Draft statutory instrument for reform of insolvency procedures: alert procedures

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AUTHOR

PierDanilo Beltrami

Introduction

On January 28 2015 the minister of justice set up the Rordorf Commission, a ministerial commission to develop and submit draft legislation designed to reform, review and reorganise the rules governing insolvency procedures in Italy. On December 29 2015 the Rordorf Commission completed its proceedings and submitted a draft statutory instrument delegating powers to the government "for a comprehensive reform of the existing rules on business crises and insolvency".

The statutory instrument that the Rordorf Commission drafted is intended to complement and supplement the provisions first introduced by Decree-Law 83/2015.(1) Decree-Law 83/2015 was intended to support a firm's rehabilitation with a view to preserving its business value in addition to limiting possible losses across the whole economic fabric. The aim of the newly proposed legislation is to make the statutory framework of insolvency procedures more comprehensive – as it has become exceedingly complex and circuitous following the numerous legislative steps taken since 2006 – and to create a consolidating act on insolvency that combines the various insolvency procedures in force in Italy into one piece of legislation.

The Council of Ministers adopted the draft statutory instrument on February 10 2016. However, it is presently merely a proposal for delegated legislation; for a draft statutory instrument to become final, it must be approved by Parliament. If it is approved, the president will promulgate the statutory instrument, which will then be published in the *Official Gazette*. The government will have 12 months from the publication date to exercise the powers delegated to it by issuing a decree-law reforming the existing insolvency procedures. The decree-law must conform to the requirements and directions set out in the statutory instrument as ultimately approved by Parliament.

This update illustrates the main requirements and directions that have been written into the draft statutory instrument, all of which are likely to be transposed into the decree-law that will be enacted by Parliament.

Alert procedures

Most jurisdictions endeavour to provide alert procedures that identify the early signs of a business crisis. The chances of preserving the business value of an undertaking in difficulty are directly proportional to the timing of the required turnaround process. Conversely, any delay in identifying the early warning signs of a business crisis may foster insolvency to the point where the state of distress becomes irreversible, thereby rendering attempts at rehabilitation futile.

For this reason, Article 4 of the proposed statutory instrument introduces alert and mediation procedures to safeguard a troubled firm's value by hastening the timely discovery of conditions of financial and business distress without the need to wait for the firm's too-often belated reaction.

In procedural terms, the proposed alert mechanism consists of two different phases:

- The 'inside' phase involves only the affected company's internal corporate bodies. Thus, the company's internal audit committee, statutory auditors or duly appointed independent auditors must notify the company's board of directors of plausible early signs of a crisis (Article 4(b)). Early warning could come from qualified creditors – such as the Revenue Agency, contracted tax collectors or social security agencies – which will notify the firm's owner or the company's governing and supervising bodies of major delinquencies (Article 4 (c)).
- The 'outside' phase can be triggered by the failure of a company's governing and supervising bodies to provide adequate responses at the inside phase. As a result, they must file a report with an *ad hoc* special section to the over-indebtedness crisis settlement panel – provided for in Act 3 of January 27 2012 and Ministerial Decree 202 of September 24 2014 – whose members must meet certain expertise, experience and independence criteria regarding possible conflicts of interest and observe a duty of confidentiality (Article 4(a)). Following receipt of the report, the special section must summon the debtor to a private and confidential hearing to identify suitable measures to resolve the crisis promptly (Article 4(d)).

The Rordorf Commission's proposal provides that debtors can apply:

- to the crisis settlement panel following the private hearing, for the appointment of a mediator (to be selected from among its members) to come up with a solution in agreement with the creditors in a reasonable time (Article 4(e)); or
- to the court, for the adoption of any protective measures deemed necessary to develop and submit to creditors a credible solution that is conducive to conciliation (Article 4(f)).

The proposal also envisages rewarding entrepreneurs that use the alert procedure and punishing those that obstruct or fail to use the procedure even though the requisite pre-conditions are apparent (Article 4(g)).

The alert procedure will be conducted confidentially (ie, without any judicial bodies being involved). The Rordorf Commission has intentionally shifted the location of the pre-crisis process to a 'neutral venue' (ie, outside the bankruptcy court's jurisdiction). Reliance has also been placed on the accountability of the debtor firm's owners and officers by identifying its internal audit and governance bodies as partners of choice during the first stage of the procedure. An outside body will be called in for assistance if needed at the second contingent stage if or when the debtor company's managing bodies fail to act.

The choice of placing the alert procedure outside the jurisdiction of the bankruptcy court – as well as identifying the troubled company's governing and supervisory bodies as the first addressees of early-warning reports – was made for compelling psychological and cultural reasons. A major cause of the belated emergence of organisational crises – especially in an economic system characterised by the prevalence of family businesses, in which revealing a firm's difficulties may adversely affect assets that are part of the family's heritage and property – is a stigma commonly associated with insolvency procedures in Italy generally.

For alert procedures to work properly, the troubled business needs to feel that it is not under surveillance, but is instead being supported in its efforts to manage a crisis. This is the only way for a business to be motivated to be open and to tackle its difficulties in a timely fashion. There is also the need for businesses which adopt these protective measures not to be vilified by customers or suppliers as being irretrievably unreliable. Rather, companies should be able to retain the support and trust of commercial partners and customers, since they are vital requirements for the success of the recovery process.

For further information on this topic please contact PierDanilo Beltrami at Lombardi Molinari Segni by telephone (+39 02 896 221) or email (p.beltrami@lmlaw.it). The Lombardi Molinari Segni website can be accessed at www.lmlaw.it.

Endnotes

(1) For further information please see "Parliament introduces amendments to Insolvency Act",

"Changes to the Insolvency Act concerning composition and moratorium agreements" and "Amendments to pre-bankruptcy agreement procedure".
