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ARTICLE

The New Italian Code of Business Crisis and Insolvency and the COVID-19 Era: A Comparison and Some Food for Thought

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Synopsis

The harsh crisis that has been hitting companies since the outbreak of the pandemic has had a significant impact on the new Italian Code on Business Crisis and Insolvency, only a very little part of which has so far entered into force.

The purpose of this article is to provide an overview of such impact with respect to some of its major aspects and the types of amendments that have been (and are being) implemented by Italian lawmakers, particularly as part of an effort to harmonise the Code with European legislation recently enacted.

1. Introduction

In a previous article of this publication,[1] we dealt for the first time with the radical reform of the 'old' Italian bankruptcy law.[2] On that occasion, we saw that such law, after more than 70 years and several fragmentary amendments, was then replaced by Legislative Decree 12 January 2019 No. 14, which, by implementing the Delegated Law 19 October 2017 No. 155, introduced the new Code of Business Crisis and Insolvency (the 'Code') in Italy.

While some of the provisions contained in the Code entered into force on 16 March 2019,[3] the rest was expected to be enacted in August 2020, i.e. after the *vacatio legis* period of 18 months from the publication of the Code in the Official Gazette.[4]

In the meantime, however, the COVID-19 health emergency has given rise to an unprecedented economic crisis. According to an analysis conducted by Assonime[5] on the basis of recent data by Cerved, 'out of 500,000 companies classified as *safe* before the pandemic, 182,000 have become *vulnerable* and 9,300 have moved from *solid* to *at risk* as a result of COVID-19. These add to 284,000 companies that have remained in an area of vulnerability before and after COVID-19 and another 181,000 that moved from *vulnerable* to *at risk* [...].'

The response of the Italian Government has been enacted, *inter alia*, through the Law Decree 8 April 2020 No. 23, converted into Law 15 June 2020 No. 40 (the so-called 'Liquidity Decree'). In particular, such response was based, on the one hand, on substantial disbursements in favour of companies and, on the other, on the temporary freezing of various corporate and insolvency law instruments, including the suspension of bankruptcies and the relaxation of several deadlines in ongoing restructuring proceedings.

In the context of the measures implemented by the emergency legislation, a compulsory step has been that of postponing the entry into force of the new regulatory system for one year.[6] This is a measure that arose from the general belief that several of the new requirements in the Code – and, first and foremost, that of the Alert, a new procedure which requires company management to adopt timely measures to deal with its financial crisis[7] – could not reasonably apply in a situation in which many companies were collapsing under the pressures of the pandemic.

Indeed, the Liquidity Decree was itself prompted by the urgency imposed by the circumstances of the pandemic: it blocked bankruptcy petitions (even when filed by insolvent company itself) and extended procedural deadlines in ongoing proceedings of Preventive Arrangement with creditors, in order to allow the amendment (or even the substitution) of restructuring plans already submitted to creditors. It thus would have been contradictory to oblige companies in financial crisis to

Notes

1 See 'Overview and First Thoughts on the New Italian Insolvency Code' (2019) 16:2 *International Corporate Rescue* 77.
2 The Royal Decree 16 March 1942 No. 267 and further amendments.
3 Among these, the new Article 2086 of the Italian Civil Code ('Civil Code'), which requires a company's governing body to set up organisational structures capable of addressing its financial crisis and to take timely action to overcome it.
4 The Decree was published in the Official Gazette on 14 February 2019.
5 See 'Note e Studi Associazione Società Italiane per Azioni' (2021) 8, p. 3.
6 According to article 5 of the Liquidity Decree, the Code will enter into force on 1st September 2021.
7 See 'Overview and First Thoughts on the New Italian Insolvency Code' (2019) 16:2 *International Corporate Rescue* 78.

adopt timely measures to deal with the pandemic crisis, in addition to the emergency measures adopted by the Liquidity Decree for the crisis.

2. The Directive (EU) 2019/1023 and its impact on the new Code

As mentioned in our brief introduction, in the first stage of the Italian government's management of the lockdown, the need to delay insolvency liquidation procedures for companies severely affected by the crisis emerged as one of the main themes for reforms to come. This was based, above all, on the fact that, if the principles of the new insolvency legislation took effect, the majority of companies would have been considered to be in a state of financial crisis or, even worse, insolvent and, therefore, would have to be liquidated.

Moreover, this temporary 'stalling' or deferral of the Code going into effect – and which could be further deferred should Italian lawmakers concur with the need for further deferral that many have already expressed – has provided time for lawmakers to focus on the need to make the Code consistent with the Directive of the European Parliament and of the Council of 20 June 2019 No. 2019/1023/EU (the 'Directive').[8] By amending prior Directive (EU) 2017/1132 on restructuring and insolvency, the new Directive deals with preventive restructuring, discharge and disqualifications as well as with measures to increase the effectiveness of restructuring, insolvency and discharge proceedings.

In the abovementioned previous article in this publication,[9] we noted that Italian lawmakers should have implemented a harmonisation with the EU's regulatory provisions on restructuring and insolvency, which the new Code had not taken into due consideration.

In this context, the Directive, which was passed immediately after the approval of the Code, has once again highlighted such need for coordination, even though it is reasonable to remark that the overall structure of the Code is certainly in line with the fundamental guidelines of the Directive itself.

An example of one of the several issues requiring such coordination is the treatment of creditors and their division into classes. In this respect, the Code requires a strict observance of the 'absolute priority rule', whereby payments to subordinated creditors may occur only when creditors with a higher priority rank have been fully satisfied.

On the contrary, the Directive mitigates this approach, introducing the 'relative priority rule', according to which creditors of the same class or rank must be treated equally, and payments to subordinated creditors are allowed as long as it does not result in them receiving a more favourable treatment than that accorded to senior creditors. In other words, senior creditors do not have to be fully satisfied prior to payments to subordinated creditors; they just have to receive a better treatment than that given to subordinated creditors.

Another instance where the need for coordination between the Code and the Directive has made itself felt concerns the approval of the Preventive Arrangement. According to the Code, this can only take place upon, on the one hand, the favourable vote of the majority of the claims permitted to vote and, on the other hand, the favourable vote of the majority of the classes in those cases in which multiple classes of creditors have been set up.

Also in this case, the Directive shows a higher degree of flexibility, introducing two alternative voting methods. Under the first one, the agreement may be approved by a percentage in amount of the claims and interests in each class not exceeding 75%, without the need for approval by the judge, while, under the second one, under certain conditions, the agreement may be deemed approved even if not all of the classes have voted in approval, but, in this case, the judge's approval is needed (the so-called 'cross class cram down').

However, these are only some of the ways in which the Code must be adapted to the Directive by the 17 July 2022 deadline (see footnote 8). For this purpose, a Decree of 22 April 2021 by the Minister of Justice set up a Commission in charge of coming up with proposals for amendments to the Code, first and foremost to address changes required by the Directive.

3. The first reform of the Code: the Corrective Decree

Before taking any steps to implement this coordination with European legislation, the lawmakers deemed it appropriate to pass Legislative Decree 26 October 2020 No. 147 (the 'Corrective Decree'), published in the Official Gazette on 5 November 2020.

This 42-article body of rules is aimed, among other things, at clarifying the content of certain provisions of the Code and, at the same time, supplementing the provisions of the Code by coordinating various legal concepts contained therein. Since it is impossible to review all the new provisions in this context, let us just summarise the main ones.

Notes

8 The Directive shall be implemented in Italy by 17 July 2022, due to the one-year extension requested from the European Commission.

9 See 'Overview and First Thoughts on the New Italian Insolvency Code' (2019) 16:2 *International Corporate Rescue* 81.

a. Changes to definitions in the Code

First of all, the Corrective Decree amends two general definitions contained in Article 2 of the Code[10] concerning, in particular, the concept of 'crisis' and that of a 'group of companies'.

As to the concept of 'crisis', it was defined in the Code as 'an economic and financial condition that is likely to result in a debtor's insolvency or, for enterprises, prospective cash flows that are insufficient to regularly fulfil obligations'.[11] The Corrective Decree has now replaced the idea of 'economic and financial condition' with that of 'economic and financial imbalance', thus bringing the concept of crisis closer to that of insolvency in the old bankruptcy legislation.[12]

The purpose of this partial 'return to the past' is to allow companies to enact the report system set forth by the rules on Alert at a later stage than that of the emergence of a mere crisis tied to 'financial condition'. In practice, however, this change will have little relevance, because a crisis is identified by a series of financial indicators that is updated by the National Council of Accountants and Bookkeeping Experts at least every three years, taking into account the best national and international practices.[13]

The second definition modified by the Corrective Decree is that of a 'group of companies'. This has been made more specific, in negative terms, by clarifying that such a group does not include the State and other territorial bodies – all of which are subject to specific rules – while it does include, as a result of this amendment, not only companies, businesses or bodies subject to unified management and coordination, but also those that carry out such management and coordination, thus also introducing a presumption similar to that of Article 2497-sexies of the Civil Code.[14]

b. Changes to Alert procedures

Another area of amendments concerns the Alert and Assisted Settlement of the Crisis. In this respect, it should be remembered that the mainstay of the Alert procedures is the internal control system of a company. Specifically, Article 2086 of the Civil Code – already in force – imposes on the entrepreneur that runs her or his business in the form of a company the duty to adopt an organisational, administrative and accounting model suitable to the nature and size of the company, designed to detect a state of crisis in a timely fashion.[15]

By resolving a series of interpretative ambiguities, the Corrective Decree has now clarified that the management of the company, which must be carried out in compliance with the provisions of Article 2086 of the Civil Code, is the exclusive responsibility of the directors, who have the duty of establishing the structures referred to in the same provision.

With regard to the crisis indicators that trigger the Alert procedures, the Corrective Decree, in addition to the new 'crisis' definition mentioned above, has clarified that they consist of the unsustainability of the company's debt, the absence of the company's ability to continue as a going concern through the end of the current financial year, as well as the inadequacy of the company's own resources compared with those of similar third party companies.[16]

With regard to the obligation of so-called 'qualified public creditors' – in particular, the Tax Authority – to report an Alert situation, the Corrective Decree has introduced specific parameters that determine the relevance of tax exposure by clarifying that it only concerns the non-payment of VAT. It also establishes a 60-day deadline by which the Tax Authority, like other qualified creditors, must make such a report.

As regards the threshold for reporting relevant VAT exposure, the Corrective Decree abandons the prior criterion of non-payment of 30% of the total amount of VAT due, and adopts a new one based on tiered levels of exposure that attempts to achieve a balance between the purpose of the Alert and the need to limit the number of reports.[17]

c. Procedural amendments: the role of the Public Prosecutor; Court-ordered protective measures

An interesting feature of the amendments in the Corrective Decree concerns the extension of the powers of the Public Prosecutor. In addition to the existing right to initiate judicial liquidation proceedings in all cases in which he or she has knowledge of the existence of a state of crisis/insolvency of a company, the Public

Notes

10 See Article 2, let. a) of the Code.
11 See 'Overview and First Thoughts on the New Italian Insolvency Code' (2019) 16:2 *International Corporate Rescue* 78.
12 See Article 1, let. a) of the Corrective Decree.
13 See Article 13 of the Code.
14 See Article 1, let. a) of the Corrective Decree.
15 See 'Overview and First Thoughts on the New Italian Insolvency Code' (2019) 16:2 *International Corporate Rescue* 78.
16 See Article 3, paragraph 1, lett. b) of the Corrective Decree.
17 According to Article 3, paragraph 4, let. a) of the Corrective Decree, the thresholds of relevance for reporting purposes are: Euro 100,000 if the turnover resulting from the tax return for the previous year is not higher than Euro 1,000,000; Euro 500,000 if the turnover resulting from the tax return for the previous year is not higher than Euro 10,000,000; Euro 1,000,000 if the turnover resulting from the tax return for the previous year is not higher than Euro 10,000,000.

Prosecutor may now intervene in all crisis and insolvency proceedings.[18]

The same provision of the Corrective Decree then turns its attention to those interim and protective measures of the debtor's assets that, at the request of an interested party, the Court may issue in the course of any insolvency proceeding – whether a judicial liquidation, preventive arrangement, or restructuring agreement. Such protective measures may include the appointment of a custodian of the business or its assets.[19] The Corrective Decree now provides that these protective measures continue to be effective even if a debtor converts a proceeding into an application for a restructuring agreement. This reverses the prior rule under the Code.

d. Amendments to restructuring procedures

As regards the specific instruments governing a crisis proceeding, the main innovations concern the requirements of the plan required in all restructuring procedures: namely, the Recovery Plans, the Restructuring Agreements and the Preventive Arrangement.

In this respect, the Corrective Decree provides, as a general rule, that the expert certifying the plan must no longer include in such assessment the 'legal' feasibility of the plan itself, since this constitutes an element that must be evaluated exclusively by the Court. Instead, the expert – i.e. an independent professional – must certify only the accuracy of the plan's business data and its economic feasibility.[20]

i. Recovery Plans

As to Recovery Plans, the plan must now also contain a list of external creditors, with a description of the resources to be allocated to the full satisfaction of their claims. The business plan also must be provided as an attachment thereto, together with its financial projections. In this way, creditors and, where needed, the Court, are in a better position to evaluate the debtor's proposal for restructuring its business, thus discouraging ill-founded plans drawn up only to buy time.

ii. Restructuring Agreements

The Corrective Decree also addresses Restructuring Agreements, by shifting away from their historical character as purely negotiated agreements between the debtor and its creditors to now providing more opportunities for Court intervention. While previously the Court intervened in such agreements only in the case of opposition by creditors (particularly, by dissenting creditors), new features under the Corrective Decree are making restructuring agreements look more like insolvency proceedings.

For example, the Corrective Decree provides that the Court may at any time appoint a Judicial Commissioner in its discretion.[21] This modifies the provisions of the Code under which such appointment was considered only upon the filing of an application for approval of a Restructuring Agreement in the context of a judicial liquidation proceeding.

The Corrective Decree also addresses Restructuring Agreements with so-called 'extended effectiveness', i.e. those which, in contrast to the provisions of the Civil Code,[22] extend their legal effect to non-signatory creditors in the same class as signatory creditors, based on their having the same legal position and economic interests vis-à-vis the debtor.

In this regard, the Corrective Decree modifies the conditions for this 'extended effectiveness' by repealing the prior provision under which creditors must be satisfied significantly or primarily through the proceeds of the debtor's business as a going concern.[23] Nonetheless, it confirms that the Restructuring Agreement must still expressly provide for the continuation of the business as a going concern, either directly (by the applicant debtor) or indirectly (by a third party) and must not involve the liquidation of the company.[24]

iii. Tax settlements

Another interesting aspect of the Corrective Decree concerns the possibility for the debtor to propose a 'tax settlement' during the negotiations preceding the execution of the Restructuring Agreements. In order to eliminate the misunderstanding generated by the word

Notes

18 See Article 7, paragraph 3 of the Corrective Decree.
19 See Article 7, paragraph 11 of the Corrective Decree.
20 See Article 8 paragraph 3 of the Corrective Decree.
21 See Article 7, paragraph 5 of the Corrective Decree.
22 According to Article 1372 of the Civil Code, a contract has no legal effect with respect to third parties, except as otherwise provided by law, while Article 1411 provides that a stipulation in favour of a third party is valid if the stipulating party has an interest in the subject matter of the stipulation.
23 See Article 9 paragraph 2 of the Corrective Decree.
24 According to Article 84 of the Code with regard to the purpose of the Restructuring Agreement with creditors, the continuity of the company's business is 'direct' if it is the responsibility of the debtor who has submitted the application for an arrangement with creditors, whereas it may be 'indirect' if the restructuring plan provides that the management of the company's current business or the resumption of its business is carried out by a third party other than the debtor by virtue of sale, usufruct (or right of use), transfer of the company to one or more transferee companies, including newly established ones, or other legal right or title.

'tax', the Corrective Decree provides that the restructuring transaction in question may concern not only tax debts but also other debts related to social security, insurance and welfare contributions.[25] In these cases, the expert's appraisal of the plan must include an evaluation of the proposed treatment of such debts under the Restructuring Agreement as compared to a judicial liquidation, a matter that then must be assessed by the Court.[26]

In addition, the Corrective Decree has shortened the debtor's deadline to fulfil a tax settlement, reducing it to 60 days from the original 90, under penalty of legal termination of the settlement itself.[27]

iv. Preventive Arrangements

As for the Preventive Arrangement, it has also been the subject of significant changes, one of the most prominent concerning the length of the moratorium in a preventive arrangement on payments to creditors with privileges, pledges or mortgages. Under the Corrective Decree, such a moratorium may no longer exceed two years,[28] thus superseding the prior provision that permitted a longer period provided that interest continued to accrue on the related debt claims.

The regulation of existing contracts in the context of a Preventive Arrangement has been a further area affected by amendments under the Corrective Decree. In this respect, contracts whose main obligations are still unfulfilled in whole or in part by both parties as of the date of the filing of the application for Preventive Arrangement continue in force, and any contract provisions authorising a party to withdraw or terminate a contract upon such a filing are unenforceable.[29]

Nevertheless, the debtor has the right to apply to the Court for authorisation to suspend or terminate one or more contracts, if the continuation of such contracts is neither consistent with the projections of the restructuring plan nor necessary to its execution. This starts a special Court procedure that may result in authorisation to terminate the contract in exchange for an indemnification in favour of contract counterparty for the debtor's non-performance. However, it should be noted that the debtor's termination right does not extend to any arbitration clause in a contract, which remains enforceable.[30]

Another particularly interesting amendment by the Corrective Decree regarding Preventive Arrangement and existing contracts concerns loan agreements. It is now provided that any borrowing base facility must be considered as an existing contract, since the lender's collection of receivables owed by the debtor's customers constitutes a 'main obligation' of such contracts that remains unfulfilled as of the filing of an application for Preventive Arrangement.[31]

v. Changes to Judicial Liquidations – Claw-back suits

As to Judicial Liquidation, which, as previously mentioned, has replaced the 'old' bankruptcy proceeding,[32] there are as well some amendments of interest. Reference is made to claw-back suits, and in particular, to the regime of exemptions which exclude certain transactions from claw-back. These include remittances to a bank account that have not permanently reduced the debtor's exposure towards the bank. In this regard, the rule as amended by the Corrective Decree no longer requires that the reduction must not be 'substantial' for the purposes of the exemption, a condition which had given rise to more than a few interpretive problems regarding how a 'substantial' reduction would be measured.[33]

As regards the date of the beginning of a Judicial Liquidation for purposes of measuring the 'look-back' period for prior transfers that are subject to claw-back suits, the Corrective Decree provides that, when the application to be admitted to an insolvency procedure is followed by the opening of a Judicial Liquidation, the measuring periods in the Code[34] for such suits are based on the date of publication of such application.[35]

vi. Amendments affecting groups of companies

To conclude this overview of amendments by the Corrective Decree, it is worth mentioning the newly amended regulation of the crisis or insolvency of groups of companies.

Apart from the definition of 'group' which, as we said at the beginning of this paragraph 3, has been revised by the Corrective Decree, another substantial amendment concerns the restructuring plan embodied in the

Notes

25 See Article 9 paragraph 3, let. a) of the Corrective Decree.
26 See Article 63 of the Code.
27 See Article 9 paragraph 3, let. d) of the Corrective Decree.
28 See Article 13, paragraph 2 of the Corrective Decree.
29 See Article 15, paragraph 2 of the Corrective Decree.
30 See Article 97 of the Code.
31 See Article 15, paragraph 2 of the Corrective Decree.
32 See 'Overview and First Thoughts on the New Italian Insolvency Code' (2019) 16:2 *International Corporate Rescue* 77.
33 See Article 20, paragraph 1 of the Corrective Decree.
34 See Articles, 163, 164, 166 paragraphs 1 and 2, and 169 of the Code.
35 See Article 20, paragraph 2 of the Corrective Decree

Recovery Plan, the Restructuring Agreements and the Preventive Arrangement for a group of companies.

In this case, the unitary plan or the linked plans for a group of companies must contain a quantification of the estimated recoveries for the creditors of each company in the group, in addition to any compensatory advantages arising from the creditors being a part of the unitary or linked plan.

Therefore, the Corrective Decree provides that the professional in charge of certifying the plan must indicate why providing a single group plan or mutually connected plans is more beneficial to creditors than an independent plan for each company, in light of the imperative to provide the best possible recovery for each company's creditors.[36]

Lastly, with respect to suits for the protection of shareholders, it should be noted that shareholders may seek relief from the prejudice resulting from contractual and reorganisational steps in a restructuring plan (for example, the liquidation of certain companies of the group or the transfer of intra-group resources) to the extent they impact the returns and value of shares.

4. Final remarks

The extensive amendments by the Corrective Decree to the Code have given rise to the sense that the Code does not represent a point of arrival – as was envisioned after a long process of reform of Italian bankruptcy laws – but is instead now seen as a starting point to be reconsidered or, perhaps, even abandoned.

In fairness, aside from the 'clouds' that any legislative reform effort always casts across the regulatory landscape, the Code certainly has its own 'bright spots', one of the main ones being that of having implemented an organic reform of Italy's insolvency procedures.

The Code includes an absolute innovation, that of providing general principles common to all insolvency procedures and intervening in the very heart of the operations of companies, which are now bound to adopt organisational structures designed to promptly detect any emerging financial crisis.

Among the various insolvency measures that the Code has reshaped, the Recovery Plan is at the top of the list. Thanks to the Code, for the first time it has become subject to an independent regulatory regime that was missing in the 'old' bankruptcy law. Previously, the plan was mentioned only in the provisions regulating claw-back suits,[37] for the sole purpose of being included among the transactions that are exempt from such suits. It was not, however, subject to any regulatory controls.

In contrast, in the regulatory framework provided by the Code, the Recovery Plan has stopped being cloaked in 'confidentiality' to finally become an insolvency measure over which the Court now plays a major supervisory role that now includes – as we have said regarding the amendments of the Corrective Decree – ensuring not only the legal feasibility of the plan, but also, and above all, its economic feasibility. The latter, in particular, should be regarded as an assessment of the future success of the implementation of the plan itself, particularly in light of the interests of third-party creditors, who are now called upon to be part of the restructuring effort for the first time.

If this is only one of many examples of the quality of the reforms embodied in the Code, it would be misleading to think that it does not need further corrections and additions.

Indeed, the serious economic crisis generated by the pandemic and the implementation of the EU's Directive demand an adaptation of the Italian insolvency system that favours, on the one hand, the restructuring of companies that, although affected by the serious economic situation, can still recover their profitability and, on the other, the rapid liquidation of those whose insolvency is not reversible.

In other words, Italy's insolvency procedures must be made even more efficient and competitive in order to meet the challenges imposed by COVID-19.[38]

With this aim in mind, the measures of the Alert and Assisted Settlement of the Crisis should be better coordinated with the 'early warning' system provided for by the Directive, with particular attention to small companies that may thus benefit from public or private support tools which an entrepreneur seeking to better manage a financial crisis may rapidly utilise.

Furthermore, with a view to simplifying insolvency procedures as suggested by the Directive, Italy's procedures could be limited to the two fundamental and alternative objectives for a troubled company, namely liquidation or continuing the business as a going concern.

An area of possible further amendments concerns creditors, in relation to whom we have already had the chance to highlight the need for a path of accountability.[39] In this regard, the writer's opinion remains unchanged: the involvement of creditors in the restructuring of a company in crisis is of fundamental importance to achieving the objectives of the restructuring. The creditors themselves should be entitled, along the lines of the Directive and in coordination with the

Notes

36 See Article 32, paragraph 1 of the Corrective Decree.
37 See Article 67 of the Royal Decree 16 March 1942 No. 267 and further amendments.
38 See the considerations made in Note e Studi Associazione Società Italiane per Azioni No. 8/2021.
39 See 'Overview and First Thoughts on the New Italian Insolvency Code' (2019) 16:2 *International Corporate Rescue* 81.

debtor, to participate in those restructuring efforts that best reflect the balance between the protection of credit and ensuring the debtor's business continuity.

To this end, the introduction of the 'relative priority rule' – which we have mentioned in paragraph 2 above – could be a good step towards encouraging creditors and shareholders to support a restructuring, as an alternative to Judicial Liquidation. The latter should always be seen as the option of last resort, though if it is nonetheless necessary, it should be designed to be quick and accompanied by an equally rapid discharge of the debtor.

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