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Impact of the Italian Business Crisis and Insolvency Code on Organizational Structures in MSMEs

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Abstract

In September 2021, the Italian Bankruptcy Law will be replaced by a new comprehensive Act, the so-called Business Crisis and Insolvency Code.

Two topics have immediately become the "mantra" of this important reform: a) the introduction into the domestic legal

framework of early warning tools and alert procedures, along the lines of the French experience; and b) the introduction of a specific obligation on the entrepreneur or the management body of collective entities to implement suitable measures or establish appropriate organizational structures to prevent future insolvency and preserve the business continuity.

These measures are closely related, insofar as the obligation to implement appropriate organizational arrangements is deemed crucial for the early warning system to be effective in preventing and detecting financial distress, and they should work in synergy.

This article will focus on Italian entrepreneurs' obligation to implement appropriate organizational arrangements, in order to evaluate its real impact on Italian micro, small, and medium-sized enterprises, MSMEs. Micro, small, and medium-sized enterprises play a key and crucial role in the Italian economy, even more important than in other European countries, and it is interesting to investigate what will change in the immediate future as a consequence of the abovementioned reform, and what change would be desirable.

I. INTRODUCTION

The Italian Bankruptcy Law (*Legge fallimentare*),[1] adopted in 1942 and subsequently amended numerous times, will finally be retired in August 2021, and will be replaced by a new comprehensive Act—the Code of Business Crisis and Insolvency (*Codice della crisi d'impresa e dell'insolvenza*, hereinafter "the Code").[2] This Code was enacted by the Italian Government in January 2019—on the basis of a delegation granted

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[1] Regio Decreto 16 marzo 1942, n.267, G.U. Apr. 6, 1942, n.81 (It.).

[2] Decreto Legislativo 12 gennaio 2019, n.14, G.U. Feb. 14, 2019, n.38 (It.).

by the Parliament[3]—after a long procedure started in January 2015, when a special Commission was appointed.[4]

The Code, which consists of 391 articles, was published in the Official Journal on 14 February 2019, and it should have entered into force 18 months after the publication, except for certain provisions concerning corporate governance, which already entered into force on March 16, 2019. But its entry into force has been recently postponed to September 1, 2021 due to the COVID-19 outbreak.

The 2019 reform has heavily amended the existing bankruptcy (*fallimento*), insolvency and preventive restructuring proceedings, including the consumer insolvency proceeding, as well as significant provisions of the Italian Civil Code (hereinafter "C.c.") concerning directors' duties, supervisory bodies of companies, and the compensation for damages caused by negligent directors, officers, and statutory auditors.

Although the innovations introduced by the new Code are many, two are topics that have become the "mantra" of the Italian reform. The first is the very controversial introduction into the domestic legal framework of early warning tools and alert procedures, along the lines of the consolidated French experience.[5] The second is the introduction as a legal norm—or "as a general clause"[6]—of a specific obligation of the (individual) entrepreneur and the management body of a collective entity to implement suitable measures or establish appropriate organizational structures in carrying out the business activity,[7] in order to prevent future insolvency and preserve the business continuity.[8]

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[3] Legge 19 ottobre 2017, n.155, G.U. Oct. 30, 2017, n.254 (It.).

[4] The Commission, known as the Rordorf Commission, was chaired by Renato Rordorf, the then President of the first Chamber of the Italian Supreme Court of Cassation. For details, *see* Enrica M. Ghia & Filippo Bosazzi, *Pre-insolvency column: Crisis management under Italy's new Rordorf*, GLOBAL RESTRUCTURING REV. 43–44 (Jan. 2018).

[5] Loi n.84-148 du 1 mars 1984 relative à la prévention et au règlement amiable des difficultés des entreprises [on the prevention and friendly settlement of business difficulties], J. OFFICIEL DE LA REPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], Mar. 2, 1984, p. 751, as subsequently amended. An exhaustive description of the French regulation can be found in LAETITIA ANTONINI-COCHIN & LAURENCE CAROLINE HENRY, DROIT DES ENTREPRISES EN DIFFICULTÉ 33–48 (2d ed. 2019); ANDRÉ JACQUEMONT ET AL., DROIT DES ENTREPRISES EN DIFFICULTÉ 41-52 (10th ed. 2017); FRANÇOISE PÉROCHON, ENTREPRISES EN DIFFICULTÉ 46–61 (10th ed. 2014).

[6] Paolo Montalenti, *Gestione dell'impresa, assetti organizzativi e procedure di allerta dalla "Proposta Rordorf" al Codice della crisi*, *in* AMEDEO BASSI ET AL., LA NUOVA DISCIPLINA DELLE PROCEDURE CONCORSUALI 482, 483 (2019).

[7] In this article, the term "organizational structure" is sometimes used for brevity to mean "organizational, administrative, and accounting structure", although these three words refer to specific arrangements. See, *infra*, Part II.

[8] Indeed, another significant innovation is the introduction of an organic regulation of crisis and insolvency of enterprise groups. *Supra* note 2, at Part 1, Title VI.

Early warning tools and alert procedures are out-of-court, confidential legal mechanisms aimed at the prompt detection of signs of financial distress of an enterprise, including the loss of business continuity, as well as quick adoption of the most suitable remedies to overcome the crisis and restore the going concern.[9] They are activated, in Italy,[10] through a written notice sent by: a) the supervisory body of a company—the board of statutory auditors (*collegio sindacale*) or single statutory auditor,[11] the supervisory board (in the tier-board system), the management control committee (in the one-tier system), and/or the external auditor or auditing firm—if certain sector-specific indicators are met;[12] or b) certain qualified public creditors—namely, the Revenue Agency, the National Social Security Institute, and the tax collection agent—in the event of indebtedness for taxes (e.g., VAT) or social security contributions exceeding the thresholds (different for each public creditor) provided by the Code.[13]

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[9] The Code explicitly refers to both terms: early warning or alert tools (*strumenti di allerta*) and alert procedures (*procedure di allerta*). *See id.* Art. 12.

[10] In France, differently from Italy, the early warning tools are several and involve many subjects or bodies: *commissaire aux comptes* (auditor), *comité social et économique* (works council), *associés or actionnaires* (company's members o shareholders), *président du tribunal de commerce* (president of the commercial court), *groupement de prévention agréé* (prevention group accredited by an order of the State representative in the region). *See* CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] arts. L. 234-1–234-4 (Fr.); CODE DU TRAVAIL [C. TRAV.] [LABOR CODE] arts. L. 2312-63–2312-69 (Fr.); CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] art. L. 223-36 (Fr.); CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] art. L. 225-232 (Fr.) CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] arts. L. 611-1–611-2-1 (France). The only French early warning tool that has been transplanted into the Italian legal framework is the alert procedure commenced by the auditors (*commissaires aux comptes*), even though the differences between the two national systems are significant: *see* Federico Pernazza, *The Legal Transplant into Italian Law of the* Procédure d'Alerte. *Duties and Responsibilities of the Companies' Bodies*, 3(2) THE ITALIAN L.J. 553, 553–81 (2017); *see also* Federica Innocenti, *Le procedure di allerta nella legislazione francese e nella prossima riforma delle discipline della crisi d'impresa e dell'insolvenza: due modelli a confronto*, 4 RIVISTA DI DIRITTO SOCIETARIO 971–1003 (2018). In particular, the *alerte par le commissaire aux comptes* is not based on financial indicators and is characterized by the involvement, in case of no or inadequate reply by the chairman of the board of directors or the management board, of the president of a commercial court instead of a non-judicial body (*see infra*, note 13).

[11] In Italian limited liability companies, the control body may consist of a single statutory auditor pursuant to Article 2477 C.c.

[12] *See* Art. 13 of the Code. According to some authors' opinion, indeed, it would be advisable that the company statutory or external auditors activate the alert process even before, when there are signals of business vulnerability. *See, e.g.,* Mauro Bini, *Procedura di allerta: indicatori della crisi ed obbligo di segnalazione da parte degli organi di controllo*, 38(4) LE SOCIETÀ 430–37 (2019).

[13] The notice is first sent to the debtor and, subsequently, in case of no or inadequate reply by the debtor or his inactivity, to the so-called OCRI—i.e., the new non-judicial body for the settlement of crisis: *see* Arts. 14 and 15 of the Code. OCRI is a panel of experts

The abovementioned measures are closely related, insofar as the obligation to implement appropriate organizational arrangements is deemed crucial for the alert system to be effective in detecting financial difficulties and preventing a business's slide into insolvency or its insolvent position worsening. As a general rule, this obligation or duty plays a crucial role in facilitating the prevention and/or the prompt detection of financial crisis even when early warning tools may not actually be activated.[14]

The debate among legal practitioners and scholars on both preventive measures are currently very lively and they will continue for some time, considering that the Code will soon be amended to revise some controversial aspects and, hopefully, to adapt its provisions to the recent EU Directive on preventive restructuring frameworks, discharge of debt and disqualifications. In this regard, I must point out that in February 2020 the Italian Government approved a draft legislative decree. This draft decree amends, among other things, some provisions relating to the alert mechanisms, but many aspects of the relevant regulation remain a moot point.

This article will focus on the legal obligation of Italian entrepreneurs to establish or implement appropriate organizational structures or measures, in order to evaluate its impact on Italian micro, small, and medium-sized enterprises (MSMEs)—i.e., enterprises employing fewer than ten workers. MSMEs play a key and crucial role in the Italian economy, even more than in other EU Member States or European countries. It is therefore interesting to investigate what will change, if anything does, as a consequence of the 2019 reform, considering the size, features, and attitudes of the Italian entrepreneurs.

The article proceeds as follows. Part II will focus on the content of the new entrepreneurial obligation provided by the Business Crisis and Insolvency Code. Part III will examine some significant issues emerging from this obligation. Part IV will focus on the positive and negative aspects of the provisions relating to the implementation of organizational arrangements. Part V will compare the Italian approach and trends in preventing insolvency and ensuring business viability, firstly with the approaches of other European countries (France, Germany, Spain, and the UK), and secondly with recent developments at the EU and international level. In Part VI, some preliminary concluding remarks will be drawn.

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established in each local Chamber of Commerce: *see* Eugenio Vaccari, *The New 'Alert Procedure' in Italy: Cross-fertilization or Legal Transplant*?, paper presented at 20th INSOL International Academics' Colloquium (London, 2018), who investigates if and to what extent Italian OCRI represents an example of legal transplant or cross-fertilization from practices of other jurisdictions.

[14] The first type of alert can be activated only in companies where a supervisory body has been appointed: namely, all joint-stock companies, the limited liability companies exceeding certain thresholds (one out of three thresholds) or meeting specific requirements set forth by Article 2477 C.c., and the limited liability companies that voluntarily appoint one or more statutory auditors or external auditors. It is important to highlight that these thresholds have been significantly reduced by the Code, thus extending the number of limited liability companies obliged to appoint a supervisory body.

II. THE OBLIGATION TO IMPLEMENT APPROPRIATE ORGANIZATIONAL ARRANGEMENTS: A NEW OBLIGATION FOR ENTERPRISES?

According to Article 375, which has amended Article 2086 C.c., and Article 3, para. 2, of the Code, any business entity—companies and other collective entities, such as (general and limited) partnerships, non-profit organizations, consortia, business networks[15]—has the duty (i) to establish (and maintain) an organizational, administrative, and accounting structure that is appropriate to the nature and the size of the business *also* in relation to the prompt detection of financial distress (crisis) and the enterprise's inability to continue as a going concern; and (ii) to activate promptly the establishment and the implementation of one of the tools provided by the law for overcoming the crisis and recovering business continuity.[16] This law provision entered into force on March 16, 2019. Its application is not limited to enterprises that are in the zone of insolvency or even insolvent, and its application has a wider scope than the detection of a financial crisis in its early stages.[17] The use of the word "also" in Article 2086, para. 2, C.c. and the inclusion of such a provision in the Italian Civil Code, precisely in the part containing general rules on business, support this statement.[18]

With regard to sole proprietorship, Article 3, para. 1, of the Code is quite different insomuch as it only provides that the individual entrepreneur shall adopt measures suitable to detect the status of crisis early and, where there is a likelihood of insolvency, adopt the necessary remedies promptly. This section, unlike Article 2086 C.c., is contained in

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[15] Article 2086, para. 2, C.c. extends the obligation to "entrepreneurs that operate in corporate or collective form."

[16] The reference to one of the tools provided by the law is ambiguous since it might be interpreted as only referring to judicial restructuring proceedings and out-of-court restructurings. For an extensive interpretation of this part of the rule, *see* Vincenzo Di Cataldo & Serenella Rossi, *Nuove regole generali per l'impresa nel nuovo Codice della crisi e dell'insolvenza*, 4 RIVISTA DI DIRITTO SOCIETARIO 745, 754–56 (2018).

[17] *See* Assonime (Association of Italian Joint-Stock Companies), *Le nuove regole societarie sull'emersione anticipata della crisi d'impresa e gli strumenti di allerta*, Circular No. 19/2019, http://www.assonime.it/attivita-editoriale/circolari/Pagine/circolare-19-2019.aspx, at 20–21; Paolo Benazzo, *Il Codice della crisi di impresa e l'organizzazione dell'imprenditore ai fini dell'allerta: diritto societario della crisi o crisi del diritto societario*, 64(2–3) RIVISTA DELLE SOCIETÀ 274, 275–76, and 283 (2019); Ilaria Capelli, *La gestione delle società di persone dopo il Codice della crisi d'impresa e dell'insolvenza: una prima lettura del nuovo art. 2257, primo comma, c.c.*, 2 RIVISTA ODC 313, 317–19 (2019).

[18] Different formulations of Article 2086 C.c. and of Article 3, para. 1, of the Code will be discussed immediately below.

the Business Crisis and Insolvency Code and has not yet entered into force: the date of its entry into force is that of the overall reform package (forthcoming September 2021). The same date for both rules would have been more reasonable and consistent with the objective of the reform.

I firstly point out that the new obligations cannot actually be qualified as an early warning tool, even though this opinion is quite common among scholars and commentators.[19] The organizational obligations are the prerequisite for the efficient functioning of the alert tools and procedures, and they operate even in enterprises to which the early warning mechanisms explicitly do not apply, such as listed companies, large corporations, or credit institutions.[20] The textual formulation of Article 12 of the Code supports this interpretation. Article 12 delineates what early warning tools are permitted under the new Italian legislation.[21]

Moving then to their specific content, it is beyond doubt that running a business—every business, whatever its size (number of workers, the volume of transactions, etc.) or legal status—requires a certain level of organization (primarily of persons) and planning, at least informal planning.[22] The general definition of an entrepreneur, contained in Article 2082 C.c., explicitly mentions organization as an essential requirement.[23] Therefore, some scholars and commentators—included the President of

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[19] *See, e.g.*, Benazzo, *supra* note 17, at 277, 298; Michele Perrino, *Crisi di impresa e allerta: indici, strumenti e procedure*, 36(5) IL CORRIERE GIURIDICO 653, 657–58 (2019); RICCARDO RANALLI, LE MISURE DI ALLERTA. DAGLI ADEGUATI ASSETTI SINO AL PROCEDIMENTO AVANTI ALL'OCRI 26 (2019); Paola Vella, *L'allerta nel codice della crisi e dell'insolvenza alla luce della Direttiva (UE) 2019/1023*, CRISI D'IMPRESA E INSOLVENZA 6-10 (July 24, 2019), https://blog.ilcaso.it/libreriaFile/1124.pdf.

[20] *But see* EUROPEAN LAW INSTITUTE, INSTRUMENT OF THE EUROPEAN LAW INSTITUTE – RESCUE OF BUSINESS IN INSOLVENCY LAW (2017), https://www.europeanlawinstitute.eu/fileadmin/user_upload/p_eli/Publications/Instrument_INSOLVENCY.pdf, Recommendation 1.21 ("Member States should provide for and support early warning mechanisms that detect a deteriorating business development and signal the respective urgency to act. Possible instruments are accounting and monitoring duties for the debtor or the debtor's management according to company or tax law as well as reporting duties under loan agreements (covenants).").

[21] *See, e.g.*, Luciano Panzani*, Il* preventive restructuring framework *nella Direttiva 2019/1023 del 20 giugno 2019 ed il codice della crisi. Assonanze e dissonanze*, CRISI D'IMPRESA E INSOLVENZA 3–4 (Oct. 14, 2019), https://blog.ilcaso.it/libreriaFile/1134.pdf; Banca d'Italia [Bank of Italy]*, Observations on "Schema di decreto legislativo recante Codice della crisi di impresa e dell'insolvenza in attuazione della legge 19 ottobre 2017, n. 155",* Commissione Giustizia – Senato della Repubblica (26 Nov. 2018).

[22] *See generally* DANILO GALLETTI, LA RIPARTIZIONE DEL RISCHIO DI INSOLVENZA, 157–255 (2006).

[23] Namely, according to Article 2082 C.c., an entrepreneur is a (natural or legal) person who professionally carries out an "organized" economic activity for the purpose of producing or exchanging goods or services.

the Reform Commission[24]—have minimized the forthcoming effects of the new rules, holding that the obligation to establish adequate organizational arrangements already existed in the domestic legal framework as it is an intrinsic, essential element of the basic definition of entrepreneur.[25]

I am not persuaded by this argument, at least as regards the first part of the new rules (namely, the obligation to implement suitable measures or appropriate organizational structures). Firstly, the term "organized" contained in the original definition of an entrepreneur essentially refers to a minimum level of organization of workers and/or assets, directed and coordinated by the entrepreneur to carry out a business activity (Articles 2086, para. 1, and 2555 C.c.),[26] distinguishing entrepreneurs from independent workers.[27] The new obligation introduced by the Code, instead, has a more defined and prescriptive content, as well as a different rationale—that is, primarily, the early and prompt detection of financial difficulties experienced by the entrepreneur and the prevention of future insolvency. The idea behind the provisions in both Article 2086 C.c. and

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[24] *See* Renato Rordorf, Hearing before the Second Commission (Justice) of the Chamber of Deputies, *Indagine conoscitiva in merito all'esame dello schema di decreto legislativo recante codice della crisi di impresa e dell'insolvenz*a (Dec. 4, 2018), https://www.camera.it/leg18/1079?idLegislatura=18&tipologia=indag&sottotipologia=c02_crisi&anno=2018&mese=12&giorno=04&idCommissione=02&numero=0002&file=indice_stenografico#stenograficoCommissione.tit00110, at 203.

[25] *See, e.g.*, Andrea Bartalena, *Le azioni di responsabilità nel codice della crisi d'impresa e dell'insolvenza*, 41(3) IL FALLIMENTO 298, 300–01 (2019); Riccardo Russo, *Collegio sindacale e prevenzione della crisi d'impresa*, 45(1) GIURISPRUDENZA COMMERCIALE 119, 139–40 (2018-I); Marco S. Spolidoro, *Note critiche sulla "gestione dell'impresa" nel nuovo art. 2086 c.c. (con una postilla sul ruolo dei soci)*, 64(2–3) RIVISTA DELLE SOCIETÀ 253, 262–63 and 267–68 (2019); and, under the previous law, *see* Vincenzo Buonocore, *Adeguatezza, precauzione, gestione, responsabilità: chiose sull'art. 2381, commi terzo e quinto del codice civile*, 33(1) GIURISPRUDENZA COMMERCIALE 5, 18–19 (2006-I); MARINA SPIOTTA, CONTINUITÀ AZIENDALE E DOVERI DEGLI ORGANI SOCIALI 32–50 (2017). *But see* Benazzo, *supra* note 17, at 282–85; Alessandro Nigro, *Il "diritto societario della crisi": nuovi orizzonti?*, 63(5–6) RIVISTA DELLE SOCIETÀ 1207, 1218–19 (2018); and Roberto Sacchi, *Sul così detto diritto societario della crisi: una categoria concettuale inutile o dannosa?*, 41(5) LE NUOVE LEGGI CIVILI COMMENTATE 1280, 1286–87 (2018), who all offer an alternative, and slightly different, interpretation of the merit of these rules.

[26] Article 2086, para. 1, C.c. provides that the employer is the head of the undertaking, on whom his collaborators hierarchically depend. Article 2555 C.c. provides the definition of business (*azienda*), stating that it is an aggregate of assets organized by the entrepreneur for conducting a business activity. The key element of a business (or ongoing business) is the functional coordination of all assets for the purpose of carrying out a business activity.

[27] *See, e.g.*, Antonio Cetra, *La fattispecie "impresa"*, *in* DIRITTO COMMERCIALE. I. DIRITTO DELL'IMPRESA 25, 33–34 (Marco Cian ed., 2017); GIAN FRANCO CAMPOBASSO, DIRITTO COMMERCIALE. 1. DIRITTO DELL'IMPRESA 27–28 (Mario Campobasso ed., 7th ed. 2013); EVA R. DESANA, L'IMPRESA FRA TRADIZIONE E INNOVAZIONE 27–30 (2018); FRANCESCO JR FERRARA & FRANCESCO CORSI, GLI IMPRENDITORI E LE SOCIETÀ 31-34 (14th ed. 2009).

Article 3 of the Code is that the implementation of appropriate organizational arrangements is a prerequisite for assuring efficient management of an undertaking and for preventing deterioration of the business. These provisions, applicable to all enterprises in any stage of their lifecycle, have a clear programmatic value in the reform scenario.[28]

Secondly, not enough attention, I think, has been paid by commentators to the fact that, according to Article 2086 C.c., the collective enterprises are obliged to establish an "organizational, administrative, and accounting structure".[29] These terms—organizational, administrative, accounting—are not regarded as equivalent in law and managerial practice,[30] and each of them would require specific implementation, though subject to a suitability assessment that takes into particular account the undertaking's size and nature.

Thirdly, those scholars who minimize the impact of these provisions usually mention the regulation of Italian joint-stock companies (s.p.a./*società per azioni*)—where similar provisions have been in force since 2004[31]—and the widespread academic trend to interpret these rules as a principle applicable to limited liability companies (s.r.l./*società a responsabilità limitata*) too.[32] This is absolutely true, although the new rules have emphasized and properly focused on the linear functional relationship between the obligation to implement organizational arrangements and prompt detection of financial crisis:[33] the real innovation is to have extended such rules outside the scope of companies and their regulation.[34]

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[28] Marco Cian, *Crisi dell'impresa e doveri degli amministratori: i principi riformati e il loro possibile impatto*, 42(5) LE NUOVE LEGGI CIVILI COMMENTATE 1160, 1162–63 (2019); Alberto Jorio, *La riforma della legge fallimentare tra utopia e realtà*, *in* AMEDEO BASSI ET AL., LA NUOVA DISCIPLINA DELLE PROCEDURE CONCORSUALI, *supra* note 6, at 413, 418–19.

[29] This formulation replicates those contained in Articles 2381, 2403 C.c., relative to, respectively, duties of the chairman, executive committee and managing directors, and duties of the board of statutory auditors of joint-stock companies.

[30] Organizational structure, for example, is a system used to define a hierarchy within an organization (it identifies each job, its function and where it reports to within the organization), whereas accounting system is a set of methods and procedures for collecting, classifying, summarizing, and reporting financial information.

[31] Arts. 2381, 2403 C.c.

[32] *See* Oreste Cagnasso, *Gli assetti adeguati nella s.r.l.*, *in* ASSETTI ADEGUATI E MODELLI ORGANIZZATIVI NELLA *CORPORATE GOVERNANCE* DELLE SOCIETÀ DI CAPITALI 573, 578–80 (Maurizio Irrera ed., 2016); *Id.*, *Gli assetti adeguati nelle società a responsabilità limitata*, 15(2) IL NUOVO DIRITTO DELLE SOCIETÀ 11, 15–17 (2017); MAURIZIO IRRERA, ASSETTI ORGANIZZATIVI ADEGUATI E GOVERNO DELLE SOCIETÀ DI CAPITALI 309-12 (2005).

[33] *See* Benazzo, *supra* note 17, at 286–87.

[34] *See also* Assonime, *supra* note 17, at 22–23; Niccolò Abriani & Antonio Rossi, *Nuova disciplina della crisi d'impresa e modificazioni del codice civile: prime letture*, 38(4) LE SOCIETÀ 393, 394–95 (2019); Stefano Ambrosini, *L'adeguatezza degli assetti organizzativi, amministrativi e contabili e il rapporto con le misure di allerta nel quadro*

It remains to analyze the second part of Articles 3 of the Code and 2086 C.c., namely the obligation to take appropriate actions without delay to overcome the crisis and restore the going concern.

It can be argued that, even in collective entities other than companies (particularly partnerships or non-profit organizations),[35] directors or the persons responsible for the management of undertakings in the zone of insolvency had some obligation in this regard under the legislation previously in force, although a specific duty was not explicitly required.[36] They, indeed, were required to act with reasonable care and skill in running the business activity. The position for sole proprietorship was somewhat different. Under the Italian Bankruptcy Law of 1942, an individual entrepreneur could only be held criminally liable for intentionally worsening his distress by refraining from filing a petition for bankruptcy,[37] or for undertaking seriously incautious transactions in order to delay the opening of the insolvency proceeding if he was then declared bankrupt.[38]

It is therefore possible to conclude that the new law provisions are not merely a clarification of something already implicit in the Italian legal framework; they do have a substantive value.

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normativo riformato, CRISI D'IMPRESA E INSOLVENZA (Oct. 15, 2019), https://blog.ilcaso.it/libreriaFile/11354.pdf; Massimo Bianca, *I nuovi doveri dell'organo di controllo tra codice della crisi e codice civile*, 94(6) IL DIRITTO FALLIMENTARE E DELLE SOCIETÀ COMMERCIALI 1339, 1343 (2019-I); Di Cataldo & Rossi, *supra* note 16, at 751; Enrico Ginevra & Chiara Presciani, *Il dovere di istituire assetti adeguati* ex *art. 2086 c.c.*, 42(5) *LE NUOVE LEGGI CIVILI COMMENTATE* 1209, 1233 (2019); Jorio, *supra* note 28, at 418–19; Montalenti, *supra* note 6, at 483.

[35] *See* Article 2260 C.c. on the liability of managing partners, and Article 28 of Decreto Legislativo 3 luglio 2017 n.117, G.U. Aug. 2, 2017, n.179) (It.), on the liability of the governing body of non-profit organizations.

[36] *See, e.g.*, Bartalena, *supra* note 25, at 300–01; Spolidoro, *supra* note 25, at 268–69. *But see* Di Cataldo & Rossi, *supra* note 16, at 754.

[37] However, in Italy, unlike the majority of EU Member States, the insolvent debtor is not *formally* required to file a petition for insolvency within a specific time. *See* Gerard McCormack, Andrew Keay, Sarah Brown & Judith Dahlgreen, European Commission, *Study on a new approach to business failure and insolvency: Comparative legal analysis of the Member States' relevant provisions and practices,* 48–53 (Jan. 2016).

[38] Art. 217 of the Italian Bankruptcy Law. This provision, titled "simple bankruptcy" (*bancarotta semplice*) has been transplanted in Article 323 of the Code.

III. OTHER SIGNIFICANT ISSUES RELEVANT TO THE NEW PROVISIONS ON THE IMPLEMENTATION OF ORGANIZATIONAL ARRANGEMENTS

Articles 3 of the Code and 2086 C.c. pose some significant practical and theoretical issues.

Firstly, the implementation of organizational arrangements is essentially seen by Italian entrepreneurs, and sometimes by their representative associations, as a cost that is added to the already existing high costs and administrative burden.[39] For a significant number of limited liability companies, these costs include appointing a supervisory body (statutory auditor/s or external auditor).[40]

It must be highlighted that MSMEs—i.e., enterprises with fewer than ten workers—play a key and crucial role in Italy: in 2017, for example, micro enterprises, which amounted to 95 percent of the "operating" enterprises (i.e., active enterprises), contributed up to 44.5 percent of total employment; additionally, in 2015 SMEs contributed up to 78.7 percent (compared to 69.4 percent on average in the other European countries). A large number of these are individual entrepreneurs, and the number of general and limited partnerships continues to be high, even though it has decreased in recent years. In particular, at the end of 2019, the number of enterprises registered on the Italian Business Register (that includes active and inactive enterprises) amounted to 6,091,971, of which 1,763,011 were limited companies,[41] 966,872 were partnerships, 3,151,407 were sole proprietorships, and 210,681 were other types of business entity. Moreover, a typical feature of Italian undertakings is to be family-run or family-based.

Additionally, the number of undertakings that entered a voluntary winding up in late 2018 and in 2019 increased, showing a deterioration in the profits and growth expectations of the entrepreneurs. In 2019, 78,134

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[39] According to a survey carried out by CGIA Mestre (the Association of Artisans and Small Businesses of Mestre), in 2020 the cost of bureaucracy for SMEs will increase by around 3.7 billion euros (including the expected costs of compliance with the Code). See the news at http://www.cgiamestre.com/wp-content/uploads/2019/11/Nuova-burocrazia-2020-21.12.2019-1.pdf.

[40] *See* note 14, *supra*.

[41] A significant number of them (259,928 at the end of December 2019) are simplified limited liability companies (s.r.l.s.), namely companies with a minimum share capital of one euro and a maximum of €9,999.99. See the news at https://www.notariato.it/it/news/srl-semplificate-pubblicati-i-numeri-aggiornati-al-2019.

solvent enterprises entered a voluntary winding up.[42] Furthermore, in 2018, economic recovery for SMEs slowed down for the first time since 2013.

In a scenario where supporting new SMEs and businesses is vital to the European economy and is continually reaffirmed at the EU level, the introduction of a new obligation for undertakings could hinder the achievement of this goal and could encourage forum shopping.

The second issue is the opportunity to make the setting up of organizational, administrative, and accounting structures—which are traditionally regarded as a prerogative of management and organizational sciences—the object of a precise legal norm that imposes a duty and limits entrepreneurial freedom. It can be countered that a similar duty has existed since 2004 for all Italian joint-stock companies[43] and has been gradually extended by scholars to limited liability companies. Moreover, specific rules on business organization have been adopted since the late 1990s, imposing the establishment of organizational structures and models in certain companies and, sometimes, in other types of undertaking for various purposes.[44]

Above all, the Italian Legislator, by means of the new provisions introduced in the Code, has actually tried to react to the chronic incapacity of Italian enterprises to promote early restructuring procedures independently, due, among other things, to their poor attitude toward implementing organizational arrangements. This is quite clear in the preparatory documents for the 2019 reform, and it is confirmed by empirical analysis. I only add, in this regard, that a very limited number of entrepreneurs in Italy establish budgets, forecast financial statements, or publish business plans.[45] Additionally, MSMEs often have an inadequate

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[42] *See Fallimenti, procedure e chiusure di imprese,* Osservatorio Cerved (Mar. 2020), https://know.cerved.com/wp-content/uploads/2020/03/Oss-Chiusure-4q-2019.pdf (A significant number of these enterprises, however, were inactive enterprises).

[43] *See* Art. 2381 C.c.

[44] Decreto Legislativo 1 settembre 1993, n.385, G.U. Sept. 30, 1993, n.230 (It.) (Consolidated Law on Banking); Decreto Legislativo 24 febbraio 1998, n.58, G.U. Mar. 26, 1998, n.71 (It.) (Consolidated Law on Finance) Decreto Legislativo 8 giugno 2001, n.231, in G.U. June 19, 2001, n.140 (It.) (providing for a direct liability of legal entities, companies, and associations for certain crimes committed by their representatives); Decreto Legislativo 7 settembre 2005, n.209, G.U. Oct. 13, 2005, n.239 (It.) (Code of Private Insurance); Decreto Legislativo 19 agosto 2016, n.175, G.U. Sep. 8, 2016, n.210 (It.) (Consolidated Law on State-Owned Companies).

[45] *See* Vella, *supra* note 19, at 29. *See also* Rapporto Cerved PMI (Cerved, 2019), https://know.cerved.com/wp-content/uploads/2019/11/Rapporto-PMI_2019_web.pdf, quoting a survey conducted by PwC Tls, at 123.

reporting system that does not allow early detection of financial distress;[46] nor are treasury systems at present widespread among Italian MSMEs.

The third issue is the regulatory approach to extending the obligation to establish an organizational, administrative, and accounting structure to all collective entities, irrespective of their nature, form, size, and scope. General partnerships, non-profit organizations, legally recognized business networks, etc., are usually more similar, in terms of organizational arrangements and organizational needs, to an individual entrepreneur than a limited liability company, or even more to a joint-stock company. As I will illustrate in the next paragraph, the rule applicable to sole proprietorships (Article 3, para. 1, of the Code) has a more general and flexible content than Article 2086 C.c. We can therefore conclude that the requirement to establish an organizational, administrative, and accounting structure in collective entities other than companies raises some doubts about its proportionality, appropriateness, and real efficiency.

Lastly, what organizational, administrative, and accounting structures are actually appropriate for a company or a business entity, in particular a micro or small business? This is not an easy question, as the considerable number of books and articles written on this topic over the years clearly shows.

IV. THE OBLIGATION TO IMPLEMENT "SUITABLE MEASURES" OR *"*APPROPRIATE ORGANIZATIONAL, ADMINISTRATIVE, ACCOUNTING STRUCTURES": WHAT DOES IT REALLY MEAN?

Both provisions—the one concerning sole proprietorship and that concerning collective entities—are formulated in general terms. They refer, respectively, to the implementation of suitable measures and the establishment of an organizational, administrative, and accounting structure appropriate to the size and the nature of the undertaking.

These quite general provisions undoubtedly make the implementation of organizational arrangements more effective and proportionate to each entrepreneurial activity and its goals. Organizational structures can look very different; thus, a tailor-made approach that considers the enterprise's

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[46] Lorenzo Stanghellini et al. (eds.), *Best Practices in European Restructuring. Contractualised Distress Resolution in the Shadow of the Law* 7 n.7 (2018); Co.Di.Re. Research Team, *Italian National Findings* (2018), https://www.codire.eu/wp-content/uploads/2018/12/Italian-National-Findings.pdf, finding 1.4; *Id.*, *Italian National Report* (2018), https://www.codire.eu/wp-content/uploads/2018/12/Italian-National-Report.pdf, Part II, finding 3.4.

needs and resources is necessary. There are no pre-established schemes with which to comply.

Indeed, the business complexity and the type of organization (simple, centralized, or multi-functional), the set of policies and procedures, the level of information flow, the need to implement internal control and risk management functions and their sophistication,[47] the implementation of integrated software, the importance of the organizational chart and of formal strategic planning, the level of hierarchy, and the frequency of financial statements and reporting differ according to a lot of variables: the market in which the business operates; the typical risks to which it is exposed; its size, scope, and nature; and external environment factors that impact the business. All of these features and factors inevitably influence assessment of the suitability of the organizational arrangements by the entrepreneur/management and control bodies.

What must be pointed out, firstly, is that the suitability test will be influenced by the future entry into force of the alert system, because the organizational structures or measures should permit the calculation of crisis indexes according to Article 13 of the Code.[48]

Secondly, as mentioned in Part II, there is no (perfect) correspondence between the content of Article 3, para. 1, of the Code, relevant to the individual entrepreneur, and that of Article 2086 C.c., applicable to all collective entities. The most important difference, and probably the only one of real significance,[49] is that the former provision generally refers to "suitable measures" to be implemented, while the latter refers to an "organizational, administrative and accounting structure appropriate to the size and the nature of the undertaking". Their diverse formulation is likely due to the usual simplicity of the organization and planning of a sole proprietorship compared to that of a company, and, perhaps, to the latent concern of the Italian Legislator about the risk of imposing excessive costs on individual entrepreneurs (often artisan entrepreneurs), considering their size and features.[50]

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[47] Specific organizational arrangements, including risk assessment programs to manage the risk of crisis, must be implemented by state-owned companies. *See* Art. 6, para. 2, of D.Lgs. n. 175/2016 (It.).

[48] Article 13 of the Code delegates the Italian National Council of Chartered Accountants and Accounting Experts (CNDCEC) to define the dashboard of indexes that reasonably let the businesses assume the existence of a crisis. The indexes are illustrated in the draft document of CNDCEC, *Gli indici dell'allerta ex art. 13, co.2 Codice della Crisi e dell'Insolvenza* (Oct. 19, 2019).

[49] *But cf.* Marina Spiotta, *Brevi riflessioni sulle discrepanze tra gli artt. 3 e 375 c.c.i.*, ILSOCIETARIO (Oct. 7, 2019), http://ilsocietario.it/articoli/focus/brevi-riflessioni-sulle-discrepanze-tra-gli-artt-3-e-375-cci.

[50] *See also* Di Cataldo & Rossi, *supra* note 16, at 750–51. *But see* Spolidoro, *supra* note 25, 260–62.

It is noteworthy that the first draft version of Article 2086 C.c. referred to all entrepreneurs, including sole proprietorship, and so does Article 14 of the Delegation Law No. 155/2017, setting forth the principles and criteria to be complied with by the Government in adopting delegated legislative decrees.[51] The shift from a fully comprehensive provision to one applicable only to collective enterprises seems to confirm the uncertainty and the difficulty for the Italian Legislator to properly balance opposing needs, all fundamental to the running of business activities in a rapidly changing economic environment. The last version of the law provision has been reaffirmed by the draft legislative decree amending the Business Crisis and Insolvency Code, supporting the idea that the distinction between sole proprietorships and collective entities is, or may be deemed to be, a precise policy choice made by the Legislator.

However, as I previously pointed out, there are small differences, in practice, between an individual entrepreneur and a general partnership or a non-profit organization, or other types of collective entity (e.g., a consortium).[52] If a distinction must be made,[53] it would have been more advisable and appropriate to limit the obligation to establish specific organizational structures to companies, for which this obligation seems proportionate. It is indeed quite clear that the Italian Legislator had in mind the latter when he drew up the above-mentioned section.

In practice, what will probably be required of a sole proprietorship operating on a small scale, according to Article 3 of the Code, will consist as a general rule in the preparation of prospective financial information—at least forecasted or projected cash flow statements[54] and, possibly, annual budgets—in performing periodic checks and adopting an internal reporting system,[55] and, hopefully, in systems of risk assessment (maybe risk assessment questionnaires).[56] There is uncertainty as to whether the same minimum measures may be deemed appropriate in collective

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[51] *See id.*, at 260, n.8 (for more information about the draft version of Article 2086 C.c.).
[52] *See* Di Cataldo & Rossi, *supra* note 16, at 750–51.
[53] *Id*. at 753 (holding that a distinction between sole proprietorship and other types of enterprise, characterized by a higher degree of structural complexity, is advisable). *But see* Spolidoro, *supra* note 25, at 260 (arguing that the general clause contained in Article 2086 C.c., which requires the organizational structures concretely implemented by the undertaking to be suitable to its nature and size, would be sufficient to avoid the risk of excessive burdens on micro enterprises).
[54] The cash flow forecast should be prepared more frequently than the annual accounts in order to permit the crisis indicators to work—in particular, the DSCR calculation. *See* the draft document of CNDCEC, *supra* note 48, para. 6.2. *See* ISAE 3400, "The Examination of Prospective Financial Information," paras. 3-5 (for a definition of prospective financial information).
[55] *See also* Ambrosini, *supra* note 34, at 6–7.
[56] Rapporto Cerved PMI, *supra* note 45, at 128.

entities, particularly in micro entities, in light of what is expressly required in Article 2086 C.c.[57] Although the suitability requirement discussed above might facilitate an extensive interpretation of the rule,[58] doubts remain.

V. EUROPEAN UNION AND EUROPEAN COUNTRIES AT A GLANCE

In this new and evolving scenario, it is interesting to compare the Italian approach to that of the other main European countries, where the probability of a firm becoming insolvent is significantly lower,[59] and to the EU and international approaches and regulatory trends.

Firstly, I will focus on the French, German, Spanish, and UK approaches, which seem to differ, to some extent, from the Italian one.[60]

In these countries, a general provision comparable to Article 3 of the Code and Article 2086 C.c., applicable to all collective entities—and to a certain extent, to sole proprietorships—is not provided for in either insolvency legislation, or civil or commercial codes. What exist are specific provisions relating to certain enterprises (i.e., limited liability companies or joint-stock companies, or enterprises exceeding some thresholds) or limited to a well-defined obligation (e.g., in the field of security and safety of workers).[61]

Secondly, the recently adopted EU Directive on restructuring and insolvency (2019/1023)[62] and supranational guidelines will be taken into consideration in order to ascertain if they include provisions or proposals that may have inspired the Italian Legislator.

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[57] *Cf.* Benazzo, *supra* note 17, at 276, n.4, 283.

[58] *See* Assonime, *supra* note 17, at 28; *see also* Capelli, *supra* note 17, at 323–25.

[59] *Cf.* EUROPEAN BANKING AUTH., *Risk Dashboard Annex – Credit Risk Parameters Q2 2019* and *Credit Risk Parameters Q3 2019*, https://eba.europa.eu/risk-analysis-and-data/risk-dashboard.

[60] I will not consider, in this comparative analysis, the national legislation implementing Article 58 of Directive (EU) 2017/1132 of 14 June 2017, 2017 O.J. (L 169) 4 (providing that, in the case of a serious loss of the subscribed capital, a general meeting of shareholders must be called to consider whether the company should be wound up or any other measures taken), although this obligation could still have a warning function.

[61] *See, e.g.,* CODE DU TRAVAIL [C. TRAV.] [LABOR CODE] arts. L. 4121-1–4121-4 (Fr.).

[62] The Proposal for a Directive on preventive restructuring frameworks was published in November 2016. *See Commission Proposal for a Directive of the European Parliament and of the Council on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency and Discharge Procedures and Amending Directive 2012/30/EU*, COM (2016) 723 final (Nov. 22, 2016), https://ec.europa.eu/information_society/newsroom/image/document/2016-48/proposal_40046.pdf.

a. France

As already mentioned, in France, early warning tools have been in force since 1984, and there are a variety of consolidated measures or *droits d'alerte*.[63] With regards to the second "mantra" of the Italian reform—namely, the existence of specific rules imposing obligations in the field of business organization—the French scenario is somewhat different.

Article L. 232-2 of the French Commercial Code provides that business companies with at least three hundred employees or a net turnover equal to or higher than 18,000,000 euros must prepare, in addition to other financial documents, a projected profit and loss statement and a projected financing plan (*compte de résultat prévisionnel* and *plan de financement prévisionnel*)—in other words, financial projections.[64] Moreover, these documents will be analyzed in written reports on the development of the company prepared by the board of directors or the management board (or managers in companies other than joint-stock companies), and the documents and reports will at the same time be notified to the supervisory board (where established), the auditor, and the works council.[65]

The obligation provided by Article L. 232-2 of the Commercial Code also applies to partnerships, GIEs (*groupements d'intérêt économique*), and non-commercial legal persons performing an economic activity that exceeds certain thresholds.[66] However, unlike the Italian rules discussed above, it only applies to large enterprises with more complex organizational structures.[67]

It must also be pointed out that the various French alert mechanisms do not impose a specific obligation on the entrepreneur or its directors to react; they continue to have broad discretion in their conduct even after an alert procedure has been initiated. [68] However, inactive directors (*dirigeants*) might be held personally liable for negligence.[69]

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[63] *See* note 10, *supra*.

[64] The requirement for the application of this provision are defined by a decree of the *Conseil d'État*, which also specifies the frequency, deadlines, and terms of preparation of the abovementioned documents. *See* ANTONINI-COCHIN & HENRY, *supra* note 5, at 23–24.

[65] CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] art. L. 232-3 (Fr.); CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] art. L. 232-4 (Fr.).

[66] CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] art. L. 612-2 (Fr.).

[67] *See* JACQUEMONT ET AL., *supra* note 5, at 41.

[68] PÉROCHON, *supra* note 5, at 54 (pointing out that the scope of these measures is to force the persons in charge of managing the enterprise to open their eyes).

[69] *Id*.

Lastly, the obligation of the debtor or its legal representatives[70] to file for insolvency proceedings (whether in the form of reorganization or liquidation proceedings) within 45 days of the occurrence of the cessation of payments pursuant to Articles L. 631-4 and L. 640-4 of the Commercial Code cannot really be deemed equivalent to the obligation to implement organizational arrangements suitable to prevent enterprise insolvency, even though the debtor is meant to control its financial status continually. As previously mentioned, the focus of the new Italian law is more on the prevention of insolvency than on its declaration, and the relevant rules kick in (or should do) at an earlier stage.

b. Germany

In Germany, § 91, para. 2, of the Stock Corporation Act (*Aktiengesetz*) requires the management board to take suitable measures, in particular surveillance measures, to ensure that developments threatening the continuation of the company are detected at an early stage. This section, as it is generally understood, provides for the duty to establish certain organizational systems,[71] and it is formulated in quite general terms.[72] Such a rule, however, only applies to joint-stock companies and, by analogy, to large limited liability companies (despite the lack of a comparable rule in the Limited Liability Companies Act).[73] Furthermore, for managing directors of German limited liability companies and members of the management board of joint-stock corporations, the duty to exercise the diligence expected of a responsible business person includes the duty, if a crisis threatens, to consider all possible remedial steps and to initiate such measures.[74]

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[70] Failure to do so may lead such persons to be prohibited from being involved in the management of a business (so-called *interdiction de gérer*): *see* CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] art. L. 653-8.

[71] JEAN J. DU PLESSIS ET AL., GERMAN CORPORATE GOVERNANCE IN INTERNATIONAL AND EUROPEAN CONTEXT 486 (3d ed. 2017).

[72] *See* Clifford Chance LLP, Mandate of the Special Representative of the Secretary-General (SRSG) on the Issue of Human Rights and Transnational Corporations and other Business Enterprises – Corporate Law Project (Sept. 2010), https://www.business-humanrights.org/sites/default/files/media/documents/ruggie/corp-law-germany-clifford-chance-for-ruggie-sep-2010.pdf, at para. 10 (stating that "[e]stablishing a monitoring system under the terms of the AktG does not necessarily mean that the management is obliged to create a comprehensive, all-encompassing risk management system. … the intended measures shall only ensure that possible risks are recognised at an early stage.").

[73] *Id.*

[74] *See* Franz Aleth & Nils Derksen, *Germany*, *in* RESTRUCTURING & INSOLVENCY 184, 188 (Catherine Balmond & Katharina Crinson eds., 2019), https://www.freshfields.com/49f85b/globalassets/what-we-do/regulatory/getting-the-deal-through-2019.pdf, question No. 18. *See generally,* McCormack et al., *supra* note 37, at 45

It must be added that in Germany, as well as in France, when a debtor (i.e., a company, certain partnerships or an association) becomes illiquid or overindebted, the managing directors or partners or the liquidators of the debtor shall file a request for the opening of insolvency proceedings without culpable delay—at the latest, three weeks after the commencement of illiquidity or over-indebtedness.[75] If they fail to file an insolvency petition, they are personally liable for damage caused to the company and its creditors resulting from the undue delay in filing.

c. Spain

The Spanish legal framework does not set out an obligation to implement organizational arrangements aimed at detecting financial distress early that is applicable to all businesses, irrespective of their legal form.

An obligation to file for insolvency, however, is provided in Article 5, para. 1, of the Spanish Insolvency Law (*Ley Concursal*): the debtor or the organization's directors must request the opening of an insolvency proceeding within two months following the date on which it knew, or should have known, about the insolvency. Late filing will lead to an insolvency proceeding being declared "guilty"—namely, the law presumes, unless proven otherwise, that the insolvency was fraudulent—and directors may be held liable wholly or partly for the company's debts.[76] But I have already explained why I do not consider this rule as having the same impact on debtors as the new Italian law provisions.

Notwithstanding the different regulatory approaches, it is noteworthy that a recent survey shows problems in Spain similar to those experienced by Italian enterprises: the structure of MSMEs, mostly family businesses; the lack of sophistication of their members or owners, who seek advice too

("[i]n most Member States there is no specific duty that requires directors to formulate plans to take preventative action to avoid insolvency or to identify possible insolvency problems, although it is arguably implicit that they do have some obligation in this regard as the directors should be managing the company responsibly and in such a way that is designed to ensure solvency … .").

[75] INSOLVENZORDNUNG [InsO] [INSOLVENCY CODE], § 15a, *translation at* https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html (Ger.); BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], § 42, para. 2, *translation at* http://www.gesetze-im-internet.de/englisch_bgb/index.html (Ger.).

[76] B.O.E. 2003, 164, arts. 165, 172, and 172 *bis* (The court ruling classifying the insolvency as tortious shall also bar the persons affected by the classification from administering the assets of others for a period of two to fifteen years, as well as from representing or managing any person or company during the same period).

late and identify problems at a very late stage; and the still existing reputational damage or social stigma of insolvency proceedings.[77]

d. The United Kingdom

In the UK, there are no rules applicable to all businesses requiring the implementation of organizational arrangements aimed at the early detection of a crisis. However, the Insolvency Act 1986 provides specific prohibition of wrongful trading.[78]

Sections 214 (in case of insolvent liquidation) and 246ZB (in case of insolvent administration) IA 1986 concern conduct—irresponsible trading—that occurs when the company has gone into insolvent liquidation or entered insolvent administration and, at some time before the liquidation or before the company entered administration, the director knew, or ought to have known, that there was no reasonable prospect that this could have been avoided.[79] Company directors (and members of limited liability partnerships) may be liable to make a contribution to the company's assets where they have engaged in wrongful trading.[80] The court shall not make an order when the incumbent or former director took every step that he ought to have taken with a view to minimizing the potential loss to the company's creditors.[81]

The wrongful trading provision clearly diverges from the obligation provided by the Italian Code, which anticipates the responsible conduct

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[77] Co.Di.Re. Research Team, *National Findings for Spain* (2018), https://www.codire.eu/wp-content/uploads/2018/12/Spanish-National-Findings.pdf; *Id., National Report: Spain* (2018), https://www.codire.eu/wp-content/uploads/2018/12/Spanish-National-Report.pdf.

[78] *See* Ryan Beckwith et al., Nicholson*: Decision to Keep Trading Not Always Wrongful*, 15 INTERNATIONAL CORPORATE RESCUE 157, 157 (2018) (pointing out that "wrongful trading … [is] one of the main ways that English law encourages directors to focus carefully and appropriately on the prospects of a company in financial difficulty.").

[79] Insolvency Act 1986, c. 45, § 214 (Gr. Brit.); Insolvency Act 1986, c. 45, § 246ZB (Gr. Brit.). This kind of provision or similar concepts exist in other EU Member States such as Malta, Ireland, and Hungary. *See* McCormack et al., *supra* note 37, at 53–54.

[80] Insolvency Act 1986, c. 45, § 214 (Gr. Brit.). Apart from personal liability, where a director engages in wrongful trading, he may be disqualified by court order under the Company Directors Disqualification Act 1986 if the court thinks fit. *See* Company Directors Disqualification Act 1986, c. 46, § 10 (Gr. Brit.). The maximum period of disqualification is 15 years and the person is prevented from being a director of a company, acting as receiver of a company's property or in any way being concerned or taking part in the promotion, formation or management of a company, and acting as an insolvency practitioner. *Id.*

[81] Section 214(3) of the Insolvency Act 1986. On the issues that exist in relation to the bringing of actions for wrongful trading in the UK, *see* Andrew R. Keay, *Wrongful trading: problems and proposals*, 65 (1) NORTHERN IRELAND LEGAL QUARTERLY 63–79 (2014).

and prudent evaluation of the debtor. But it is relevant to the topic at hand, since it is intended to operate at an early stage too ("at some time before the commencement of the winding up of the company"),[82] although there are relatively few reported cases and relatively few successes.

e. European Union and International Soft Legislation

As regards the European Union, after Recommendation 2014/135/EU,[83] the long-awaited EU Directive on preventive restructuring frameworks, discharge of debt and disqualifications was finally adopted on June 20, 2019.

Article 19 of the Directive provides, in very general terms, that Member States shall ensure that, where there is a likelihood of insolvency, directors have due regard, among other things, to take steps to avoid insolvency. Article 19 does not specify which legislative model or regulatory approach should be used by the Member States to pursue this aim: it allows them to retain flexibility as to the most appropriate means to implement this principle. They could, for example, make use of early warning tools where applicable, and/or seek professional advice, or even introduce specific directors' fiduciary duties toward creditors (in particular, when the company has become insolvent or is in the zone of insolvency).

The underlying rationale of Article 19 is to obligate Member States to impose specific duties on directors in the vicinity of insolvency which will incentivize them to pursue early restructuring while the business is viable. In particular, as stated in the European Commission Proposal, "rules on company managers' duty of care when nearing insolvency also play an important role in developing a culture of business rescue instead of liquidation, as they encourage early restructuring, prevent misconduct and avoidable losses for creditors."[84]

First, the provision refers to "directors," and thus, it applies only to certain business entities (in particular, it does not apply to sole proprietorships).[85] Secondly, comparing its content with that of the corresponding Italian law provisions, it seems quite evident that the Italian Legislator has taken a step forward by introducing the obligation to

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[82] Section 214(2)(b) of the Insolvency Act 1986. *See* MICHAEL J. MUMFORD & ALAN J. KATZ, MAKING CREDITOR PROTECTION EFFECTIVE 51-52 (2010).

[83] Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency.

[84] *See Explanatory Memorandum*, para. 1 ("Objective of the proposal"), of the Proposal for Directive [COM (2016) 723 final], *supra* note 62.

[85] The provision has been partially revised in the last version of the Directive, but without a real impact on the issue dealt with in this article.

implement an appropriate organizational set-up even if the business entity—and, to some extent, the sole proprietorship—is not yet insolvent or in the zone of insolvency.

The scenario would have been slightly different if some of the suggested amendments to the provision on duties of directors had been accepted by the EU institutions.[86] In this regard, it must be pointed out that the UNCITRAL Legislative Guide on Insolvency Law[87] explicitly mentions and recommends a list of appropriate operating steps that directors might take to avoid insolvency or, where it is unavoidable, to minimize the extent of insolvency. These steps include evaluating the current financial situation of the company and ensuring proper accounts are being maintained and that they are up-to-date; being independently informed as to the current and ongoing financial situation of the company; and seeking professional advice, including insolvency or legal advice, so that any decisions taken can withstand objective and independent scrutiny.[88] The rationale of these UNCITRAL Recommendations seems close to that of Article 3 of the Code and Article 2086 C.c.

Moving to the early warning, Article 3 of the Directive explicitly requires Member States to "ensure that debtors have access to one or more clear and transparent early warning tools which can detect circumstances that could give rise to a likelihood of insolvency and can signal to them the need to act without delay". This provision, as well as Recital No. 22 ("… one or more early warning tools should therefore be put in place to incentivise debtors that start to experience financial difficulties to take early action"), shows some similarities at least with Article 3, para. 1, of

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[86] See the amendments to Article 18 (now Article 19) suggested by the Co.Di.Re. Research Team, which proposed to introduce the following paragraph: "2. The measures expected from directors under paragraph 1 might include, among others: the commencement of honest negotiations with the relevant stakeholders with a view to reaching an agreement, either by restructuring bilaterally the obligations or by using one of the out-of-court tools or proceedings existing in the jurisdiction; gathering and evaluating the financial situation of the business, including, when necessary and feasible, requesting independent advice; increasing communication amongst directors, and between the former and financial controllers and the auditor of the entity; modifying management practice to take account of the interests of creditors and other relevant stakeholders; adopting measures to protect the value of the key company assets; adopting measures to ensure the continuation of the debtor's business when the directors have reasonable grounds for believing that to do so is in the interests of the creditors as a whole; requesting the commencement of formal insolvency proceedings.". *See* Co.Di.Re. Research Team, *Comments to the Proposal for Directive [COM(2016) 723 final]* (2018), http://www.codire.eu/wp-content/uploads/2018/07/Re-drafting-suggestions-for-the-EU-Directive-ver-11-final.pdf.

[87] U.N. COMM'N. ON INT'L TRADE LAW LEGISLATIVE GUIDE ON INSOLVENCY LAW. PART FOUR: DIRECTORS' OBLIGATIONS IN THE PERIOD APPROACHING INSOLVENCY, U.N. Sales No. E.13.V.10. (2013).

[88] *Id*. at 13–14 (Recommendations 255–256).

the Code, even though the real impact of the supranational provision will depend on its implementation by the Member States.

In this scenario, the Italian law provisions may be meant as strict rules, and the perspective of the domestic legislation appears to be broader than that of the European Union.

It is then noteworthy that the Commission Proposal of 22 November 2016, in Recital No. 16, stated that possible early warning tools should include accounting and monitoring duties for the debtor or the debtor's management, as well as reporting duties under loan agreements.[89] This statement, however, does not appear in the corresponding Recital No. 22 of the Directive (EU) 2019/1023.

To conclude and complete the analysis, it is opportune to mention Article 19 of Directive 2013/34/EU, the Accounting Directive.[90] It provides that the management report shall include a description of the principal risks and uncertainties that it faces, and it may be reasonably held that the requirement to disclose the main risks and uncertainties in the annual (and interim) reports obliges companies to install at least a risk and uncertainty identification system.[91] But, again, the scope of the Directive is limited to specific types of undertaking, listed in Annexes I and II, and does not encompass all businesses.[92] Furthermore, according to Article 19, para. 3, it is possible for Member States to exempt small (and micro) undertakings from the obligation to prepare management reports, considering their limited resources.[93]

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[89] *Cf.* STANGHELLINI ET AL., *supra* note 46, at 7 ("While it may be considered very creative and, in fact, euphemistic to qualify personal or management duties as 'tools' that debtors should be given access to and receive concise information about, this approach seems sensible in theory. Its problems lie on the practical side.").

[90] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the Annual Financial Statements, Consolidated Financial Statements, and Related Reports of Certain Types of Undertakings, Amending Directive 2006/43/EC of the European Parliament and of the Council and Repealing Council Directives 78/660/EEC and 83/349/EEC, 2013 O.J. (L 182) 19.

[91] Gaia Balp, *Early warning tools at the crossroads of insolvency law and company law* 24-25 (BOCCONI LEGAL STUDIES RESEARCH PAPER NO. 3010300, 2018), https://ssrn.com/abstract=3010300; Christoph Van der Elst, *The Risk Management Duties of the Board of Directors* 7 (FINANCIAL LAW INSTITUTE WORKING PAPER SERIES 2013-02, 2013), https://ssrn.com/abstract=2267502.

[92] *See* Directive 2013/34/EU, *supra* note 90.

[93] *Id.*

VI. CONCLUSION

To sum up, Article 2086 C.c. and, to a certain extent, Article 3 of the Code may be meant as strict rules. Their rationale is clear and, in principle, shareable if we focus on the main objective of the reform—that is the detection of enterprises' financial difficulties at an early stage and the prevention of insolvency.

Some issues and doubts about their effectiveness arise if we look at the side effects of the new domestic rules when the obligation to implement appropriate organizational arrangements, though tailor-made, applies to MSMEs—in particular, to a sole proprietorship, a general or limited partnership, or a non-profit organization.

Apart from the risk of forum shopping,[94] what are these side effects?

Firstly, implementation of the prescribed organizational measures will undoubtedly increase the compliance burden and the normal costs for MSMEs,[95] at least in the short to medium term, whereas Italian entrepreneurs, as a general rule, are far from recognizing the importance of internal control and reporting systems, or the need to plan their business activities. In this scenario, the trade-off between the perceived benefits of an appropriate organizational structure and its perceived costs will be negative—that is, the perceived costs will exceed the perceived benefits.

Secondly, apart from the limited resources of MSMEs, there is a concrete risk of non-effectiveness (or incomplete effectiveness) of the new provisions due to the scarce entrepreneurial incentives to observe the law prescriptions. [96]

Violation of the obligation to implement suitable measures or to establish appropriate organizational structures is not adequately sanctioned by the law, in particular if the non-compliant entity is a sole proprietorship, to whom the legal provisions on duties and liability of

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[94] *See* Giovanni Strampelli, *Verso una disciplina europea dei doveri degli amministratori nella società in crisi*?, *in* AMEDEO BASSI ET AL., LA NUOVA DISCIPLINA DELLE PROCEDURE CONCORSUALI, *supra* note 6, at 637, 642-43. *See also* Irit Mevorach, *Forum Shopping in Times of Crisis: A Directors' Duties Perspective*, 10(4) EUR. CO. & FIN. REV., 523-53 (2013) (for a general discussion on forum shopping by companies in close proximity to insolvency).

[95] *See* Rapporto Cerved PMI, *supra* note 45, at 127-33, where an in-depth analysis of compliance costs for SMEs is carried out. *See also id.* at 134-38, where the report also evaluates the possible positive effects of the new mechanisms to detect financial distress in terms of enterprise restructuring or more efficient liquidation of the remaining assets, and it estimates that the overall benefits will greatly exceed the costs in the event of full compliance.

[96] *Id.* at 129 (explaining that the estimated implementation of measures to detect signals of crisis will be especially low in micro enterprises without a supervisory body, and these enterprises will prefer elementary systems).

directors do not apply, or a general partner, who has unlimited liability for all partnership debts.[97]

In addition, as previously mentioned, the obligation to set up an organizational arrangement is strictly linked to the functioning of the early warning mechanisms and to the scope to detect financial difficulties threatening the continuation of the business early. However, there is not a perfect correspondence, in practice, between those enterprises under the obligation to establish a suitable organizational, administrative, and accounting system and to take appropriate actions and those effectively involved in the forthcoming Italian alert procedures. In Italy, differently from the various *mesures d'alerte* provided by the French *Code de commerce*, the early warning tools consist essentially of a warning notice by qualified public creditors when the debtor has not made certain types of payment (taxes or social security contributions),[98] or a warning notice by the supervisory bodies and/or external auditors of the company. If the business entity has no supervisory body or auditor—that is, it is a partnership, a non-profit organization, a consortium, or a limited liability company that does not exceed certain thresholds—or the debtor is an individual entrepreneur, the latter mechanism cannot be activated. Even among companies, those without any supervisory body are the large majority in Italy.

Thirdly, according to Article 25 of the Code, a business entity that takes prompt and suitable measures in order to overcome financial difficulties would have non-negligible advantages, in terms of exemption from personal liability and criminal offences (or penalty reduction), and reduction of tax sanctions and interest rate. The adoption of a clear-cut organizational structure is a prerequisite for taking prompt and active steps and, thus, to benefiting from such advantages. But Italian entrepreneurs are traditionally reluctant to reveal their financial difficulties spontaneously and address them openly, or to draw the obvious conclusions emerging from their financial statements and accounts. Apart from socio-cultural factors and the typical features of Italian undertakings—the separation between ownership and control is very uncommon and the number of owner-managers is considerably high[99]—

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[97] *See* Di Cataldo & Rossi, *supra* note 16, at 751.

[98] The most common and valid criticism of this alert tool is that by the time the qualified public creditor highlights any serious delay in payments, insolvency has already kicked in. *See* Roberto Fontana, Hearing before the Second Commission (Justice) of the Chamber of Deputies, *Indagine conoscitiva in merito all'esame dello schema di decreto legislativo recante codice della crisi di impresa e dell'insolvenz*a (Dec. 4, 2018), *supra* note 24, at 9-11.

[99] *See* Alberto Jorio, *Su allerta e dintorni*, 43(3) GIURISPRUDENZA COMMERCIALE 261, 263 (2016-I).

crisis situations produce additional risks for businesses (e.g., a rush to the exit for creditors), thus discouraging the entrepreneur's active role. This reluctance to file for insolvency or restructuring proceedings, or the habit to do so very late, is hard to overcome.

Lastly, the approach of the abovementioned European countries, where provisions on debtor/directors' obligations only affect debtors that are large enterprises or limited companies, confirms doubts about the effectiveness and appropriateness of the new Italian rules.

However, the rigid Italian approach compared to other countries could also have a positive effect. It may lead to a change of entrepreneurial culture and mentality and facilitate the development of a forward-looking rather than a backward-looking approach, by incentivizing the entrepreneurs to plan their business and periodically review their strategic plans. In other words, the introduction of the obligation to implement organizational arrangements could help, in the non-immediate future, to promote virtuous entrepreneurial behaviors,[100] also considering the possible positive effects of the new legislative measures on MSMEs' access to credit.[101]

This, I believe, is the real gamble of the Italian insolvency reform.

[100] *See also* Alberto Jorio, *supra* note 28, at 435.
[101] *See* Rapporto Cerved PMI, *supra* note 45, at 137–38.