The New Italian Crisis and Insolvency Code: Focus on Early Warning

Rita Gismondi – Fellow INSOL International – Gianni Origoni Grippo Cappelli & Partners

1. Foreword

Over the past few years, the Italian insolvency legislation has been significantly and intensively amended, but only in 2019 a comprehensive and organic reform has been enacted. The Italian legislative decree no. 14 of 12 January 2019 now provides a Code of corporate crisis and insolvency (hereinafter, the "**Code**"), implementing the general principles and guidelines set forth by the Italian legislator in 2017, and also taking into account some inputs received at the European Union level.

Most of the provisions of law included in the Code will be effective after a 18-month period from the date of publication of the above mentioned legislative decree in the Official Gazette of the Italian Republic (i.e., 14 February 2019), with the exception of certain provisions of law which are applicable after a 30-day period from such date (and, thus, which are already applicable as of 16 March 2019). Therefore, a certain time frame is allowed in order to assess the possible impact of the rules set forth by the Code and to enable any further amendments and corrective actions, if needed.

Generally speaking, the Code appears to be in line with the most advanced legal systems and, in addition to traditional liquidation proceedings, it offers more efficient, early and flexible corporate reorganization and restructuring tools aimed at business continuity, where possible.

In particular, the new rules and provisions of the Code are aimed at ensuring, among other things:

- an earlier emersion of the distress situation, through certain preventive restructuring remedies;

- "*concordato preventivo*" (settlement with creditors) proceedings as a tool for restructurings based on business continuity (as opposed to liquidation), which would be treated by the courts as a matter of priority;

- a new concept of judicial liquidation, with a replacement of the expression "*fallimento*" (bankruptcy);

- faster and more cost-effective crisis and insolvency proceedings, on the basis of a single judicial process;

- special rules on the insolvency and restructuring of group companies; and

- amendments to the rules on new financings.

The new provisions of the Code follow the path of international conventions and European Union rules, in order to deal effectively with cross border insolvency issues, as well as to make available more effective restructuring tools. Although (i) Italy has not implemented yet the UNCITRAL Model Law on cross border insolvency, and (ii) express reference to the international conventions and European Union legislation is made only in relation to jurisdiction issues (i.e., opening of insolvency proceedings and COMI issues: Articles 11 and 26 of the Code), it is clear that the Code has been enacted on the basis of both international and European insolvency law inputs, having regard to, in particular:

i) Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (the "**Regulation 2015/848**");
ii) Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures, which is expected to be enacted in 2019 (the "**Restructuring Frameworks Directive**"); and
iii) Recommendation of the European Commission 2014/135 of 12 March 2014 on a new approach

to business failure and insolvency (the "**Recommendation 2014/135**").

In this note we will focus on the new early warning tools and alert mechanisms (Article 12 ff. of the Code), on which the debate and discussions among legal practitioners and scholars are very lively at the moment. Further notes will follow to provide more details on other specific topics and issues.

2. Early Warning Tools and Crisis Management Proceedings under the Code

Pursuant to the new provisions of the Code, both early warning tools and crisis management proceedings are out-of-court, confidential legal mechanisms aimed at ensuring an earlier emersion of the distress situation of the company, as well as a quick adoption of the more suitable/appropriate remedies.

In particular, early warning tools are alert obligations upon certain subjects and entities, which are aimed at a prompt detection of crisis indicators, as well as a quick adoption of the more appropriate measures, in addition to the internal organizational models adopted by the companies and their corporate bodies.

The crisis indicators could be any economic or financial imbalances, also considering the dimension and history of the company, and the kind of business activity carried out by the same, arising from certain indexes of business continuity and sustainability of debts for a certain timeframe.

Early warning tools are activated through a notice sent by:

- the control bodies (internal auditors or external auditors, where provided) to the directors of the company, with a short term for the adoption of the required remedies; lacking any reply or action from the directors, the control bodies shall inform the so called OCRI (i.e., "*Organismo di Composizione della Crisi d'Impresa*"), an independent body for the management of crisis situations; or

- qualified public creditors (e.g., Tax Agencies and Social Securities Authority) to the debtor, in the event of indebtedness exceeding certain indebtedness thresholds; if the indebtedness is not cured, or actions are not taken by the debtor within a certain timeframe, the above mentioned creditors shall inform OCRI.

OCRI is entitled to summon the debtor and, if a crisis situation occurs, to suggest any possible measures to be adopted further to an out-of-court, confidential and quick process. In the framework of such crisis management proceedings, the same debtor may request OCRI to facilitate an agreement with creditors aimed at the restructuring of the indebtedness. In any event, the same debtor is entitled to promptly request the opening of a confidential crisis management proceedings before the OCRI, also in order to benefit from certain reward measures. Any stay of individual enforcement actions over the debtor's assets does not automatically apply, being required a filing of the debtor with the court.

3. Comments and Remarks

The provisions set forth by the Code on early warning tools and crisis management proceedings are no doubt a significant step forward for increased harmonization and consistency of the domestic remedies with the rules and best practices already available in other jurisdictions, or proposed at the European Union level.

Indeed, the Recommendation 2014/135 was already focused in providing access for viable enterprises in financial difficulties to national insolvency frameworks which enable them to restructure at an early stage with a view to preventing their insolvency and, thus, maximise the total value to all stakeholders.

According to the Recommendation 2014/135, a restructuring framework should enable debtors to address their financial difficulties at an early stage, when their insolvency could be prevented and the continuation of their business assured, bearing in mind that, in order to avoid any potential risks of the procedure being misused, the financial difficulties of the debtor must be likely to lead to its insolvency and the restructuring plan must be capable of preventing the insolvency of the debtor and ensuring the viability of the business.

Furthermore, in order to promote efficiency and reduce delays and costs, national preventive restructuring frameworks should include flexible procedures limiting court formalities to where they are necessary and proportionate in order to safeguard the interests of creditors and other interested parties likely to be affected.

In the same line, the Restructuring Frameworks Directive – which is going to be enacted very soon – aims to enhance the rescue culture in the European Union and to establish a common framework to ensure effective restructuring, as well as second chance and efficient procedures both at national and cross-border level.

According to the Restructuring Frameworks Directive, in particular, preventive remedies should, among other things:

(i) enable the enterprises to restructure at an early stage and to avoid their insolvency;
(ii) maximise the total value to creditors, owners and the economy as a whole;
(iii) prevent unnecessary job losses, as well as losses of knowledge and skills; and
(iv) prevent the build-up of non-performing loans.

The Restructuring Frameworks Directive also provides that:

- clear information on the available preventive restructuring procedures, as well as early warning tools, should be put in place in order to push debtors to take early action at the onset of economic and financial problems;
- possible early warning mechanisms should include accounting and monitoring duties for the debtor, or the debtor's management, as well as reporting duties under loan agreements;
- third parties with relevant information such as accountants, tax and social security authorities could be incentivised (or obliged) under national law to flag a negative development;
- the involvement of judicial or administrative authorities should be limited to where it is necessary and proportionate in order to safeguard the interests of creditors and other interested parties likely to be affected (e.g., when a general stay of individual enforcement actions is granted by the judicial or administrative authority).

In light of the above, it seems that the Code has anticipated to a certain extent the implementation of the main principles of the Restructuring Frameworks Directive relating to early warning and alert mechanisms. However, such remedies are relatively new and untested in Italy and, thus, a deeper and careful consideration during the term of implementation, as well as a comparative analysis of any similar legal tools experienced in other jurisdictions, would be helpful in order to improve the relevant effectiveness, and to prevent any possible drawbacks.

4. Final Considerations

The Code represents a significant step forward with a view of aligning the Italian legislation with the more advanced insolvency regimes, as well as with the latest provisions and principles of the European Union legislative framework.

The main advantage arising from the Code would be the availability of a legislative framework based on greater certainty for insolvency practitioners, being it focused on ensuring a coherent and predictable interpretation of the relevant provisions of law (interpretation which often used to be different in the past, also depending on the court having jurisdiction for the judicial proceedings), as well as a more short and predictable timing of the relevant proceedings (which has always been one of the reason of concern in relation to the Italian jurisdiction).

In addition to it, the business continuity would be the main path to achieve a successful restructuring (also by means of extraordinary transactions), but it should be reserved only to cases which allow a real reorganization, while non-viable enterprises with no chance of survival should be orderly and efficiently liquidated.

In the above scenario, early warning tools and crisis management proceedings, as briefly outlined in paragraph 2 above, are no doubt a significant step forward in order to allow a quicker emersion of the distress situation and, if possible, a successful restructuring based on business continuity.

The provisions set forth by the Code on early warning tools and crisis management proceedings are new and untested in our jurisdiction and they may give rise to certain drawbacks. One of the reasons of concern already raised in relation to the early warning and, in particular, to the connected alert obligations upon certain entities (i.e., control bodies and qualified public creditors), would be the actual level of confidentiality and the significant limitation of the time available for the rescue, with the possible consequence of a quick worsening of the distress situation and, thus, of an unavoidable filing of judicial liquidation proceedings. Such concern is also related to liability issues for all the players involved, considering in particular the short time frame and the strict thresholds provided by the Code for starting the process. In addition to this, the length of the stay from any individual enforcement or precautionary actions and the impact on pending agreements or executory contracts are sensitive issues. Very important is also the need of an increase of skills, specialization and expertise of all the professionals involved in the distress and insolvency situations, including (but not limited to) those eligible for the OCRI.

In light of the above, it is very welcome the possibility to further amend and supplement the provisions of law set forth by the Code during the 18-month term provided for the entry into force of the same, also on the basis of any suggestions provided at the European Union level and experiences made in other jurisdictions, as well as of any issues raised by the professionals involved in the insolvency and restructuring processes. Such approach could enable the management of the distress situation of the companies taking into account the interests of all stakeholders, as well as a greater and actual effectiveness of the new provisions of law. This is our wish, also in a view of strengthening the reliability of the Italian legal system and the certainty of the relevant insolvency rules, in order to attract new investments and increase business opportunities.

Rita Gismondi
Fellow INSOL International

Gianni Origoni Grippo Cappelli & Partners
Counsel
Via delle Quattro Fontane 20
00184 Rome - Italy
☎+39 06 478751
rgismondi@gop.it