-Mass Market Investments (NMMIs). Mass marketing of RMMIs to retail clients is prohibited, while mass marketing of the NMMIs to retail clients is subject to increased requirements on promotions such as strengthened risk warnings and a ban on inducements to invest.

Units in a CIS, a QIS or an LTAF are currently considered NMMIs by the FCA. However, as detailed above, the FCA proposes to re-classify units in an LTAF as RMMIs, which would increase the ability for units in an LTAF to be promoted to retail clients (subject to relevant restrictions). Rules related to risk warnings will have effect from 1 December 2022, and all other rules from 1 February 2023.

Action points:

Retail fund managers, wholesale fund managers with retail clients investing, and other fund managers or firms who make or approve financial promotions of RMMIs or NMMIs should consider these incoming rules as a matter of urgency.

AIFMD 2

We can't write an article about regulation of funds without mentioning AIFMD! AIFMD 2 is currently being considered by the EU and we would anticipate this coming into force in 2024 or 2025. The final rules are not yet available but the drafts have been well received from industry on the basis that it is not as bad as it could be.

UK fund managers will not be directly affected by this as the UK is not implementing these rules, but some rules such as delegation may be imposed on UK fund managers and advisers/arrangers. UK fund managers may find third party European AIFMs can perform a wider range of activities, including loan origination, the servicing of securitisation special purpose entities, benchmark administration and credit servicing, under the current proposals.

Action points:

If you are a principal you need to ensure that you implement the new oversight obligations, amend contracts and ensure you are able to implement this.

Jake Green
Partner
T +44 20 7859 1034
M +44 7876 030 472
jake.green@ashurst.com

Greg Patton
Senior Associate
T +44 20 7859 1159
greg.patton@ashurst.com

The new Italian insolvency code

An overview

By Paolo Manganelli

In accordance with the guidelines provided by Insolvency Directive 2019/1023 of 20 June 2019, on 15 July 2022 the new Italian crisis and insolvency code (the "**New Code**"), which was adopted by Legislative Decree No. 14/2019, entered into force. The New Code contains:

Terms innovations

The New Code replaces the term "bankruptcy" with "Judicial Liquidation". Also "bankruptcy proceedings" are now "crisis and insolvency regulation tools".

The New Code introduces several definitions, including:

(a) **Crisis:** "a situation which will likely lead to insolvency when the forecasted cash flow is not sufficient to fulfil the company's obligations over the next twelve months". The definition of insolvency, on the other hand, refers to the inability of a company to regularly meet its obligations as they fall due, whether caused by defaults or other external factors.

(b) **Group of companies:** "the group of companies, enterprises and entities, excluding the State and territorial entities, which, pursuant to articles 2497 and 2545-*septies* of the Italian Civil Code, exercise or are subject to the management and coordination activities by a company, entity or natural person".

(c) **Centre Of Main Interests ("COMI"):** "the place where the debtor habitually manages its business in a way recognisable by third parties".

System innovations

Protected super-senior financing

Where the business is to be preserved as a going concern under the relevant procedure, the debtor may request and obtain new financing, in any form, including the issuance of guarantees which benefit from super-priority status subject to court authorisation.

Where judicial liquidation proceedings are subsequently commenced, however, such super-priority status would not apply where:

(i) the petition to the court was based on false information/data, material information was omitted from the petition or the debtor committed fraudulent actions which were detrimental to its creditors obtaining the new financing; and

(ii) the lenders were aware of those circumstances.

Unified procedure to access judicial proceedings

The New Code provides for a unified procedure to access judicial proceedings before the competent courts. The main documentation which the debtor has to provide to the relevant court is the same across all the restructuring tools.

In each proceeding, the debtor may ask the court to approve tailored protective measures which are best suited to its needs. The court may confirm, amend or revoke such measures at any time.

The duration of the protective measures may not exceed 12 months in aggregate.

The protective measures cannot affect employees' credits rights.

Group of companies

The New Code introduces specific provisions concerning the insolvency of a group of companies.

Companies belonging to the same group and having their COMI in Italy may file a single petition for a *concordato* or for the homologation of a group debt restructuring agreement, where doing so is more convenient than filing multiple separate petitions. Convenience is evaluated taking into account group compensatory benefits.

In order to protect the equal treatment of creditors (*par condicio creditorum*), each company's assets and liabilities must be segregated and no commingling is allowed.

In *concordato* proceedings, the court appoints one designated judge and one judicial commissioner; the costs of the proceedings are shared among the group companies in proportion to their respective assets and liabilities. Pre-petition intragroup loans are subordinated to other debts and excluded from voting procedures.

Substantive innovations

Negotiated composition

The New Code has introduced a new path for the reorganisation of a company's financial and economic imbalance, the "negotiated composition" (*composizione negoziata*).

Through this path, the commercial and agricultural entrepreneur requests the Chamber of Commerce to appoint an expert, whose role is to facilitate negotiations with creditors and any other interested parties.

The expert's appointment lasts 180 days, which can be extended for 180 days by agreement of the parties.

While negotiations are pending, the debtor retains the ordinary and extraordinary management of the company. The debtor must inform the expert in advance of any acts of extraordinary administration or payments that are incoherent with the negotiations and reorganisation perspectives. The expert may express their dissent by registration in the commercial register and such act may be subject to claw-back actions during the subsequent insolvency proceedings.

The debtor may apply to the court for the grant of temporary protective measures over the company's assets. The application of protective measures prevents creditors from initiating enforcement and precautionary actions.

When a solution is reached to overcome the financial imbalance, the parties may:

(i) enter into an agreement, provided that the expert declares that such agreement is able to allow the debtor to regain economic and financial balance and preserve the business as a going concern for at least two years;

(ii) reach a moratorium agreement;

(iii) enter into an agreement, which will be signed also by the expert and will benefit from the same protections provided for reorganization plans (eg no claw-back actions or personal liabilities).

If at the outcome of the negotiations one of the above solutions is not reached, the debtor may, alternatively:

(iv) adopt a reorganisation plan under article 56 of the New Code;

(v) file for the homologation of a debt restructuring agreement under articles 57, 60 and 61 of the New Code;

(vi) file for the new simplified *concordato* for liquidation purposes under article 25-*sexies* of the New Code; or

(vii) file for any other restructuring or insolvency tools.

Simplified *concordato* for liquidation purposes

When the expert in the final report declares that the negotiations were carried out fairly and in good faith and that they were unsuccessful, the debtor may file, within 60 days of the communication of the final report, a simplified *concordato* for liquidation purposes plan and proposal.

Creditors must be no worse off than in judicial liquidation; the *concordato* proposal must ensure 'a utility' to any creditor.

The procedure is simplified: the creditors' voting phase is completely absent and creditors can only object to homologation.

Three distinct figures are involved:

(i) the expert, who must give an opinion on the results of the liquidation of the company;

(ii) the auxiliary, appointed by the court, must give an opinion on the plan and on the results of the liquidation; and

(iii) the liquidator, appointed by the court with the homologation decree to liquidate debtors' assets.

There is no automatic stay, but the debtor may apply for protective and precautionary measures.

During the proceeding, the debtor retains the administration of its assets. Urgent acts are subject to authorisation of the court.

Restructuring plan subject to homologation

The New Code has introduced a new restructuring tool: the restructuring plan subject to homologation.

It is a completely new tool, with compulsory ranking of creditors, in which the value generated by the plan can be distributed in derogation of the absolute priority rule, provided that the proposal is approved unanimously by the classes. However, the New Code provides for special "simplified" majority thresholds: a proposal is deemed to receive the approval of each class of creditors where it has gained the consent of:

(i) more than 50% (by value) of the creditors entitled to vote; or

(ii) more than two-thirds (by value) of the creditors voting in favour, provided that at least 50% (by value) of the creditors entitled to vote actually vote.

Secured creditors and employees are not entitled to vote if the plan provides for full satisfaction of their credits within 180 days and 30 days (respectively) of homologation.

If the restructuring plan is not approved by all classes, the debtor may file a proposal for *concordato preventivo*.

Composition with creditors (*concordato preventivo*)

(a) Liquidation vs going concern

The *concordato preventivo* regime has been materially amended by the New Code.

Different provisions apply to:

(i) a *concordato* for liquidation purposes; and

(ii) a *concordato* where the business is to be preserved as a going concern. In the case of liquidation, the proposal must provide for external funding which increases the value of assets available at the petition date by at least 10% and ensures that not less than 20% (by value) of the unsecured creditors' claims are satisfied.

In the case of a *concordato preventivo* with the aim of preserving the business as a going concern:

(i) business as a going concern can be pursued either directly or indirectly;

(ii) the division of creditors into classes is mandatory;

(iii) the plan may provide for a moratorium for secured creditors, who consequently have the right to vote on the *concordato* proposal. For employees' claims, the moratorium cannot be longer than six months, starting from the homologation date;

(iv) the consent of each class of creditors has to be obtained. However, the New Code provides for special "simplified" majority thresholds. Notwithstanding the above, the *concordato preventivo* can be approved even if there are dissenting classes such that they can be crammed-down.

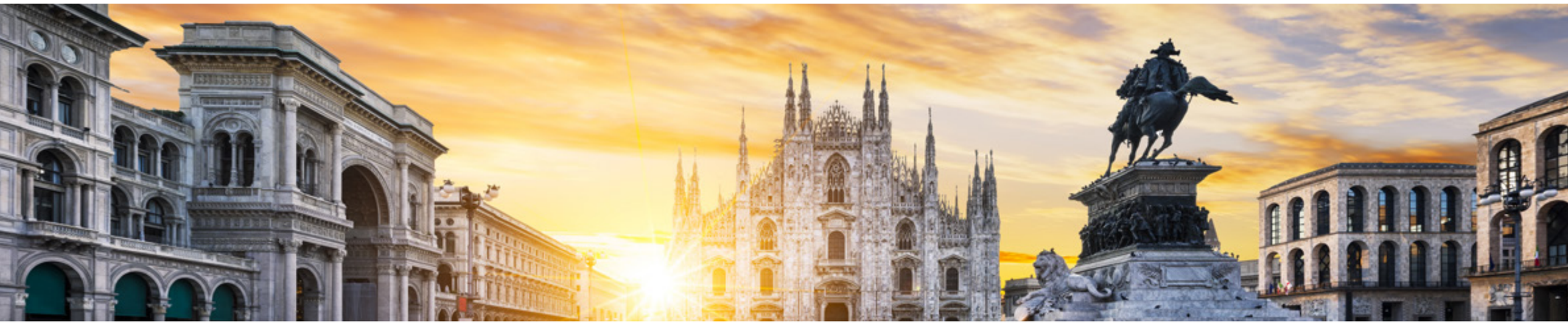
(b) Voting procedures

The New Code introduces two new voting rules:

(i) creditors with a conflict of interest are excluded from the voting procedures and their claims are not accounted for when calculating the requisite majorities (however, the New Code does not define 'conflict of interest'); and

(ii) where a creditor holds more than 50 per cent (by value) of the claims entitled to vote, the consent of a majority in number of creditors entitled to vote is required, in addition to the support of more than 50% (by value) of the creditors entitled to vote, in order to approve the *concordato*.

The *concordato preventivo* must be approved by creditors representing the majority (by value) of the creditors entitled to vote and by the majority of the classes (where applicable). Different rules apply to a *concordato preventivo* which has the aim of preserving the business as a going concern.



(c) Homologation

Where there are one or more dissenting classes, the *concordato preventivo,* which has the aim of preserving the business as a going concern, may be approved by the court at the request of the debtor – or with the debtor's consent in the case of competing proposals whether

(i) the liquidation value is distributed to creditors in accordance with the absolute priority rule;

(ii) the excess value is distributed to creditors in such a way that the creditors belonging to a dissenting class receive not less than a class of equal rank and more than a class of a lower rank (according to the relative priority rule);

(iii) no creditor receives more than the amount of their claim; and

(iv) the proposal is approved if:

(A) all classes of creditors voted in favour; or

(B) more than two-thirds (by value) of the creditors voted in favour, provided that at least 50% (by value) of the creditors entitled to vote have cast their votes; or

(C) it is approved by the majority of the classes provided that at least one of the classes voting in favour is composed of secured creditors;

(D) it's voted by at least one class of creditors who would be partially satisfied respecting the absolute priority rule also on the excess liquidation value.

Shareholders in restructuring proceedings

One of the most striking features of the New Code is the introduction of specific rules concerning shareholders in restructuring proceedings and their relationship with the management body.

In particular:

(i) the management body is solely responsible for filing an application for restructuring proceedings;

(ii) the restructuring plan may entail any amendment of the by-laws of the company, including

(A) share capital increases with the exclusion of option rights;

(B) changes in shareholders' rights;

(C) mergers and de-mergers;

(iii) from the filing date and until homologation, directors may not be dismissed except for just cause;

(iv) any resolution for the dismissal of a director must be approved by the commercial court (*Tribunale delle Imprese*);

(v) the plan may provide for the division of shareholders into classes. Division into a separate class is mandatory if the plan provides for amendments to shareholders' rights and shareholders vote based on their participation in the share capital of the debtor company;

(vi) in *concordato* proceedings where the business is to be preserved as a going concern, if the restructuring is also intended to benefit pre-filing shareholders (determined by calculating the effective value of their participation in the company resulting from the homologation of the *concordato*, less potential capital contributions made to the *concordato*), where there are dissenting class(es), the *concordato* can be homologated if the treatment proposed to that dissenting class is at least equal to any class of equal rank and not worse than any class of lower rank, even if the value intended for the shareholders is attributable to a dissenting class;

(viii) changes to the corporate structure as a result of the implementation of a restructuring tool do not constitute grounds for the termination or amendment of contracts entered into by the company. Accordingly, change of control clauses are deemed ineffective.

Relative and Absolute Priority Rule

The New Code provides for certain exceptions to the absolute priority rule. In particular:

(a) Composition with creditors (*concordato preventivo*)

In an arrangement with creditors as a going concern:

(i) the liquidation value must be distributed in full respect of the absolute priority rule, which prevents the satisfaction of the lower-ranking credit if there has not been full satisfaction of the higher-ranking claim;

(ii) the excess liquidation value resulting from the prosecution of the business activity must be distributed according to the relative priority rule, by which the claims have to be paid in equal proportion to claims of equal rank and in greater proportion to claims of lower rank.

(b) Restructuring plan subject to homologation

The value generated by the restructuring plan can be distributed in derogation of the absolute priority rule, provided that the proposal is approved unanimously by the classes.

Paolo Manganelli
Partner
T +39 02 85423314
M +39 334 6660228
paolo.manganelli@ashurst.com

Ashurst podcasts

Fresh perspectives and actionable insights on
key business issues of today (and tomorrow)

Groundbreaking technology and digital transformation. Economic and political change. Climate risk and energy transition. Social activism. A global pandemic... Truly, we are living and working in extraordinary times.

Our podcasts offer you unique and engaging viewpoints on the issues that matter. Every episode contains fresh perspectives and actionable insights on the key trends impacting business. Whether we're exploring legal issues, business strategy, or sustainability, our podcasts draw upon the expertise of our people and our global network of thought leaders and change makers.

ESG Matters @ Ashurst

Reveals how business leaders are rising to mounting environmental, social and governance challenges

LISTEN ON

Business Agenda

Tackles the strategic issues business leaders face

LISTEN ON

Legal Outlook

Explains the legal requirements and impacts of our fast-changing world

LISTEN ON

ashurst.com