

The Reform of the Italian Bankruptcy law and the Uncitral Insolvency Guide Law

by Lucio Ghia

I – Discipline for the resolution of crisis of enterprises

The view over enterprises in default and their management is the variest. It is hard to state if the regime applicable to such cases is unitary, actually there is not any.

In the course of the works held by the Trevisanato Commission for the reform of the bankruptcy law, a preferential way was dedicated to reach results whose impact would have been compatible with the Italian system. First of all we are focusing the values and the objectives to protect also through the work dedicated to the enterprises' reorganization.

We remember an historical period in which the objectives and the enterprises' reorganization were started focusing on the social-economic solidity based upon the maintenance of the employment, and that's the reason why many and substantial interventions were made.

After that a first rumour, also considering that foreigner investments' in Italy could have been increased, proposed to consider the creditors as through the solution of the enterprises' crisis the investors' interests would be fulfilled.

As a consequence of the influence of the British and US models, the core of the matter was identified with the opportunity to save the value of the enterprise considered as the capacity to produce goods and services. If the economic results due to the continuation of the activity would improve, the enterprise's reorganization should be planned.

As a consequence of the efforts to save the economic capacity of the enterprise is the protection of the creditors' interests under several aspects.

For first the value of the economic power of the enterprise should be calculated under the aspect referring to the economical balance between expenses and incomes in production more than the results of the liquidation of the assets. Moreover we should wonder if the difference could be nullified by the sizeable operating expenses or the ones related to the reorganization itself; and secondarily if the advantage made by the presaid difference comes to the creditors.

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All the operations made to reorganize the enterprise should answer positively to both the questions, and debtors and creditors should cooperate: no reorganization should be thought without a relevant role played by creditors.

Even the agreements made between creditors and debtors meet some obstacles to their application. Agreements to remove the crisis, to save or reorganise represent, under a legal view, non-typical agreements, most of them are bilateral, as on one side there is the debtor on the other there are the creditors.

Some of the most renowned author, as for instance Prof. Guido Alpa, refers to those bilateral agreements as to a whole and the parties will provide to enforce the agreements apart from the legal renewal of the same.

The reorganization will be the result of following consents to those agreements and many experiences abroad are directed to improve their adoption, as for instance, the *London approach*. It does not fix any rule, it points out general principles directed to facilitate the agreements between creditors and the debtor for the case the reorganization of the enterprise and its business to be continued are preferred to its liquidation.

In any case, the deepest analysis of the economic and financial states of the company is essential as for the ancient italic maxim for which “the debtor always knows something that his creditor ignores”. The most of the times many difficulties arise for the fact many securities encumbering the collaterals damage the unsecured creditors and their visibility is not full.

The agreements are headed to reduce the business illiquidity and the debt also through the provision that credits could be temporarily uncollectable. Other provisions in order to reorganize the company were made, as for instance the opportunity given to Italian banks to turn up to 15% of their credits’ amount into venture capital, or postponing the credits. These are provisions through which to improve the enterprise’s financial resources also considering primarily the creditors who did not subscribe the reorganization plan since the plan itself was started, and secondarily the payments to those latters to eliminate their objections by acquiring their credits.

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II – Roles and responsibilities in the reorganization.

The duties and the liabilities of the extraordinary commissioner entitled to enact the reorganization plan should be identified and responsibilities referring the management should stay separated from those referring the previous direction of the company. A further very sensitive topic refers to the necessity to provide creditors continuous information, to ensure transparency to all the operations in the conduct of the plan so as the ones representing the debtor will not be encharged for *mala gestio*. On behalf of the professionals involved with the reorganization specific provisions of protection must be held for the case of future claims for liabilities.

Moreover the provisions regarding the eventual judicial proceeding filed by those opposing the plan and the case the agreement must be terminated are necessary.

Considering the section 1322 of the Italian Civil Code, it is necessary to know by the national legal system if the agreement providing the reorganization plan has its own legal protection or not, for being the agreement itself deputy to defend the objectives as fixed at sect. 39 and 42 of the Italian Constitution. The answer is not unitary and it is given considering the results obtained (or not): if the reorganization as a result of the content provided in the agreement achieves its aims, the agreement both against creditors and third parties cannot be changed; for the case the agreement failed the reorganization, the bankruptcy judges and the public prosecutors might point out in the reorganization plan contents *contra legem*.

One more relevant topic refers to those professionals involved in the reorganization's plan as they will have to exclude their own personal liability. As an example, we could refer to the default involving the Italian company dealing with fabrics Trevitex and the local authorities, trade unions, mass media, shareholders of the Ravenna Football Team in the Nineties'. They all supported a pool of Italian banks to finance a reorganization plan for a total amount of 100 billions liras, which have to be added to the 800 billions liras already disbursed by banks. The reorganization plan failed and the CEO and the directors involved were summoned in a trial as the bodies liable to have contributed to compound the default through illicit loans. The civil action was then transferred into the criminal proceeding the public prosecutor had filed against the company's executive officers and shareholders.

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The executive officers and the chairmen of the Italian primary banks were charged of bankruptcy offence. At the same time Trevitex shareholders filed a claim for *mala gestio* against the banks involved and charging the officers of embezzlement, of superficial management, of behaving as *de facto* shareholders. In the shareholders' opinion the company default was a direct result of the management of the officers. If on a side there was a proceeding filed against banks to have stopped financing the company, on the other we had the opposite case of financing the company through illicit loans.

The acceptance made by banks' officers and managers could be the premise for further claims as public prosecutors individuated in the presaid acceptance given by the institutional creditors, a sort of intervention in the management of the restructuring company especially for the case a report delivered to the banks by the company containing reference to decisions to be taken on the management, and for that considered as a proof, was discovered.

It is necessary to highlight the judgment n. 5045 issued on 27 april 2004 by the Civil Court of Milan (in which about fifteen banks were summoned for the company default to recover the damages for *mala gestio* and for illicit loans), which faced the topic under a civil point of view. In the reasons for the decision, the liability of the banks was excluded and a series of main points were fixed in order to exclude the management liability on behalf of the financing banks. Moreover the judges considered the positive evaluation given to te reorganization plan on behalf of the Bank of Italy as fundamental. The Bank of Italy, as provided in the legislative decree n.385/1993 providing a domestic unitary discipline for banks, will have to give an advice on the activities held by the banks intervened to restructure the enterprise in crisis.

In the building of the reorganization plans and of infra-banks agreements great attention has to be dedicated to distinguish the assets from the management, to nominate the board of creditors, to fix roles and rules, and the matters on which creditors have to decide will be highlighted; it will be necessary also to consider the different majorities expected to decide on different topics as the market runs fast and wasting time is forbidden.

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III - Obstacles in the legal system for an efficient and effective reorganization.

The specific obstacles have to be inserted into a wider scenario which makes the reorganization more difficult. With regard to the debtor for the case the enterprise is a subsidiary, the lack of rules governing the group of companies added to the judgements related the liability of the holding company are elements to consider.

Recently in Italy the principle renewed as “piercing the veil” (born and adopted in USA) was accepted and the holding has got the opportunity to intervene into the management of the subsidiaries of the group because the strategy of the group may assign a role to each company.

On the example yet given by the US Courts, recent judgments issued by different Italian Courts renewed the liability of the administrators of the holding towards the creditors of the subsidiary considering both the internal policy issued by the whole group and the advantages and disadvantages the subsidiary received being part of the group itself.

A further obstacle to the reorganization of enterprises in default is the multitude of the creditors and the different privileges they hold as regulated by the Italian civil code. In examining sections 2745/2748 of the code, there are about 40 different types of priorities and in addition to these several types of special priorities as defined in many rules and related to specific categories of goods, have to be taken into account. As far as ham and cheese can be encumbered with priorities registered by the banks financing that kind of business and as a consequence it will not be unusual to find onto Parmesan cheese and S. Daniele ham numbers referring to the registration.

Such a system has also been extended to machinery, ships, aircrafts to secure the rights of the manufacturer and it makes the secured creditor be interested to protect a position he yet held through a prompt liquidation, instead of financing the reorganization by providing the amount necessary.

The banks and other financing bodies who would like to help the enterprise to be reorganized by providing the financial sources, will have to consider the status of the secured credits, if the assets owned by the enterprise are fully encumbered and the ranking of the priorities in order to stay aware of the effective conditions of the debtor.

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The legal origin of the major part of secured credits makes not easy to realize agreements between creditors for giving a new negotial discipline for secured credits, to accept the reduction of the due amounts or to set free some strategical assets or to accept their substitution .

The nations whose legal systems provide a limited discipline for the priorities' ranking, use to rule the securities on an agreement base; the priority is the result of the agreement held between the creditor and the debtor, and the advantage is that the ranking of the securities is ease to screen through the adoption of a regime of publicity based on registers: though the ranking of priorities is the measure of the financial solidity of the company and the index for being the company considered. In this framework the principle known as *par condicio creditorum*, contained in sectt.2740/2741 of the Italian Civil Code, represents a further obstacle to the reorganization as the rights owned by different creditors are different enough to justify different treatments. For the presaid reason the new Italian discipline (Decree Law n.35/2005 on competition, then converted in Law n.80/2005) dealing with companies' reorganization provided different classes of creditors, each assembling creditors whose interests are homogeneous.

Agreements for companies' reorganization, held between debtors and creditors, also under the Italan system, will not have to treat equally the creditors belonging to the same category, both secured and unsecured. Everyone will have to value if preferring to support the reorganization of the company in default through postponements, deductions, deferments, discounts relying on the future renewal of the activity and on future earnings from a restarted bussiness, instead of facing the risks, costs, and time occurring for the liquidation of the assets encumbered by the guarantees. In Italy the sales of the assets encumbered are made under the control of the Courts and such a system involves to spend a lot of time for the sales to be held.

A further well known obstacle is represented by the unbalance existing between the venture capital, the whole amount of the debts towards banks and other financier bodies, and the average related to that kind of enterprise operating on the market, should be deeply examined.

The presaid statement is justified for not existing within the Italian system the concept of *house bank*, i.e. the bank dealing with the client/enterprise for the whole financial operations held by this latter and re-transferred to different banks, each of them providing specific services.

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On the other hand, Italian enterprises usually refers to different banks, each one providing services of the same kind. For the case of default of the enterprise, if on one side the Italian system advantages the banks by providing the instruments to mutual assistance, on the other it keeps on ignoring the necessity of a more confidential relation between financier and client and of a wider view on the debts of the enterprise. With regard to small business representing the major part of the national incomings, the US system appears as the way the clearest and the most effective for a reorganization plan.

IV- The new contents of the reform of the Italian Bankruptcy Law.

Through this brief report I would like to highlight the guidelines of two important issues coming from my personal experience. The first one, ended just a few months ago, concerns the **Reform of the Italian Bankruptcy Law** of which the Commission Trevisanato, chairman of the commission, was uncharged to elaborate a text. The Commission has finally handed over the Minister of Foreign Affairs, a plentiful documentation and a reform bill based also on foreign experiences. As a member of this Commission, I would like to underline that after our work, many Italian legislative institutions began to take into consideration such important documents and recommendations. So, at the Senate many professional men have been working on a text know as “Caruso text”; at the Presidency of the Cabinet a bill related to “competition” has been elaborated and enacted through law decree 14 March 2005 no. 35 as converted in law no. 80/2005.

Many issues that this decree analyzes come from U.S. experience. For example, the American “discharge” has been the purpose of a long studying among the Italian commissioners, who tried to “italianize” such institute. In fact, the new discipline gives the possibility for the insolvent debtor to restart as a consumer and as an entrepreneur. The complex and previous rigid rules on the “esdebitation procedure” and on the “rehabilitation” have been now substituted by the necessity for the debtor, in order to obtain the discharge, to co-operate with the insolvent administrator and maintain a correct behaviour during the procedure. However, some doubts remain on the automatic discharge adopted without the necessity to achieve a minimum percentage, through the liquidation of the assets, in the payment of creditors.

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The new procedure adopted by the legislative in the reorganization, is more flexible and gives the possibility for an arrangement between the debtor and his creditors outside the Court. It is a regulation inspired to the “pre-packaged reorganization” typical of the U.S. experience. These and other new rules for a more effective and efficient liquidation or reorganization are included in this law decree 14 March 2005 no. 35 as converted in law no. 80/2005. This represents the legislative answer to make more competitive and attractive the judicially discipline of insolvency situation, in state of administrative solution assured by special legislation improved in the last years.

In these last years, in fact, Italy is distinguishing itself, especially on the international field, for its engagement to extend the management / extraordinary proceeding to trade areas until now excluded from this application. The Italian legislative, since the enactment of Law no. 270 / 1970, know as “Law Prodi bis”, through the recently modification of Law Marzano (Law no. 6/2005 know as Marzano bis), has covered many jurisdictional insolvency’s areas; in other words, a “work in progress” has been enacted which drives judicial insolvency procedures to extraordinary proceedings and to lost fund financing. The Government, in case of big companies insolvency, does not intervene anymore through the fund but through the commissioners!

This is not the time to ask ourselves why this is happening, but it is however important to realize that more time will pass by and less words will be spent for non judicial bankruptcy.

The Italian legislative, however, through law decree 14 March 2005 no. 35 as converted in law no. 80/2005, still maintains its own regulation on insolvency characterized by typical objective and subjective profiles. As a matter of fact, in the U.S. system almost all debtors are subordinated to the insolvency declaration. On the contrary, in accordance with the Italian rule, professional men, artists, non entrepreneur are not subordinated to bankruptcy. If we move on and analyze the limit under an objective profile, we may see how the Italian regulation was modified several times: At the beginning, law no. 95/1979 known as law Prodi bis provided *i*) a bankrupt liabilities amount higher than two thirds of the assets and profit and *ii*) a number of 200 employers; today, law no. 6/2005 (Volare Airlines SpA) provides an *i*) indebtedness of 300 million of euros and *ii*) a number of 500 employers..

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Through this brief statistics, it is easy to understand how big and medium companies today can accede to the extraordinary procedures. It is under this profile, as I said before, that Italian legislative distinguishes itself respect the international view which tries, on the contrary, to uniform all the procedures and filed them with the Court.

I would like to remark that in front of a company in crisis, it would be easier to find “new finance” if we decide to reorganize and maintain the company in the market rather than obtain new resources through the Government.

The Government in fact, intervenes through its extraordinary commissioners, the Minister for the productive activity, its committee of control and, above all, through the automatic stay *sine die* of all the creditors. This approach, based on the recourse of extraordinary management, is difficult to be accepted by the European rule and the way to apply this system, under the international side, is not smooth. In fact, the European commission does not allow avoidance actions during reorganization proceeding permitting such actions only in case of liquidation.

V) *The UNCITRAL Insolvency Guide Law*

The second issue that I would like to consider, concerns the “Insolvency Guide Law”. This Guide has been elaborated by the *UNCITRAL – United Nation Commission on International trade law* – through mandate of the General Assembly, and was published last November 2004 after four years of hard studying. The text is composed by a collection of complete guide standards and recommendations for the Study of all the United Nation State members so that they may modify their national law in accordance with common European principles.

The *Uncitral Insolvency Guide* represents a four years study made at the *UNCITRAL – United Nation Commission on International trade law* – a permanent commission composed by hundreds of delegations of State members, and non governmental organizations specialized on international trade, saving protection and company in crisis. Among these institutions a relevant role is played by the International Monetary Fund and by the World bank.

This hard study work gives us today the possibility to analyze the Italian regulation, related to company in crisis and creditors protection, in a larger view based on the study of the economic situation of all the other State members.

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UNCITRAL work is usually realized through different legislative means such as the model law or the guide law. The *model law* has a more rigid structure and an articulated regulation. The national legislative can utilize the entire text or just a part of it and modify it in order to better adapt it to the national regulation

The legislative *Guide*, on the contrary, is characterized by a larger and more elastic structure. The working group on insolvency chose to spread its work through the publication of a *Guide law* on November 2004. Today, this *Guide* is beginning to make its first steps into bigger areas such as the international performances made in favour of the legislative of the 190 United Nation State members. The work inside the *Guide* is divided in two parts, the first one more descriptive, the second one composed by 192 recommendations. The *Guide* represents, therefore, an extremely rich patrimony of international experiences and offers to each national legislative the result of the international studies collected into a sole compilation, and a collection of “best practices” on the basis of the legislative and praxis experiences made in these various countries. In other words, the *Guide* represents a study of optimum behaviour, efficient and effective procedures whose roots come from England and U.S. to which the national legislative may draw in order to enact new rules and up date the old legislation, as the Italian one, unable to assure new instruments and to give actual answers to creditors and companies’ expectations.

On the insolvency view, the disappointed results obtained by the Italian creditors are sadly known. This frame discourages, of course, international investments whose percentage reaches a maximum 15% level. However, through the enactment of the new regulation on competition (law decree 14 March 2005 no. 35) we believe to reach better results.

It is important to consider the FIRST QUESTION the UNCITRAL Guide highlights. The national legislative will have to ask himself what values are important in accordance with each specific historical period, and how these values might be protected. Several times, Italy has tried to conciliate values in conflict through the recourse of insolvency proceedings, but today such procedures are not anymore able to contemporary satisfy all the interests involved.

Law no.167 / 1942 was enacted in order to face problems related to social matters, and defend stability and local matters.

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Sometimes this law was sacrificed so as the economic logic which governed the ability of companies to stay in the market, and their competition has usually been subdued for different needs. This crisis often brought the company in crisis into an insolvency condition.

The bankrupt company suffered an economic loss bigger than the damage that the company would have suffered if faster and immediate liquidation means were utilized. UNCITRAL gives us the opportunity to realize that a company in crisis cannot give positive answers if first, it does not resolve its own economic and financial problems. Today, in Italy, a different approach comes into light with Parmalat group default and more recently with Volare Airlines S.p.A. default.

At the beginning, the Government intervened in order to support the companies in crisis through several financial resources and lost fund interests, but creditors' interests still did not receive enough protection. This kind of choice made by the Italian legislative discouraged foreign investments and increased the "country cost". We have to realize that also under the trade-union pressure, and the social stability needs, our country protects more "the credit" so as the interest of institutional creditors. If their expectations related to the invested capital return are discouraged by procedures which do not deeply care about their claims, we cannot then moan that the research for a "new finance" becomes extremely difficult.

The Insolvency Guide highlights a SECOND QUESTION: how may creditors' interest be protected, in particular those creditors who have suffered a company crisis. The company's value represents the ground where all the claims are compared. The Guide puts into light more questions consequently suggesting the respective answers. How do we know which is the best solution in order to protect creditors' interests? Should the company be liquidated or should continue its business in order to better protect their interest?. The chosen procedure will give pragmatic answers.

As we know, if in accordance with the continuation of the production during the reorganization proceeding, some assets, such as immaterial goods, projects, trademarks, company start, know how, technical and operative employee quality, will continue to maintain their values, these same assets, during the liquidation, will be swept away.

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These kind of choices therefore require more examination and put into light the necessity to ask for more questions such as the following. What value will be taken into consideration respect the creditors expectations in case of reorganization?

What will be the economic results for creditors in case of liquidation? The examination of these two results should direct us toward the best procedure to chose in order to handle in the best way a company crisis.

Another relevant matter described in the Guide is the costs of reorganization and liquidation. These costs, under the UNCITRAL recommendation, will be fixed by the Court and will definitely direct us toward specific and immediate solutions.

The Insolvency Guide analyzes, then, the kind of proceeding that might be chosen (reorganization / liquidation). Creditors must decide what procedure apply. Through the use of “best practices”, it is possible to elaborate a fast, feasible and less bureaucratic proceeding which might be filed outside the Court (It is the case of pre-packaged reorganization). The Court has the only task to resolve contrasts in case creditors do not reach an agreement or if a minority of them claims because of a worse treatment respect the majority. In such cases the Court will be called to decide nothing else than the controversy. All the proceeding matter will be instead conducted by the insolvency administrator (the equivalent of the Italian receiver) who will have to continuously talk with creditors in order to protect the company’s value and resolve the related problems. Creditors assume a main role in both cases (reorganization / liquidation). They will initially take the decisions and they will control during the reorganization that this chosen proceeding represents the best choice for all the concerned time. Creditors’ minority who disagree to the plan will have to accept that program as a duty imposed by the judge.

The insolvency Guide highlights the importance to protect the new finance which supports the reorganization of the company in crisis. The guide suggests to introduce *super-priorities* (in Italy known as “garanzie prededucibili”) in order to protect and encourage the new finance, which supports the reorganitazion of the company and assures the real satisfaction of these credits.

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The ability to affect on the already existed interests, means especially for Italian professional men to stand outside the code standards, such as the *par condicio creditorum* and the lien order in accordance with sec. 2740 2741 of the Italian civil code.

This is the reason of the increasing, in the U.S. reorganization, of specific different capitals, also related to far countries. For example, in the reorganization of some air companies, the necessary finance has been bought by Japan Indonesia, Korea as specialized banks in credit risk who believed in the U.S. insolvency system and in the possibility to protect creditors.

The assignment of these credits are supported by specific contractual provisions related to i) the control of the proceeding and ii) to the regularity of the reorganization plan for an eventual security performance. This system offers to our legislative many elements in order to study the Italian insolvency reform in part planned by the law decree 14 March 2005 no. 35. The Guide gives also many recommendations on the liquidation matter.

The bankruptcy liquidation issue is deprived by all the inquisitor conduct respect the bankrupt, natural or artificial person, often considered guilty and responsible for incorrect operations. On the contrary, this proceeding is now characterized by economic aims: how to reach the best result for the creditors or what procedure may give optimum results for the creditors list.

The acceleration of time of liquidation depends on the ability of the insolvency administrator to search for the requesters. These last, pragmatically estimate the assets, and indicate their value. The Guide discourages the utilization of long and expensive analysis on the assets which at the end of useless sales find their own market price. More important, the liquidation of the assets does not provide any lack of time. This approach represents an important news for our regulation which, on the contrary, in accordance with the Italian bankruptcy law, imposes first to sell the assets, complete the valuation of all the credits and define the elaboration of the bankrupt liabilities. This phase in case of a high presence of creditors may last for several years and for such reason the assets may be remain unsold. The Guide, instead, pragmatically suggests to sell immediately the assets under the control of the Court.

There would be many other recommendations outlined by the Guide that will be explained in another moment.

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Sooner or later, the Italian legislative will have to deal with this new U.N. regulation. Schematically, I can say that the Guide does not suggest any subjective exemption from the bankruptcy proceedings neither provides objective exemptions or special procedures except for a few particular cases related to banks and insurance institutes. Outside these exceptions, only one procedure is provided by the Guide: the reorganization or the liquidation proceeding.

The legislative Guide, describes the insolvency proceedings and the proceedings coming from developed countries, as “best practice” to follow. Obviously, the American model has an important influence over all the other countries but needs, for the company reorganization, specific capitals to be collected. As a matter of fact, it is amazing to see how in U.S. a part of the capital comes from foreign markets, such as Japan, Indonesia and Korea. The insolvency procedures, therefore, need to obtain a “new finance” also through the placement of specific financial products.

Moreover, the American insolvency system is also characterized by organizations able to liquidate any bankruptcy asset to be taken in block and consequently be placed separately on the market. Specific professional qualities therefore characterize the U.S. insolvency procedures.

We should ask ourselves, now if this American system, to which all the European State member try to get close to, may also be applied to countries characterized by weak economic stability such as South of America or Africa. Under my point of view, this regulation cannot be indifferently be applied in block but, in order to reach the positive planned results, it needs to be modelled in accordance with each country’s peculiarity.

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