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FROM BLANK SLATE TO BOOMTOWN

Pre-insolvency column: Crisis management under Italy's new Rordorf

Partner **Enrica Maria Ghia** and associate **Filippo Bosazzi** of Studio Legale Ghia in Milan summarise the new Rordorf Law passed in Italy in October, in the latest edition of *GRR*'s pre-insolvency column in association with TMA Europe.

Italian insolvency law and the measures dealing with over-indebtedness have, in general, been complex and stratified over the years since 1942. This is the reason the Italian government considered it necessary to assess existing legislation and analyse any proposed modifications.

On 28 January 2015, the Italian minister of justice established a committee to study the reform of bankruptcy law. The committee was formed of judges, university professors and professionals, and chaired by **Renato Rordorf,** president of the Court of Cassation's first section.

The committee had to focus, inter alia, on rationalising and simplifying the procedures set out in Italian bankruptcy law in conjunction with the various initiatives of the European Commission, including Recommendation 2014/135/EU on a new approach to business failure and insolvency, the recast European Insolvency Regulation of 2015, and the 22 November 2016 proposal for a directive on insolvency, restructuring and second chance. It also had to identify appropriate alert measures to create a positive restructuring framework enabling debtors to address their financial difficulties at an early stage, and establish guidelines for the reorganisation of the entire structure of Italian insolvency law.

The Rordorf Commission presented a draft in 2016 that was discussed by the Italian Parliament, integrated and modified, and finally approved on 11 October 2017. In order for the law to become effective, the government now has up to the first months of 2018 to issue implementing decrees.

Language features

One of the main characteristics of the new reform act is its carefully chosen language. First of all, the Rordorf Law has banned the use of such terms as bankruptcy and bankrupt (article 2, letter a) to gradually erase the indelible social discredit arising from a bankruptcy declaration.

The stigma should be now erased forever since hereafter the word "bankruptcy" will be substituted by the expression "judicial liquidation".

This change tries to deal with the social impact of a bankruptcy declaration over the psychological stability of all those directly involved, from the entrepreneurs to the workers and their families. The legislator's intention is to make a fresh start and a second chance easier for the debtor, abandoning the concept of "fault" and introducing the new concept that everyone can make bad choices and mistakes, but the show must go on.

At the same time, the Rordorf Law has introduced the expression "state of crisis" as a status different from the one covered by the definition of "insolvency" as referred to in article 5 of the 1942 Royal Decree No. 267 (the Italian Bankruptcy Law). Indeed, the state of crisis is identified as a "probability of a future insolvency" (article 2, letter c) quite typical in many companies notwithstanding their size.

The legislator's main goal is to create a net separation between the concept of enterprise crisis and the one of insolvency. Companies in crisis can be saved if the crisis is approached with the right measures and the right timing, while insolvent companies need to be liquidated.

A state of crisis is the condition required by the law for the application of all measures other than judicial liquidation introduced or reformed by the new law. These restructuring measures include the turnaround plan (article 67, letter d), debt restructuring agreements (article 182 bis of the Bankruptcy Law), debt restructuring agreements with financial intermediaries (article 182-septies) and arrangement with creditors (article 160).

On the other hand, nothing has changed for insolvency administrators who will keep their name, even though their role will be adapted to the new features established by the Rordorf Law.

According to the new law, the insolvency administrator will now have to prove higher skills and experiences to be listed in the *ad hoc* registers of insolvency administrators set by each court. The register will also be public, referable on the court's website, and updated with the data of the professionals who will also have to pass an annual assessment by the court.

Early warning tools and assisted composition of the crisis

Time is value especially for a company in distress. In order to increase awareness and therefore encourage managers to anticipate when it is necessary to take into consideration the signs of crisis, the legislation introduces early warning tools and prevention measures (article 4 – "*misure di allerta*"), which are the main innovations of the new reform act.

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Timely intervention allows the company's value to be preserved, while a delay in perceiving the signs of distress often brings irreversible insolvency. The Rordorf Law ensures that debtors and entrepreneurs have access to early warning tools to detect signals of crisis that might deteriorate the business in the future, requiring them to act as a matter of urgency.

These early warning tools provide incentives for those who use the measures properly and disincentives for those who do not.

They are also characterised by their non-judicial and confidential nature: it is clear that confidentiality is of great importance, especially if related to the domino effect the news of a crisis may create in stakeholders, even if the debtor company is handling the situation perfectly. A breach of confidentiality and therefore a leak of information that is not properly managed could lead to a reputational risk and jeopardise an enterprise's business.

These new tools answer the needs of small and medium-sized enterprises facing financial difficulties, since these companies rarely have resources to hire professional advice. Therefore, the early warning tools should help debtors and companies to spot the crisis signals and act urgently.

The legislation has also introduced a new entity called a crisis composition agency, to support the debtor in this early stage. Crisis composition agencies shall be established at each Chamber of Commerce office. The Rordorf Law states that it is up to the debtor to request the intervention of a crisis composition agency; however, only few and identified subjects, such as qualified public creditors

(for example, a tax revenue agency), boards of directors and auditors, may file a petition before the agencies. After checking the corporate's economic situation, the competent agency will have to convene the debtor immediately to identify the most suitable measures to remedy the crisis and to promote a mutually agreed solution between the entrepreneur and creditors, within a reasonable time framework not exceeding six months.

What if an agreement is not reached between debtor and creditors? The Rordorf Law does not give an answer, leaving it to the market to deal with the problem. In view of this, it can be said that early warning tools should serve to shake the entrepreneur in an effort to wake him or her up and help him or her to face reality.

Insolvency proceedings for groups

For a long time, Italian turnaround professionals had to experience difficulties in coordinating restructuring processes when they were related to an enterprise belonging to a corporate group. Indeed, the previous regulation did not allow the filing of a single proceeding for the restructuring of several companies of the same group, leading to inefficiencies and increased costs. This way of dealing with group insolvency was a real nightmare if the competent courts for each procedure were in different places. The Rordorf Law has finally introduced a group insolvency procedure, to answer the practical problems faced up to now.

More specifically, the Rordorf Law introduces the definition of a "group", based on the notion of direction and coordination provided by article 2497 of the Italian Civil Code.

Furthermore, the new reform act foresees the possibility for enterprises belonging to the same group to propose a single application before a single court for a debt restructuring agreement under article 182 bis of the Bankruptcy Law, a composition with creditors or judicial liquidation.

To assess the territorial jurisdiction of the court, the European concept of "centre of main interest" must be applied. The positive impact on the procedural costs is absolutely terrific: the new law provides for the appointment of just one judge and just one court commissioner (in the case of composition with creditors) or insolvency administrator (in the case of judicial liquidation).

Finally, the Rordorf Law also has a rule to protect the par condicio creditorum or equal treatment of creditors, keeping separate the creditors of each company and excluding intercompany creditors from the vote to mitigate any potential distorted effects.

Cost reduction, specialities, speeding up and simplifications

The Rordorf Law tries to give substance to a legal framework that should aim to secure efficiency in the market.

With the goal of simplifying the rules and speeding up the proceedings, the competent court will be identified on the basis of the size and type of insolvency procedure, by assigning those relating to large companies to the enterprise-specialised section of the court. This should speed up the entire process and will help to create a uniformity of decisions across the courts.

The other practical target is reducing costs of insolvency procedures, as one of the main elements that drive entrepreneur choice. The new law deals with the procedural costs and professional fees since these amounts are pre-secured and in general quite high, sometimes producing a deterrent for entrepreneurs to access insolvency or pre-insolvency proceedings.

These topics will be developed in the implementing decrees, which we are anxious to read.

In conclusion, this legislative intervention with its comprehensive approach to reforming the Bankruptcy Law was absolutely necessary for resolving practical issues, such as significant amounts of liabilities in the insolvency proceedings, the low percentage of creditors' claims satisfaction and, last but not least, the length of procedures.

The Rordorf Law clearly aims to empower the entrepreneur by promoting the use of alternative crisis resolution procedures. How? By adapting insolvency procedures to market needs and enabling debtors in financial difficulties to start a turnaround early before the crisis becomes irreversible.

The new reform act also covers insolvency-related measures with a direct impact on the duration and efficiency of procedures: judges' specialisation and the professionalism of practitioners are key to its success.

Moreover, the Rordorf Law has changed the Italian approach to the problem of a company in crisis, passing from a punitive scope to a purely economic one: allowing honest entrepreneurs a second opportunity, discharging their debts and making a fresh start possible, to preserve the business and all social assets directly or indirectly related.

The goals are fully shared. Now, we just have to wait for the implementing decrees. However, any definitive judgment on the reform act has to be postponed until the outcome of its concrete practical application has had an effect on the Italian economy.

Further reading

Article 2497 of the Italian Civil Code: "Liability. The company or the entities which, exercising direction and coordination of the company operate in their own or in others' entrepreneurial interest in breach of the principles of the correct corporate and entrepreneurial management are directly liable towards the members of said companies for the prejudice caused to the profitability and the value of the corporate holding as well as towards the creditors of the company for the damage caused to the integrity of the assets of the company. There is no liability when the damage does not exist in the light of an aggregate result of the activity of direction and coordination or entirely eliminated also as a consequence of the transaction directed to such purpose. 2. The person who contributed to the damage is jointly liable and, to the extent of the benefit received, the person who consciously obtained a benefit. 3. The member and the creditor of the company may act against the company or the entity that exercises the activity of direction and coordination only if not satisfied by the company being subject to the activity of direction and coordination. 4. In the event of bankruptcy, forced administrative liquidation and extraordinary administration of a company subject to the direction and coordination of others, the action belonging to the creditors of said company is exercised by the trustee or by the liquidating commissioner or by the extraordinary commissioner."