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Italy: New Bankruptcy Code

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I. Introduction

Italy has replaced its Bankruptcy Act of 1942 with a comprehensive reform, the process for which started two years ago. On 19 October 2017, Parliament passed Law No. 155 of 2017 delegating the Government to adopt, within the next 12 months, a comprehensive reform of the rules governing financial crises and insolvency procedures. On 10 January 2019, the Government approved Legislative Decree No. 14 of 2019, captioned "Code for Distress and Insolvency" (*Codice della Crisi d'Impresa e dell'Insovenza*—the "Code").

The Code pursues the aim to create tools for the early detection of a "crisis" to prevent future insolvency and, where prevention fails, to handle insolvency with the objective of overcoming the distress and return the business to profitability. Thus, the procedures finalized at liquidating a company's assets are discouraged and often made more burdensome for the debtor.

The Code mainly pursues the above aims by:

- providing that companies implement an adequate organizational structure able to detect a crisis as early as possible and adopt suitable initiatives to address the situation;
- simplifying court proceedings, through the adoption of online processes (*e.g.* the approval of the *concordato preventivo* by the creditors will be through an electronic voting system) and other measures;
- amending some of the existing procedures and introducing new ones (*e.g.* crisis of group companies, standstill agreements with non-financial creditors, and early warning mechanisms);
- amending certain provisions of the Civil Code to facilitate the disclosure of distress and to encourage company directors to implement adequate organizational structures also in smaller companies. In particular, the reform lowered the thresholds above which limited liability companies (*Società a responsabilità limitata—Srl*) have an obligation to appoint a board of statutory auditors, thus increasing the number of Srls obliged to appoint such body.

II. The Main Innovations

The Code provides for the following main innovations regarding joint stock companies SpA or (*Società per Azioni*) and limited liability companies:

2.1 **The Notion of "Bankruptcy" (*fallimento*):** The notion of "bankruptcy" (*fallimento*) will be replaced by "judicial liquidation" (*liquidazione giudiziale*), to reduce the reputational damages historically connected to the word "bankruptcy", with the aim of offering to any entrepreneur declared insolvent, better chances in restarting a business activity. The judicial liquidation will become the last resort, to be commenced only when the debtor has failed to identify any other suitable solution.

2.2 **The Definition of "Crisis":** The Code defines "crisis" as a status of economic and financial condition which makes likely a future insolvency of the debtor, while insolvency will continue to indicate the status of the debtor which is no longer able to regularly fulfil its obligations.

2.3 **The Status of Crisis or Insolvency:** A single procedure will ascertain the status of crisis or insolvency. Any type of debtor can be subject to crisis or insolvency (with the exception of public entities). The competent court is determined in having regard to the centre of the debtor's main interests.

2.4 **Public Prosecutor's Powers:** The Public Prosecutor must request the judicial liquidation of an entity in any case he/she becomes aware that the entity is insolvent (hitherto, the Prosecutor's obligation was triggered only in specific circumstances).

2.5 **Duties of the Creditors:** The creditors are obliged to cooperate loyally with the debtor and the bodies of the relevant procedures, and must act fairly and in good faith.

2.6 **Restructuring Plans:** The plan must have certain date (*data certa*).

2.7 **Composition with Creditors (*concordato preventivo*):** The composition with creditors must focus on business continuity (as a consequence, the *concordato* for liquidation purposes is discouraged by making it subject to restrictions and more burdensome for the debtor). Specifically, the main innovations relating to *concordato preventivo* are the following:

i. <u>Approval</u>:

The *concordato preventivo* is approved if voted by the creditors representing the majority of the claims admitted to vote and the majority of classes. If a single creditor holds more than 50% of the claims admitted to vote, the *concordato preventivo* is approved if voted also by the majority of the other creditors.

The court must assess the economic feasibility of the *concordato* plan, in addition to the compliance of the request with the relevant formalities.

ii. <u>Alternative Proposals (*proposta concorrente*)</u>:

Similar to the current bankruptcy legislation, one or more creditors holding at least 10% of the overall claims (including claims acquired after the *concordato* petition has been filed by the debtor) are entitled to submit an alternative proposal for *concordato preventivo*. Conversely, different from the current bankruptcy legislation, the alternative proposals cannot be submitted if the debtor's proposal provides for the payment of at least (i) 30% of unsecured creditors or (ii) 20% of the unsecured creditors, if the debtor has activated the early warning mechanism and initiated the aided composition of the crises (*composizione assistita della crisi*—See 2.12 below) according to the Code. In addition, the Code provides that, if alternative proposals are submitted, the debtor and the creditor(s) who submitted a proposal for *concordato preventivo* may submit amendments of the same until 20 days before the creditors' vote.

Creditors filing an alternative proposal and their related parties can vote on the proposal only if they are put in a separate class.

iii. Extraordinary Transactions:

If the *concordato* proposal provides for the completion by the debtor—during the procedure or after its homologation—of extraordinary transactions such as transformation, merger or demerger, the validity of such transactions may be challenged by creditors only with the opposition to the homologation.

iv. Duration:

The Code does not provide for a maximum duration of the composition with creditors; however, it is worth mentioning that any protective measure granted to the debtor cannot exceed 12 months. In addition, different from the current legislation, the protective measures are not an automatic consequence of the initiation of a procedure, but must be requested by the debtor and approved by the court. If asked, the protective measures will operate until the court decides whether to approve them and their duration.

v. *Concordato preventivo* for Liquidation Purposes:

The procedure is available only if (i) new external financing, increasing the unsecured creditors' satisfaction by at least 10%, is available, and (ii) the proposal contemplates the payment of at least 20% of all unsecured claims.

vi. Moratorium in the *concordato preventivo* with Going Concern:

If the *concordato preventivo* is with going concern, the underlying plan may provide for a moratorium for the payment of secured and priority creditors. Under the current legislation, the moratorium is admitted for a period of one year. The Code extends the period to two years after the homologation of the *concordato preventivo*. The moratorium is allowed only if the plan does not contemplate the liquidation of the assets guaranteeing secured creditors.

2.8 **Debt Restructuring Agreements (*accordi di ristrutturazione dei debiti*):** Under the current legislation, a debt restructuring agreement is entered into between the debtor and creditors representing at least 60% of all claims.

The Code provides the additional option of a debt restructuring agreement with at least 30% of the overall claims, if the debtor does not request (i) a moratorium on the creditors not adhering to the agreement and (ii) the application of temporary protective measures.

Furthermore, the Code provides that the terms of the debt restructuring agreement apply to non-adhering creditors—other than banks or financial intermediaries—of the same category, subject to certain conditions, such as (i) the non-adhering creditors having been duly informed and invited to participate in the negotiations, (ii) the debt restructuring agreement not contemplating the liquidation of the debtor's assets, rather the continuation of the business, and (iii) the claims of the creditors adhering to the agreement represent at least 75% of the creditors of such category.

The debt restructuring agreement must have a certain date (*data certa*).

2.9 **Shorter Terms to File the *concordato preventivo* Plan and the Debt Arrangement Agreement:** If the *concordato* plan is not ready or the debt arrangement agreement has not been agreed yet, the debtor may request from the court the granting of a 30- to 60-day term for the filing of the *concordato* plan or the debt arrangement agreement. Stay is automatically granted upon the filing of the petition until the first hearing therefrom, during which the judge must decide whether to confirm the stay and, in the positive, its duration. The term may be extended up to 60 days if there are justified reasons (*giustificati motivi*) and no request for liquidation of the company is pending. The extension may be granted up to 120 days if the debtor has been adequately responsive to the crises symptoms (see Paragraph 2.13 for more details).

2.10 **Moratorium Agreements with Non-financial Creditors:** Under the Code, the debtor may enter into moratorium agreements with non-financial creditors (i.e. creditors which are not banks or financial intermediaries) to govern the relationship with its creditors during the crisis period. The Code provides that the terms of the moratorium agreement are extended to the dissenting creditors of the same category, if (i) the dissenting creditors have been duly informed and invited to participate in the negotiations, (ii) the claims of the creditor parties to the agreement represent at least 75% of the claims of such category, and (iii) it is likely that the dissenting creditors of the same category are repaid in a manner no less satisfactory than they would be from a liquidation procedure.

2.11 **Crisis of Group Companies:** The Code introduces a unified procedure for all companies of the same group or the connection of other processes, with the aim of simplifying and making more efficient the management of the crisis when it affects more than one company of the same group. It will be possible to file a single application for all of the companies of the same group for a composition with creditors, a debt restructuring agreement, or a judicial liquidation, provided that such unified procedure or the connected procedures are more satisfactory to the creditors of each of the group companies and their respective assets and liabilities are treated separately. In addition, to make the *concordato preventivo* process more efficient, it is provided that (i) one delegated judge and one judicial commissioner will be appointed to supervise the procedure with respect to all the entities involved; and (ii) the creditors of each company will vote at the same time, but separately. The identification of the companies to which the rules in question apply is based on the notion of the so-called “direction and coordination” (*direzione e coordinamento*) pursuant to Article 2497 of the Civil Code.[1]

2.12 **Aided Composition of Crisis (*composizione assistita della crisi*):** This out-of-court procedure may be activated by the distressed company and will be undertaken by a special body to be established within the local Chamber of Commerce. The Code provides rules regarding the confidentiality of the proceedings, the exchange of information between the special body established within the Chamber of Commerce and certain bodies (such as board of the statutory auditors and external auditors of the relevant companies, as well as the Tax Authority (*Agenzia delle Entrate*), the National Social Insurance Agency (*Istituto Nazionale della Previdenza Sociale*), and the collection agency (*agente della riscossione*)) and duration of the proceeding (*i.e.* within a three-month term, extendable for an additional maximum term of three months in case of positive progress of the negotiations). The agreement with the creditors will have the effects of a restructuring plan and cannot be extended to dissenting creditors. The debtor may ask the Chamber of Commerce to grant protective measures to complete the negotiations. The protective measures cannot last more than three months, and can be extended one or more times up to three months, provided that significant progress in the negotiations has been made. Furthermore, the debtor may also ask to deviate from the rules imposing (i) the implementation of actions in case of reduction of the corporate capital and (ii) the liquidation as a consequence of the reduction of the corporate capital. The Chamber of Commerce must inform the Public Prosecutor if no suitable measures to ensure the settlement of the crisis are identified and there is evidence of the debtor’s insolvency. The procedure does not apply to listed companies and large corporations.[2]

2.13 **The Early Warning Procedures (*procedura di allerta*):** The Code provides for a “warning procedure” to address in the most efficient manner a financial crisis if certain indicators set forth in the Code are met. In this respect, the Code provides that: (i) the debtor’s statutory or external auditors must immediately inform the company’s directors of any symptoms of a crisis, and (ii) the Tax Authority, the National Social Insurance Agency (INPS), and the collection agency, in the event the company fails to pay taxes or social security contributions for an amount exceeding the thresholds provided for by the Code, must immediately notify the debtor that, failure to pay the outstanding amounts within 90 days or has not initiated one of the restructuring procedures provided for by the law to recover from the distress, would result in information being delivered to the special body to be established within the local Chamber of Commerce. If the debtor does not react promptly, the auditors and the above creditors must inform the Chamber of Commerce. A company may adopt other crisis' indicators if it believes that the ones set forth by the Code are not adequate for the company's circumstances. The indicators must be included in the explanatory notes to the financial statements of the company, together with the statement of an independent expert certifying the adequacy of such indicators to detect the crisis. The indicators will be valid for the following financial year.

A debtor who has been adequately responsive to the crises symptoms is rewarded with: (i) a reduction of the fiscal sanctions and tax debt interests accrued during the procedure; (ii) longer term extension for the filing of *concordato preventivo* or a debt restructuring agreement; and (iii) the exclusion or reduction of punishment for certain bankruptcy crimes which caused limited damages. Listed companies, companies with securities held by a relevant number of holders, and large undertakings[3], as well as medium- and large-sized[4] groups[5] are not obliged to apply the early warning rules, but will benefit from the rewarding measures if they do.

2.14 **Compulsory Administrative Liquidation (*liquidazione coatta amministrativa*):** In regulated sectors (*e.g.* banking), the competent supervisory authority (*autorità di vigilanza*) will be empowered to receive reporting of indicia described in Paragraph 2.13 above from the debtor's statutory or external auditors and the public authorities mentioned above.

III. Entry into Force

The Code was published in the Official Journal (*Gazzetta Ufficiale*) on 14 February 2019 and its provisions will enter into force 18 months after the publication, *i.e.* on 14 August 2020, with the exception of certain provisions amending the Civil Code, including the new rules on the appointment of the Board of Statutory Auditors of Srl-type companies, which will enter into force 30 days following the publication of the Code, *i.e.* on 16 March 2019.

IV. Comments

The Code aims to (i) re-order the existing rules on out-of-court and in-court restructurings and insolvencies by providing a consistent set of rules applicable to all the restructuring and insolvency mechanisms, (ii) provide rules for the prevention and early detection of crises, (ii) promote the timely restructuring of distressed companies, (iv) favor the restructuring of businesses, limiting the use of liquidation tools to extreme situations where softer alternatives are not viable, and (v) make restructuring and insolvency procedures more effective and more efficient, with savings in time and costs.

The Code also aims to harmonise Italian insolvency procedures with the EU Regulation 2015/848 by reducing the differences in the interpretation of the applicable law, thus allowing a more effective management of insolvency. The Code follows a string of piecemeal reforms of the Bankruptcy Act of 1942 and is consistent with reforms introduced by several EU Member States in recent years, all generally aimed at introducing instruments for the early detection, prevention, and fast resolution of distressed situations.

While a comprehensive reform of the rules on restructurings and insolvencies was clearly overdue (the Bankruptcy Act was introduced in 1942, over 75 years ago, and notwithstanding several reforms, it could not hide its obsolescence), certain provisions of the Code have been criticized for being detrimental to the interests of creditors and investors in distressed claims. Also, the Code does not supersede the rules applicable to the insolvency of large companies (*i.e.* the so-called Prodi-*bis* and Marzano Acts), thus failing to provide a legal framework for all Italian companies.

Given that the majority of the rules of the Code will become effective in August 2020, it is possible that Parliament will take advantage of this period to take into account the criticisms levied against the Code, and adjust certain provisions.

Lenders and equity investors with a mid- to long-term outlook should be mindful that after August 2020 a crisis affecting the company in which they have or will be investing will be resolved on the basis of the new rules enshrined in the Code.

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[1] Italian law contains no definition of the expression "direction and coordination", nor is it a term of art in Italian company law. The Italian Civil Code sets out a list of circumstances in which a situation of direction and coordinated activity is presumed, unless the entity considered to exercise "direction and coordination" can established that such situation does in fact not exist. In particular, under Article 2497-*sexies* of the Italian Civil Code, an entity is presumed to exercise direction and coordination of a company where: (a) it consolidates the results of such company in its financial statements, or (b) it exercises control over such company pursuant to Article 2359 of the Italian Civil Code, *i.e.* it (i) has the right to express the majority of the votes in the ordinary shareholders' meeting of that company (also considering indirect votes, *i.e.* those expressed through subsidiaries, affiliates, and fiduciary entities), (ii) has the right to express a number of votes sufficient to exert a dominant influence on the ordinary shareholders' meeting of that company (also considering indirect votes, *i.e.* those expressed through subsidiaries, affiliates, and fiduciary entities), or (iii) exerts a dominant influence on the company by reason of particular contractual arrangements.

[2] "Large companies" are defined as companies which on their balance sheet date exceed specific thresholds—*i.e.* two of the following three limits: (1) balance sheet total: EUR 20,000,000; (2) net revenues: EUR 40,000,000; (3) average number of employees during the year: 250.

[3] Large undertakings shall be undertakings which on their balance sheet date exceed at least two of the three following criteria: (a) balance sheet total: EUR 20,000,000; (b) net turnover: EUR 40,000,000; (c) average number of employees during the financial year: 250.

[4] Including groups which are not small groups, which consist of parent and subsidiary undertakings to be included in a consolidation and which, on a consolidated basis, do not exceed the limits of at least two of the three following criteria on the balance sheet date of the parent undertaking: (a) balance sheet total: EUR 20,000,000; (b) net turnover: EUR 40,000,000; (c) average number of employees during the financial year: 250.

[5] Are groups consisting of parent and subsidiary undertakings to be included in a consolidation and which, on a consolidated basis, exceed the limits of at least two of the three following criteria on the balance sheet date of the parent undertaking: (a) balance sheet total: EUR 20,000,000; (b) net turnover: EUR 40,000,000; (c) average number of employees during the financial year: 250.