****

**Inside Story – March 2018**

**Italian Insolvency Reforms:**

**Some Comments on the February 2018 draft Legislative Decree**

*Carlo Ghia, Partner, Studio Ghia Legale*

*carlo.ghia@ghia.legal*

*Introduction*

During the past three decades, the gradual and fast tendency of the markets to “globalization” have determined the recent tendency of States to adopt legal provisions dedicated to the prevention of financial crises and to avoid insolvencies of market operators. In fact, the adoption of such measures is today one of the essential elements in the determination of international ratings for the evaluation of the integrity of internal market.[[1]](#footnote-1)

“Predictability” and “risk management” have gradually become common words, essential for the prevention of crisis, opening also the possibility for entrepreneurs to have a second chance and remerge in the markets after a “dark night” period.[[2]](#footnote-2) In this particular context, therefore, an efficient system for the resolution of issues related to insolvency becomes an essential task for a State in order to guarantee the right balance to the internal market of a country, also with the scope of attracting foreign interested investors and implement the economy.

To this extent, various States, including Italy, have recently started to move towards reform projects of insolvency law, in order to facilitate and speed up, efficiently, the approach to insolvency issues.[[3]](#footnote-3)

## A Brief Historical Background of Italian Bankruptcy Law

The “Italian way” of approaching insolvency finds its roots in Royal Decree no. 267/194 (also called the “Bankruptcy Law”), originally and substantively based on the concept of “bankruptcy” and “punishment” of the entrepreneur who has failed in its activity. Over the course of seventy-five years (from 1942 to 2017), the Italian legislator’s approach to insolvency has, slowly, had an evolution in the way of thinking about entrepreneurs in crisis.

From a (limited) “asset-based” approach, principally linked to the concept of “satisfaction of creditors come first through the liquidation of the assets and through the guarantee of *par condicio creditorum*”, the visual started to change in the late 1970s and accelerated after 2000, when the market logic and the necessity to “govern” the crisis, considering not only the “liquidation profiles”, but also the stakeholders’ interest and the necessity to preserve the going concern, emerged with some importance.

In the original system based on Royal Decree no. 267/1942, the liquidation of the assets of the entrepreneur was the principal procedure. The reasons for the crisis of the enterprise (which today are the *leitmotiv* of any kind of restructuring plan or composition with creditors) did not influence the legislator, whose attention was focused principally on the situation “*after”* the crisis, in order to guarantee the maximum satisfaction of creditors through the liquidation of the entrepreneur’s assets. Just to give an example of the 1942 legislator’s “punishment” way of thinking, the original Article 142 of the Bankruptcy Law provided that the bankrupt entrepreneur should be recorded in a “public record of bankrupt debtors” and did not have permission to restart its activities, save in the presence of very restricted conditions.

Since the late 1970s, when the first economic crisis involved large companies, the culture of the approach to insolvency started to change in Italy and the legislator introduced measures, limited to large entities, for the management of crisis with view to preserving the going concern at a moment where the companies were not yet in a default situation. Furthermore, the intervention of the Italian legislator in the 1970s-90s was focused on specific situations (mostly the crisis of big-sized enterprises and groups), though the implementation of the substantive part of the 1942 Bankruptcy Law remained mostly the same until the first few years after 2000. In particular, after the introduction of an *ad-hoc* law necessary for the approach to the crisis of multinational enterprises - such as Parmalat - the Italian legislator, primarily influenced by UK and US insolvency regulations, started a real and progressive work for a substantial reform of bankruptcy law.

This saw the introduction, in particular between the years 2005-2007, of some radical changes in the law in order to facilitate and promote access to judicial and non-judicial procedures, such as restructuring plans (*accordi di ristrutturazione*) and composition with creditors (*concordato preventivo*), which aimed at preventing the final and drastic solution of forced liquidation and to preserve the going concern. One of the major innovations of this reform was the introduction of the concept of “*discharge*” of the debtor after the conclusion of the bankruptcy proceeding, an inheritance from Chapter 7 of the US Bankruptcy Code.

Following that period and from 2007 to 2016, several other laws and regulations have been adopted with view to making corrections to previous interventions and to implementing out-of-court solutions and negotiations between the debtor and creditors, in order to guarantee the best balance between the satisfaction of the claims and the preservation of the value of the company (or of the group of companies), limiting as much as possible the definitive default of the entrepreneurs. One of the most important interventions made by the legislator was Law no. 3/2012 which introduced new procedures for the management of insolvency to be applied to those categories of individuals (such as consumers, for example) who cannot enter into the procedures recognized by Royal Decree no. 267/1942.

*The Lead-Up to Reform*

Within the particular framework of Italian insolvency law, the necessity emerged in 2015 to “re-organize” a discipline which had been continuously modified and which contained some contradictions. To this end, in January 2015, a highly skilled commission (so called “*Rodorf* Commission”, after the name of its chair, Renato Rodorf, judge of the Supreme Court), composed of eminent judges, university professors and professionals, was appointed for the drafting of a new legal proposal regarding the organic reform of insolvency law, aimed at “*[defining] a regulatory framework in which will be well determined the common juridical* *principles for the approach to insolvency, suitable for any kind of procedure”.*

The Commission focused a substantial part of its work on fixing the general principles for the implementation and simplification of the procedures provided by the old Bankruptcy Law, taking into consideration international best practice and, in particular, the UNCITRAL Model Law as well as various EU provisions, such as Recommendation 2014/135/EU on a new approach to business failure and insolvency and the Recast European Insolvency Regulation (Regulation no. 848/2015) (“Recast EIR”).

At the end of its work, the Rodorf Commission presented a draft of a law proposal in 2016, which was finally approved by the Italian Parliament on 11 October 2017 with the promulgation of Law no. 155/2017. Since the new law only fixes the general principles for the organic reform, in order to implement the execution of the law, the Italian Government was required to write the technical regulation to apply the principles. In February 2018, a draft Legislative Decree was in fact prepared by the Government and is ready to be approved by Parliament. However, because of the recent elections in Italy, it will take a few more months for the reforms to become effective.

*Highlights of the Reform Text*

Some of the principal innovative aspects of the draft Legislative Decree include:

### A “Cultural” Reform: No more “Bankruptcy”!

The reform provides a radical change of culture, primarily with a lexical and cultural profile. In fact, the legislator of 2017 has definitely banned the use of terms such as “bankruptcy” and “bankrupt”, substituting them with expressions such as “judicial liquidation procedure” or simply “debtor”. The intent of the legislator is clear and aims at a radical cut-off from the past and from the negative concept of insolvency as “failure”, introducing terms and tools for the debtor in order to give him more opportunities to restart in the market. To this end, the new insolvency code will provide the possibility for the debtor to ask for discharge immediately after the close of the procedure or, in any case, after three years from the opening of the procedure.

Another lexical “innovation” is the introduction of the definition of “state of crisis”, different from the concept of “insolvency”. The state of crisis is identified as a “probability of a future insolvency”, quite typical in many companies notwithstanding their size. The introduction of this distinction between the “state of crisis” and “insolvency” aims to separate into two different areas the tools for the management of the crisis: preventive tools (turnaround plans, debt restructuring agreements, debt restructuring agreements with financial intermediaries and arrangements with creditors) and liquidation procedures, where the only relevant aspect is the maximization of the sale of the debtor’s assets.

### International Best Practice

The Italian legislator has taken into consideration also the development of international best practices with regard to cross-border insolvency matters. To this end, the provisions regarding Italian jurisdiction on insolvency cases are inspired by the COMI approach and, therefore, by the principles and regulations contained in the Recast EIR, distinguishing the opening of principal and secondary procedures. In particular, the new code will provide for the application of Article 36 of the Recast EIR regarding the so called “virtual secondary procedures”: the possibility for a representative of a principal foreign procedure to seek an agreement with local creditors in order to avoid the opening of a secondary procedure in Italy and guarantee them the same treatment that they would have had in case the proceeding was effectively opened.

The scheme of the code also provides for the procedure regarding the recognition and enforcement of foreign decisions regarding insolvency proceedings and, in application of the UNCITRAL principles, facilitates the communication between the courts and insolvency practitioners of different States.

### Early Warning Tools

Prevention and predictability of crisis are one of the most important tasks that the legislator of 2017 has aimed at including within the draft reform text. The introduction of early warning tools tries to achieve that goal. The tool is inspired by the French “*procédure d’alerte”*, which gives to the auditors of the company the powers and duties to intervene during a crisis, firstly from within the company by alerting the executive directors and, secondly, from outside, by reaching the *Tribunal de Commerce* in case of the directors being passive in the face of an approaching crisis.

The early warning tools aim at creating various levels of “alert” in order to have consciousness of crisis at an early stage in the interest of the company and, much more importantly, in the interest of the market and of the stakeholders. To that end, the tools will consist of:

1. Organizational Tools: creation of highly skilled entities (Organisms for the composition of the crisis, OCC) which will have the duty to give support to debtors/entrepreneurs in crisis, facilitating a settlement of the crisis with the creditors;
2. Tools for verification of the crisis of the enterprise for auditors: auditors are primarily in charge to control and verify the financial and economic situation of the company and to alert the directors of the company where they find any cause for alerting them of a crisis. In cases where the directors are passive, auditors must ask for the intervention of the OCC to avoid the crisis.
3. Sanctions for auditors: in case of any delay in informing the OCC;
4. Tools of verification of the crisis for “qualified public creditors”: these include creditors, such as the Income Revenue Authorities and Social Security Entities, which will have a duty to control the persistence of a certain level of indebtedness of the debtor and to give immediate information to the company’s auditors;
5. Sanctions for “qualified public creditors”: in cases where the qualified public creditors do not supply the information noted above, their secured claims will be considered unsecured on the company’s insolvency.

### Procedures for Crisis Management: Restructuring Agreements and Compositions with Creditors

Providing and implementing solutions, as alternatives to liquidation which can prevent insolvency and the definitive default of the company, is the main issue for the 2017 legislator. Therefore, certain provisions of the law have been implemented in order to guarantee, also through the standstill process, the success of negotiations (whether in or out of Court) in order to facilitate the possibility, for a company in crisis, to continue in activity so as to preserve itself as a going concern.

### Groups of Companies

Another important innovation of the law reform is in respect of the regulation of a crisis for a group of companies, based on the notion of direction and coordination provided in Article 2497 of the Italian Civil Code. The new law will provide a specific regulation, for both liquidation and non-liquidation procedures for groups of companies, establishing, principally, that the procedures involving separate entities must be uniform and treated as one procedure. It also provides a specific procedure for single entities (that are part of a group), which apply for a single insolvency or crisis procedure by regulating, for example, the subordination of all shareholder loans to other creditor claims in case of liquidation.

### Other Reforms

Last, but not least, the new reform will provide a particular and uniformed procedure, which will regulate the approach to crisis for consumers and for those categories of professionals and entrepreneurs who cannot have access to the “main” insolvency procedures. The tools provided are in substance two:

(1) a restructuring plan negotiated with creditors (that must be approved by a majority (50%+) of the total claims);

(2) a consumer plan, only for consumers, which must be prepared through a competent organism for the settlement of the crisis. In this particular case, it is important to highlight that creditors do not have any right to vote. Only a Judge has the power to verify if the plan is reasonable (also in respect to the satisfaction of the creditor’s claim) and, more importantly, if the consumer merits access to the procedure (in other words if the level of indebtedness of the debtor is due to his behavior or to a contingency that brought him to the crisis).

*Summary*

The reform text will undoubtedly bring major changes to the landscape of Italian insolvency law, particularly in changing the culture away from bankruptcy and punishment towards rescue and rehabilitation. It will take some time for practitioners and judges to become used to the new way of doing things, which however are very necessary for the modernisation of the insolvency law framework in Italy.

1. International ratings are provided by the World Bank in the annual “Doing Business” reports, in which the efficiency of 189 States is analysed through the analysis of market components, of the systems for the resolution of controversies; of the reliability of tools necessary to resolve insolvency issues. In 2017, Italy has been placed at number 46 in the complex rating and at number 24 with regard to “[Resolving Insolvency](http://www.doingbusiness.org/rankings)”: <<http://www.doingbusiness.org/data/exploreeconomies/italy>>. [↑](#footnote-ref-1)
2. “*Effective insolvency systems facilitate the rehabilitation of enterprises and also provide an efficient mechanism for the liquidation of those enterprises that cannot rehabilitated”:* S. Hagan, “Promoting Orderly and Effective Procedures” (2000) 37(1) *Finance and Development* 50. [↑](#footnote-ref-2)
3. [↑](#footnote-ref-3)