SQUIRE PATTON BOGGS

# Directors’ Duties – Italy

## 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.
- A new Italian Code for Distress and Insolvency which, inter alia, creates new directors’ duties and liabilities in respect of distressed situations (see Financial Distress box below) entered into force on 15 July 2022. However, new rules introducing alert procedures for companies with financial difficulties are not scheduled to come into force until 31 December 2023.

**Financial Distress**

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

- Directors have a duty to try to overcome the financial difficulties of the company either in the form of continued operations, such as out-of-court or court supervised restructuring arrangements, or by filing insolvency procedures.
- If signs of financial distress that may have a negative impact on share capital are detected, directors must immediately convene a shareholders’ meeting for the adoption of appropriate measures in respect to the financial situation of the company. During such meeting, the directors must share a report on the financial situation.
- 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.
- 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.
- The board must avoid carrying out transactions that may cause the dissipation of the company’s assets.

The new Italian Code for Distress and Insolvency provides that, during the implementation of restructuring agreements with creditors, insolvency regulation proceedings and the preceding negotiations, directors must ensure that the company:

- Explains the company’s situation in a complete, truthful and transparent manner, providing creditors with all the necessary information appropriate for the crisis or insolvency regulation instrument chosen.
- Takes appropriate initiatives for the rapid settlement of the procedure in due time, in order to safeguard the rights of creditors.
- Manages its assets during the crisis or insolvency regulation proceedings in the priority interest of creditors.

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.
- Great caution should be taken before making any redundancy plans or taking serious structural decisions for the company

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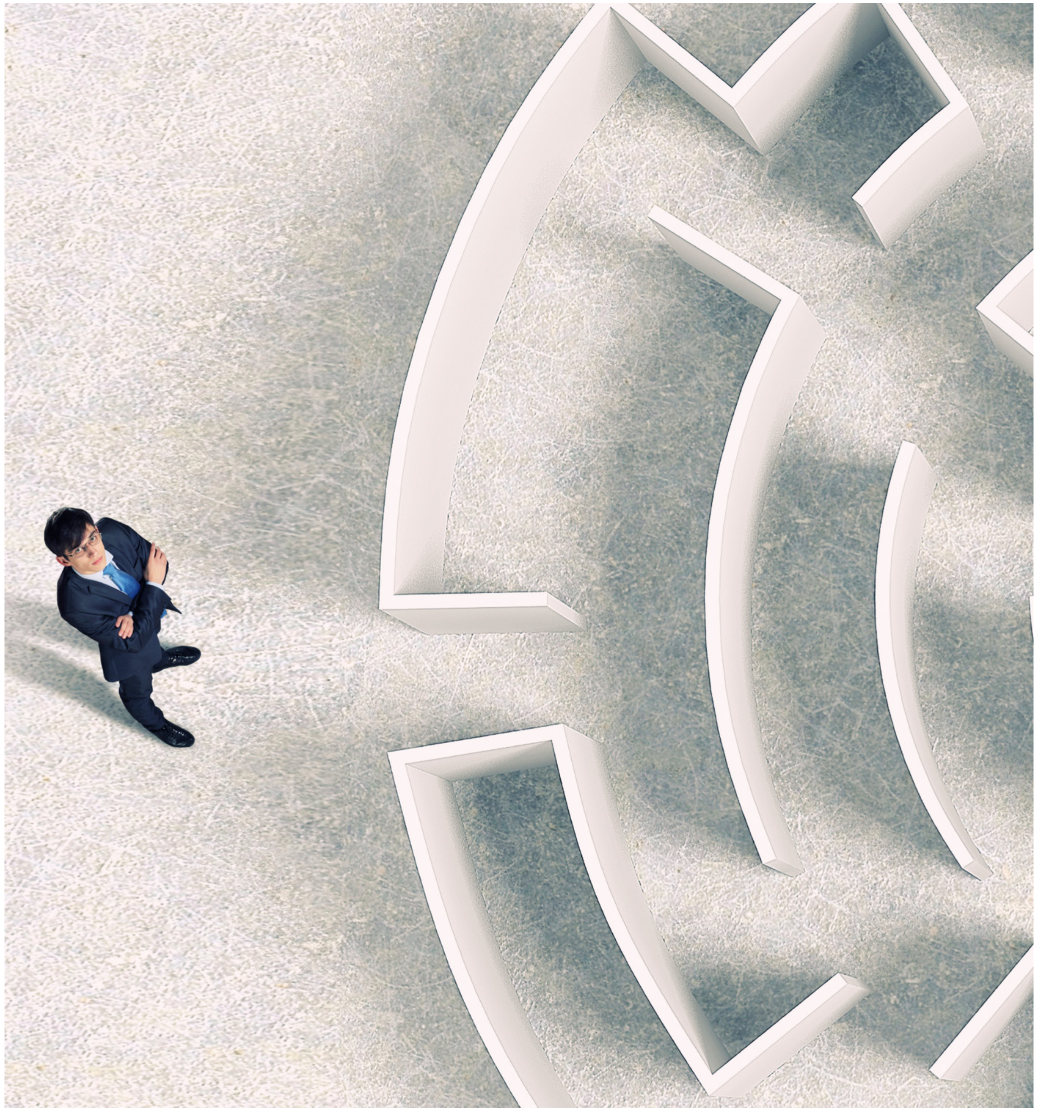
## Contact

**Ian Tully**
Partner, Milan
T +39 02 1241 27702
E ian.tully@squirepb.com





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