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The reform of Italian insolvency law. An ongoing process. The preventive restructuring schemes and the Directive 1023/2019

On 10 January 2019 the Italian Government approved the consolidated act *"Code of corporate crisis and insolvency"* (the "Code"), which brings new rules for restructuring and insolvency which are applicable to all categories of debtors, including individuals, and introduces innovations on alert and preventive composition of crisis.

The Code will be in force from August 2020, even though certain provisions are already effective, namely those increasing the cases in which companies are obliged to appoint internal auditors, who after August 2020 will be in charge for reporting duties upon occurrence of symptoms of crisis or the company.

At the same time, following a long-lasting process, at a EU level the Directive (EU) 2019/1023 of the European Parliament and the Council has been approved on 20 June 2019 (the "Directive"), related to preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt.

Member States shall adopt and publish, by 17 July 2021, the laws, regulations and administrative provisions necessary to comply with the Directive, with possible prorogation of one year and longer timing to comply with certain provisions related to digital innovations.

The terms of the Directive, which contains 101 "whereas", are to some extent generical, even in the tautological definition of "restructuring" meaning "measures aimed at restructuring the debtor's business",. At the same time, the subject matter and the scope pointed under article 1 are mostly clear and consist in laying down rules on

a) preventive restructuring frameworks available for debtors in financial difficulties;
b) procedures leading to a discharge of debt incurred by insolvent entrepreneurs; and
c) measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt.

In addition, members States are requested to ensure that debtors have access to one or more clear and transparent early warning tools which can detect circumstances that could give rise to a likelihood of insolvency and can flag the need to act without delay.

The Code indeed anticipated the requirement expressed by the Directive, providing, under article 12, the "instruments of alert", intended as duties to report imposed on the internal auditors and certain "qualified" creditors (currently identified in the Tax Agent and the social security body), aimed at the prompt identification of the symptoms of crisis upon occurrence of certain indicators to be identified on an annual basis by the Chartered Accountants, in order to immediately adopt the measures considered fit for its resolution.

Such duties are of utmost relevance, given that their violation may trigger liabilities and ineffectiveness of the possible priority rights for qualified creditors failing to report the symptom of crisis.

According to the Directive, members States shall ensure that where there is a likelihood of insolvency, debtors have access to a preventive restructuring framework that enables them to restructure, with a view to preventing insolvency and ensuring their viability, without prejudice to other solutions for avoiding insolvency, thereby protecting jobs and maintaining business activity.

In order to pursue such scope, it is foreseen that the

debtor accessing preventive restructuring procedures shall remain totally, or at least partially, in control of their assets and the day-to-day operation of their business (art. 5 – debtor in possession), and can benefit from a stay of individual enforcement actions to support the negotiations of a restructuring plan in a preventive restructuring framework for a maximum period of four months, save when the stay no longer fulfils the objective of supporting the negotiations on the restructuring plan causes a prejudice of the creditors.

The Code basically provides for all the mentioned measures, through the introduction of an ad hoc body for composition of corporate crisis ("OCRI"), to be set up at each chamber of commerce, in charge for receiving the crisis reports and manage the procedure of alert, and to support the entrepreneur in the procedure of composition of crisis.

Once the OCRI receives the report or the request by the debtor, fixes the audition of the latter and identifies the possible measures to cope with the crisis, imposing a term to the debtor to comply therewith. In case of breach or if the debtor does not appear, the bodies which addressed the report will be informed, as well as the public prosecutor, and they would be entitled to request the insolvency of the debtor.

If, on the other hand, the debtor will request to start the procedure of assisted resolution of the crisis, a maximum three-months' time will be set in order to find possible solutions for coping with the crisis (such as the recourse to the composition with creditors – *"concordato preventivo"*, or the debt restructuring agreements – *"accordi di ristrutturazione del debito"*, with an automatic stay for equal timeframe).

The debtor will keep in any case the control of the company and will remain in possession, with a different level of control by the insolvency the court that varies depending on the specific selected procedure.

The circumstance that OCRI must report to the public prosecutor that the debtor did not appear or that no agreement was found and no recourse was made to composition with creditors or debt restructuring agreement, with consequent risk of declaration of insolvency of the debtor, renders to some extent the procedure compulsory. This may lead to a possible conflict with the provisions of the Directive, which states that preventing restructuring schemes are a mere option for the debtor, so the implementation of the Directive in Italy may imply an amendment to the Code.

The Directive also provides that Members States enable restructuring plans with minimum common features, such as the division into classes of the creditors (already provided in Italy, but not in many other EU States) and the intervention of the court for the homologation of plans that (i) affect the claims or interests of dissenting affected parties; (ii) provides for new financing; (iii) involve the loss of more than 25% of the workforce.

The latter provision is however conditional to the admissibility of such reduction of workforce by the relevant State.

In relation to the other two provisions requiring the intervention of the court for the homologation of restructuring plans (that the Directive defines as "cross-class Cram-down"), Italy may deem to be compliant already, in light of the *"cram-down"* provisions under the Code (whereby effects of the agreement can be extended also to dissenting creditors of the same category) and the granting of financing that may be authorised before the homologation of the composition with creditors or debt-restructuring agreements, or in the course of such procedures.

The Directive seeks to preserve such credit facilities, requesting to the Members States to provide that they are not declared null or void in case of subsequent insolvency of the debtor, so as to reduce the cases of possible claw-back, which in Italy are in abstract possible only for financing granted after that the debtor became unable to pay its overdue debts.

Also financing parties shall not be considered liable if such financings are of prejudice for the creditors, save for possible other reasons provided by national law (such as fraud).

Finally, particular focus is given by the Directive on the "discharge", on the assumption that the national rules offering a second opportunity to entrepreneurs vary between members states in terms of duration and conditions for the admission to the discharge. Therefore, the Directive, under article 21, Member States shall ensure that the period after which insolvent entrepreneurs are able to be fully discharged from their debts is no longer than three years from the opening of the procedure, and that no decision by any authority shall be needed.

Such provisions are fully respected by the Code, which excludes the benefit – as allowed by the Directive – only for the entrepreneur who has been held liable for bankruptcy crimes or has benefited two times of the discharge (*"esdebitazione"*) or has in any case already benefited it within a recent timeframe.

Basically, if on one side Italy seems to have approved a legal scheme mostly consistent with the European needs and, therefore, the implementation of the Directive is de facto in advanced stage, the

mechanism of *"early warning"* structured in the Code would need a simplification, being currently more similar to a pre-insolvency procedure rather than to a simple and quick out-of-court restructuring procedure.

Such scope shall move together with a sensibilisation of the Italian companies towards such procedures at a stage which is not of ascertained insolvency, but is effectively precocious and able to prevent future insolvency, and to pursue such objective it will be necessary to ensure that directors are not dissuaded from exercising reasonable business judgment or taking reasonable commercial risks, particularly where doing so would improve the chances of a restructuring of potentially viable businesses ("whereas" 70 of the Directive).

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