

## Considerations for Directors When a Company Is in Financial Difficulty



This quick guide summarises the duties that directors of companies incorporated in Italy are subject to, and how those duties change when the company is insolvent or at risk of being insolvent.

It also gives an overview of the personal risk to directors when the company is in financial difficulty.

This note is intended as an overview and should not be relied on as legal advice. Should you require legal advice in relation to your specific circumstances, please contact the Restructuring & Insolvency team members whose contact details are at the end of this note.

### Directors' Duties When Solvent

- Directors must fulfil duties imposed by law and company bylaws, with the diligence required by the nature of their duties and their specific competences.
- These duties include the duty to monitor and ascertain the occurrence of an event that would result in the insolvency of the company.
- Since 2019, all companies have been obliged to set up and maintain organisational, accounting and administrative measures adequate to the nature and size of their businesses, to promptly detect any signs of an impending crisis.
- As soon as signs of a crisis are detected, the company's directors should adopt all appropriate remedies to address it and (if appropriate) a voluntary reorganisation, i.e. entering into a composition with creditors, restructuring agreements or extraordinary administration.
- The new Italian "Code for Distress and Insolvency" which should have entered into force in August 2020 and creates new directors duties and liabilities in respect of distressed situations is, due to the current emergency situation, postponed. This will not come into force until 2 September 2021.

### Financial Distress

### Directors' Duties When Insolvent, or at Risk of Being Insolvent

- When a company is insolvent, its directors must preserve the asset value of the company; avoid making preferential payments; not continue trading in a way that would be detrimental to the financial position of the company; and if the statutory minimum share capital is lost, not enter into new transactions.
- Directors must file a petition for insolvency without undue delay, to avoid further worsening the company's financial position; however, due to the COVID-19 emergency, since 9 April 2020 and until 30 June 2020, all applications concerning bankruptcy and insolvency proceedings will be dismissed.  
Dismissal does not apply in cases of:
  - voluntary filings for bankruptcy, when the insolvency is not a consequence of the COVID 19 spread;
  - bankruptcy applications filed as a consequence of (a) a court's declaration of inadmissibility of the arrangement with creditors; (b) interruption of the arrangement with creditors, and (c) rejection of the arrangement with creditors upon request of creditors or the public prosecutor; or
  - bankruptcy applications filed by the public prosecutor (a) together with requests for precautionary or protective measures for the company's assets or the company itself is subject to the insolvency procedure, or (b) when the insolvency situation results from, inter alia, a criminal proceeding.
- If the company is in crisis, the duties of the directors do not shift to the creditors of the company; however, they can be held liable to them.
- Since 9 April 2020 and until 31 December, 2020, in response to the COVID-19 crisis, new measures require that:
  - When preparing the 2020 financial statements, directors should assess the accounting principles of continuity of the business as a going concern and prudence in light of the situation as at the date of the latest approved financial statements.
  - There is no obligation to resolve upon the reduction and a simultaneous increase of the share capital to a figure not less than the minimum required by law, or to transform the company, in cases where there is a loss of more than one-third of share capital and the share capital is reduced below the minimum required by law.
  - In the year after a company has reduced its share capital by more than one-third due to losses, there is no obligation to further reduce its share capital, even though losses have not been reduced by at least one third.
  - The reduction or loss of share capital below the minimum required by law, may not be invoked as grounds for the dissolution of a company
  - Repayment of shareholders' loans are no longer subordinated to the satisfaction of other creditors of the company.



It is important for directors to understand their directors' duties, as well as how their actions and the decisions the board makes when the company is in financial distress could expose them to personal liability, criminal sanction and risk.

Below is an overview of the potential claims and potential exposure for directors if the company is insolvent or at risk of insolvency.

### Liability to the Company

If a director negligently failing to fulfil duties imposed by law or the company's bylaws fails to supervise the general conduct of the company or fails to take appropriate action upon becoming aware of their prejudicial acts, it could result in a civil action for damages.

### Liability to Creditors

A director may be liable to a company's creditors if the company's assets are insufficient to satisfy creditor claims as a result of failure by the directors to preserve the company's assets, e.g. unduly preferring certain creditors to others in breach of the statutory order of priority or continuing to trade in the absence of a reasonable prospect of continuing activities as a going concern.

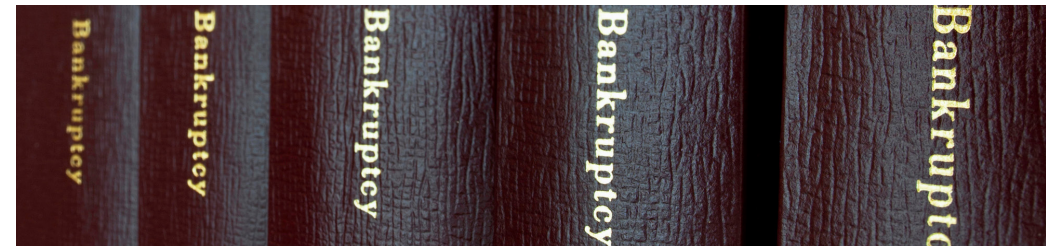
### Liability to Third Parties

A director could face a claim for damages by a shareholder or a third party if they suffer damage as a consequence of the director's conduct.

### Criminal Liabilities

A director could face criminal sanctions if the director:

- Hides the company's crisis and insolvency or continues to obtain loans from credit institutions
- Attributes non-existent assets to themselves, for the sole purpose of being admitted to a composition with creditors or obtaining approval of a restructuring agreement with financial intermediaries
- Simulates claims that are wholly or partially non-existent, in order to influence the formation of necessary majorities to obtain approval of a restructuring agreement



### Fraudulent Bankruptcy

A director may be criminally liable if the director:

- Disposes of or transfers all or part of the company's assets with the intent to defraud creditors of the company
- Destroys or falsifies all or part of the corporate books or other accounting records
- Before or during judicial liquidation proceedings, makes payments with the intent to prefer one or more creditors

### Simple Bankruptcy

A director could be criminally liable if the director:

- Carries out high-risk transactions with the intent of delaying the commencement of bankruptcy proceedings
- Increases the company's liabilities by failing to file a petition for the commencement of the insolvency proceedings when the company was insolvent or over-indebted
- During the three years preceding the declaration of insolvency, did not keep the corporate books and the other accounting records prescribed by law

### Directors' Disqualification

If a company facing a situation of financial distress is admitted to insolvency proceedings, directors remain in office but are no longer allowed to exercise their powers to the full extent. Breaching such prohibition may lead to disqualification from managing a commercial enterprise or even imprisonment.



## Practical Tips to Mitigate Liability

- Directors should exercise extreme caution when selecting payments if there are any signs of insolvency or prospective insolvency.
- Directors should consider how creditors are ranked under the statutory provisions of Italian law and the role that creditors may play in ensuring the continuity of the business.
- Directors should convene board meetings on a more regular basis (possibly as often as weekly) when they can no longer be confident that the company will remain solvent.
- The board should closely monitor the company's financial performance and, in particular, whether that performance is in line with its business plan, KPIs and cash-flow forecasts.
- The board should take even greater care to document its decisions, including the rationale for those decisions, and the information and advice relied upon in order to reach them.
- During board meetings, directors should make sure that any dissenting opinion given in the best interest of the company is reported in the minutes of that meeting, in the record book of the meetings and resolutions of the board of directors.
- The board must avoid carrying out transactions that may cause the dissipation of the company's assets.
- The board should not take any action with the intention of putting a creditor in a preferential position.

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