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PANDEMIC AND INSOLVENCY LAW: THE ITALIAN ANSWER

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The Italian Government, similarly to others, has enacted several measures aimed at curbing the potentially devastating economic effects of the COVID19 pandemic. The lockdown designed to limit contagion has paralyzed entire industries, abruptly caused losses and liquidity shortages of an unprecedented magnitude, and is threatening millions of jobs. Insolvencies looms and a chain-reaction might overhaul the very fabric of the economy.

I. The Italian Government, similarly to others, has enacted several measures aimed at curbing the potentially devastating economic effects of the COVID19 pandemic. The lockdown designed to limit contagion has paralyzed entire industries, abruptly caused losses and liquidity shortages of an unprecedented magnitude, and is threatening millions of jobs. Insolvencies looms and a chain-reaction might overhaul the very fabric of the economy.

In order to tackle these issues, a decree of April 8 (Decree-Law No. 23 of April 8, 2020; hereinafter the "Decree") puts forward a panoply of tools, from measures to support the liquidity of companies to stronger golden powers of the State to control acquisitions in strategic sectors; from fiscal measures to a suspension of litigation; from a simplification of shareholders' meetings to emergency provisions in support of employment. We want to focus here on some important new rules concerning insolvency procedures, turn-arounds and consequences of losses.

The idea behind the measures we are going to illustrate is to 'sterilise', at least temporarily, the economic effects of the pandemic. We posit, however, that these measures create a kind of legal limbo that might generate dangerous uncertainties, especially if these measures were interpreted and applied as special rules that may derogate from the general criteria of correct business management.

II. A first measure, the more general one, concerns the postponement of the entry into force of the new Code of Crisis and Insolvency (CCI), initially scheduled for 15 August 2020 and now postponed to 1 September 2021. One of the alleged goals of this piece of legislation is to facilitate the turn around of companies also through alert procedures designed to intercept at an early stage the symptoms of a crisis. It might therefore seem contradictory to delay the entry into force of a statute pursuing these goals. Obviously enough, however, the new rules were not envisioned to operate in a massive depression due to exogenous causes. In the current scenario, its application would result in countless procedures to avoid insolvency, or in significant risks for entrepreneurs or directors that do not activate them. In addition, there is a serious question concerning the adequacy of the judicial and extra-judicial resources that would be required to face a massive number of procedures, further complicated by the very novelty of the law. It is therefore preferable to remain with our feet on the ground and continue to use the current regulatory framework, imperfect as it might be, but with the potential advantage of not triggering forays in a new and uncharted territory.

The negative side of the coin is that the postponement of the entry into force of the CCI also limits the ability to use certain new and virtuous mechanisms such as the composition with creditors and agreements for the restructuring of group debts; the over-indebtedness of the family; the facilitated treatment of tax claims.

However, we believe that there is the possibility of applying some of these mechanisms "in advance", on the basis of an evolutionary and systematic interpretation. In particular, it seems possible to apply those institutions which are new but which do not represent real exceptions to the rules currently in force: and we referring, in particular, to the rules on groups and over-indebtedness of families.

III. Other, more specific, measures, affecting Italian insolvency law are set forth under Articles 9 and 10 of the Decree.

III.1 Article 9, affects proceedings based on agreements with creditors, such as debt restructuring agreements and arrangements with creditors. The amendments act differently depending on the stage the procedure was at on 23 February 2020.

(a) For procedures in the execution phase which provide for a deadline for fulfilment falling between 23 February and 31 December 2020, the law provides for an automatic deferral of six months of that deadline.

(b) For procedures in progress for which the approval hearing has not yet taken place, the law first allows the debtor to request the court to grant a period of 90 days to file a new plan or a new proposal for composition or a new restructuring agreement. In the case of a concordat, the application is inadmissible if there has already been a meeting of the creditors and the majorities required by law have not been reached; secondly, it allows the debtor who wishes to asking for a mere deferment of the terms of the agreement to apply to the court, filing the documents proving the need for deferment, which may grant the extension for no more than six months

(c) For procedures that have not yet been formally opened, the law allows the debtor to extend the deadline for submitting the agreed plan and proposal or for negotiations in debt restructuring agreements, for a maximum of 90 days, if the court considers that the request for extension is based on concrete and justified reasons.

III.2 The second provision, Article 10 of the Decree, on the other hand, freezes applications for the declaration of bankruptcy filed in the period from 9 March 2020 to 30 June 2020, declaring them inadmissible.

IV. There are also two provisions of company law that indirectly concern insolvency law.

IV.1 Article 6 of the Decree concerns the legal treatment of balance-sheet losses. The “recapitalize or liquidate” rule, which required to either recapitalize a corporation or to liquidate it in case of substantial losses that reduce the capital, is suspended until 31 December 2020.

The provision replicates Article 182-*sexies* of the bankruptcy law for companies that have entered into composition and restructuring agreement procedures, performing a protective function of the company's assets and, indirectly, the function of facilitating possible future attempts to restructure debt.

IV.2 Article 8 governs shareholders’ and intra-group loans that may be disbursed in the period following the entry into force of the decree and on 31 December 2020, sterilising the rule of (absolute and legal) subordination and the obligation on the lender to repay the loan reimbursed in the year before the opening of insolvency proceedings. This measure is part of the provision to support the liquidity of distressed companies, favouring the use of the other "traditional" financing channel, especially for SMEs, given by shareholder and intra-group financing.

V. The Government's choice was therefore to intervene in support of enterprises in crisis, either current or prospective, from two different angles: on the one hand, by extending their credit capacity through the issuance of State guarantees, thus allowing them access to financing channels that would certainly have been impracticable without public intervention; on the other hand, by creating a time buffering to be used to overcome the distress situation through the recovery of the normal economic cycle, or through reorganization proceedings.

Expanding the credit capacity of a company in crisis does not mean, obviously, taking on the losses suffered by it; just as moving forward the deadline for the fulfilment of tax and social security obligations; it does not mean to forgive them. In other words, the measures contained in Decree No. 23 of 2020 do not allow companies to "write off" liabilities; on the contrary, these measures, especially if misinterpreted and applied, risk amplifying (or even determining) the crisis in the medium term. There has not been, at least directly and in the first instance, any collectivization (*id est*, suffered by taxpayers) of the economic effects of the healthcare pandemic.

On the other hand, making a bankruptcy petition unforeseeable does not mean that the state of insolvency will no longer exist; just as granting a moratorium to finalize an agreement with creditors (or enforce it) in the context of a pre-insolvency procedure does not mean removing the state of distress.

The consequence of this is that companies, even if they are allowed to do so by virtue of the guarantee given by the State, should only have access to the new financing channels if they reasonably consider, on the basis of a careful examination of possible future scenarios, that they can repay the borrowed capital. In other words, there is no derogation from the criteria of correct business administration; and, above all, there are no exceptions to the duty of protection towards creditors imposed on the debtor. The deterioration of the economic condition of the company, as a result of conduct not inspired by the criteria of correct business administration, inevitably exposes the director to liability.

The likelihood of being able to take benefit from the public guarantee could trigger a phenomenon of moral hazard that pushes the directors to gamble "all or nothing", even when it would be reasonable not to increase the leverage ratio, thus making concrete the risk of asset depletion to the detriment of: a) taxpayers, within the limits of the losses associated with the enforcement of the guarantee against the State; b) previous creditors, because of the risk altering caused by fresh money; c) subsequent creditors, who could be induced to lend credit to the distressed company, by virtue of the appearance of solvency generated by the guaranteed financing.

The domino effect is just around the corner.

Rationality, prudence, expertise, diligence, good faith and fairness: today more than ever it is necessary to refer to “general clauses” to conform the behaviour of economic agents. Otherwise, markets already weakened might implode.