

## **The Italian bankruptcy law reform<sup>1</sup>.**

1. The recent reform of Italian bankruptcy law was accomplished by the Government in two phases. The first one referred only to the discipline of the pre-insolvency procedure of “concordato preventivo” (composition with creditors) and restructuring agreement. This phase also reformed the avoidable transfers discipline. The second phase was directed to the liquidation proceeding (fallimento).

The first part of the reform was settled by the decree of March 14<sup>th</sup> 2005, n. 35, confirmed by the Act of May 14<sup>th</sup> 2005, n. 80. These rules are already in force. The second part was accomplished by the Government decree of January 9<sup>th</sup> 2006, n. 5, according with the Act 80/2005. This second part will be in force from the July 16<sup>th</sup> of this year.

2. The reform changes the discipline established by the 1942 Act in many important ways, but many parts of the old law are still in force.

The main purposes of the reform were:

a) to increase the possibilities of an agreement between the entrepreneur and creditors to restructure the enterprise or also to settle the insolvency.

b) to facilitate access to the Court and encourage an agreement among creditors. The aim was to remove all the difficulties to such agreement according to the old law. It was recognized that the banks were not inclined to finance the enterprise restructuring because their payments on their loans could be recovered like avoidable transfers in case of bankruptcy. The banks were also exposed to suits for damages from other creditors because the financing could be considered unfair prolonging the enterprise's life according to the insolvency situation. Also the suppliers were not inclined to supply the restructuring enterprise because the payments could be recovered like avoidable transfers in case of bankruptcy.

c) to create procedures for restructuring through a composition with creditors to settle insolvency in the creditors' interest. The previous system was intended to admit the entrepreneur to the agreement procedures only when his conduct had been fair. Because of this, many times it wasn't possible to save the enterprise even when an agreement could be useful for the creditors.

d) to reduce the judge's power in the procedure and to increase the creditors powers. The slogan is more power to the market and less power to the judge. In the new liquidation proceeding, the trustee can decide how and when sell the goods, but he needs the authorisation of the creditors committee.

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<sup>1</sup> I am grateful to Judge Charles G. Case II who revised the English text.

e) to reduce the number of bankruptcy cases, reserving the procedure to serious insolvency cases, and to avoid the excessive length of proceedings and the resulting lower distribution to creditors.

f) to eliminate the incapacity consequences for the debtor after the procedure's end and to accord him the discharge if he is a physical person.

3. To reach these objectives the new agreement procedures provide:

3.1 The "concordato preventivo" (composition with creditors) procedure. The entrepreneur may ask the Court to be admitted in an insolvency case when the enterprise is only in a crisis situation and not technically "insolvent". The law doesn't say when there is a crisis situation, but generally we can say that this situation occurs when there are financial or economical difficulties in the enterprise managing which have not yet reached insolvency. That means that it is possible to ask to be admitted to the procedure when it's still possible to reorganise the enterprise and reach an agreement with the creditors.

The law does not require that the entrepreneur's previous conduct must have been fair, but the entrepreneur must present a turn-around plan providing for restructuring of the debt. This plan may provide for payment to creditors in different ways, including attributing to the creditors stock options that change their debt capital into risk capital. If this approach is taken, the assets are transferred to a different enterprise ("assuntore") that will pay the creditors.

Creditors may be divided in classes, according to the legal and economic nature of the debt; classes may then be given different treatment. In any event, secured creditors (in Italy there are many more secured creditors than in U.S.) must be totally paid.

The entrepreneur must always present an expert opinion on the feasibility of the plan.

The Court does not have the power to examine if the debtor's plan is well founded. The Court may only check if the procedure has been fulfilled according the law. But the Court must check if the classes were well formed according to the law and the nature of the debt. In the first few months of experience, some Courts decided they had the power to control the feasibility of the plan, but probably these decisions were suggested by the old law habits. The former discipline provided the Court's power to control the plan's feasibility, but now the law is sufficiently clear. Many Courts decided that they had the power to control if the creditors had sufficient information about the feasibility of the plan and if the expert report provided complete data to make a serious judgement to permit the creditors to vote.

The judgement on the proposal's merit is reserved to the creditors who vote on the plan. Only the unsecured creditors may vote. The secured creditors do not vote

because their credits must be completely paid. The plan is approved if the simple majority of the creditors according to the amount of debt is achieved. If the proposal divides the creditors in classes, all classes must approve the plan.

The debtor's admittance to the procedure stops the enforcement of claims and the administration of the debtor's assets is controlled by a judicial administrator ("commissario giudiziale") appointed by the Court. The administrator must prepare his report on the plan before the creditors vote.

After the creditors vote, the Court must approve the agreement. Creditors and also other people who can be affected by the agreement can request the Court to reject the agreement. In this case and also when the proposal divides the creditors in classes, the Court has the power to examine the plan. If a minority of the classes voted against the plan, the Court may use the cram-down and approve the plan if the creditors who voted against will receive not less than they could receive with other possible crisis solutions, generally with liquidation procedure.

The law provides that the procedure must last not more than six months. The Court can prolong this term for sixty days.

3.2 The Consensual Restructuring Agreement ("Accordi di ristrutturazione dei debiti") is a new procedure introduced by the Reform. It is not a judicial proceeding, because the debtor must reach an agreement with creditors without the legal protections against enforcement of the creditors' claims, but when the Agreement is fulfilled the debtor may ask to the Court to approve the Agreement. The only consequence of the Court's approval is to exempt the payments made according to the Agreement from the avoidable transfers' discipline.

The Consensual Restructuring Agreement must be approved by 60% by value of claims. The debtor must present an expert opinion on ability to pay 40% of remaining claims when due, on the terms provided by the original contract. These claims are not affected by the Agreement. For this reason the creditors who did not approve the Agreement may challenge before the Court by requiring verification that their claims may be normally paid. Only if this condition is accomplished may the Court grant the exemption from the avoidable transfers discipline.

The Consensual Restructuring Agreement is a new procedure. The law says that the Agreement is enforceable when it is published in the Register of Companies, before the Court's approval. So the Agreement should remain enforceable for those creditors who gave their approval even if the Court rejects it, thereby not granting the avoidable transfer discipline exemption. For this reason, creditors will probably sign the Agreement only conditioned on the Court's approval.

3.3 The Turn Around Plan is not a judicial procedure; it is a creditors agreement founded on the consensual restructuring of the enterprise, without a moratorium

provided by the law. The agreement may provide the enterprise reorganization or also the liquidation and the insolvency or crisis settlement.

Also in this case if the debtor provides an expert opinion on “reasonableness” of the plan, the law accords the exemption from the claw back of payments made if bankruptcy is declared.

The expert’s appointment must be done by the Court when the debtor is a corporation or is quoted in the stock exchange market. The law is new, so it is not possible at the moment to know if the Courts in case of avoidable transfers actions made after the bankruptcy opening, will decide that the payments will be exempt from the claw back in any case or only when the expert’s report will be considered complete and fair.

4. The bankruptcy procedure is always a proceeding founded on the enterprise insolvency. Italy does know an insolvency procedure outside the enterprise law. To open the procedure always requires a finding of insolvency, but the Reform is trying to reduce the number of the bankruptcy proceedings by:

1. requiring that the debtor is an enterprise which did investments for more than 200.000 euro in capital or had gross earnings in the last three years of more than 300.000 euro for each year;

2. requiring that a creditor files a bankruptcy petition state that all the creditors’ claims are not less than 25.000 euro;

3. establishing that the Court can decide not to verify the creditors’ claims after the bankruptcy procedure opening when there are not assets to pay any of the creditors, except for the procedure’s expenses.

4.2 In order to induce the debtor to reach a creditors agreement before insolvency, after the bankruptcy procedure opening the debtor is not allowed for six months to propose to his creditors a creditor’s agreement. In the meantime each creditor, other interested people and also the trustee can propose a creditors agreement in this way:

- Shortly after declaration of insolvency a compromise can be proposed by creditors and third parties
- Secured creditors must be offered an amount resulting from the proceeds of the “secured” assets
- No voting rights are admitted for secured creditors.
- The agreement must be approved by the majority by value of unsecured creditors.
- The creditors division into classes and cram down are provided.
- Benefit of claw back actions may be transferred to a third party

In this way the enterprise may go on with another entrepreneur. The debtor is thus encouraged to reach a reasonable agreement with the creditors, because otherwise the creditors or a third party could decide that a different crisis solution could be reached through the compromise proposal after the bankruptcy declaration. In the meantime this compromise could be better for creditors than the liquidation by the trustee that generally is not able to save the real value of the assets.

4.3 As said before, the Reform decided to reduce the Court's power and to enhance the creditors' power. Before the reform, the judge had control of the procedure. The trustee was required to seek authorisation for his actions from the Court. Also, the legal actions that the trustee was allowed to propose had to be authorised in advance by the judge. In some cases the judge who authorised the trustee to file the action was the same asked to decide the case.

The new law has reduced the judge's power. The Court still appoints the trustee, but the creditors' majority may ask for a different trustee. Also the creditors committee is appointed by the Court, but also in this case the creditors' majority can ask for different people.

All the authorisation powers are now in the hands of the creditors committee. However, the determination of creditors' claims is still made by the Court and also the liquidation program, which is the general plan of the liquidation's activities, must obtain the creditors' committee agreement and the Court's favourable judgement.

There is a great discussion at the moment in Italy about the judges' power reduction. As said before, the reform's reason was to have "more market and less judge" in the opinion that the judge is too far from the market and that many times the requirement for the judge's authorisation may retard the liquidation of the assets. But in the history of Italian law the creditors committee never has been an effective body. In the most cases, the creditors were not interested to be part of the committee and this organ was not able to fulfil the creditors' interest.

Other scholars suggest that only the great creditors, i.e. the banks, would be interested to sit on the committee, to obtain full attention by the trustee to their interests and to avoid actions by the procedure against them, like avoidable transfers' suits and damages suits according to the credit policy used with the debtor.

The law provides a very limited fee for the members of the creditors committee and only when such fee is voted by the creditors' majority. On the other hand, the committee members are liable for their activities and also for control of the trustee's acts. Therefore, it is possible that many people will not agree to be members of the committee. And also the banks may not be interested in participating on the committee, if the liability for the control on the trustee is considered too dangerous.

According to the law, if the creditors committee will not be able to operate, the judge will substitute himself to the committee. In this case an important part of the reform will not be a success.

4.4. A positive topic of the new law is that the trustee has been given much more power than in the past. As we said before, the trustee must have the creditors committee's authorisation, but according with the liquidation program provisions, he can sell the debtor's assets with a great freedom.

In the past, he couldn't sell real estate directly to a buyer. An auction by the judge was required. For the selling of other goods it was also necessary for the judge to give authorisation. Now the trustee can sell all goods without special authorisation, provided that there is a fair value by an expert, advertisement and competition between all the people interested to buy. The trustee may also rent the assets and he must choose to sell the assets as a going concern if possible. If he decides to rent the assets he must choose the renter according also with the feasibility of the business plan presented by the renter, including the number of employees maintained by him.

4.5. As stated before, the Reform introduced in the Italian bankruptcy law the discharge, reserved to physical persons. Legal entities may not receive this benefit.

The discharge is admitted only when the debtor, after the bankruptcy procedure, has paid a part of his debts. The law doesn't establish a minimum percentage of payments to creditors, but it is necessary that creditors receive at least some payment. Further, a discharge is a benefit, so it is not allowed for debtors who were prosecuted for criminal offences against bankruptcy law or did not cooperate with the trustee and other organs of the procedure. The discharge is admitted only for the debtor and not for the obligations of others.

As stated before, the bankruptcy is reserved in Italy to the commercial entrepreneur. There is no insolvency procedure for the civil debtor. So the discharge is not admitted for consumer debts or for the civil debtor also if insolvency is linked to an enterprise crisis, like in the case of the guarantee offered by the owners of the company.

This is a very serious problem. Probably in the future the law should provide a procedure for such cases, but at the moment such a proposal would probably be rejected by the Constitutional Court.

4.6 The reform has removed the incapacity of a debtor who has been declared bankrupt under the procedure. Under the old law, the name of the bankrupt was inserted in a public register and he was not able to practice many professions, including company director, lawyer, public accountant, public notary, etc. Also for five years the bankrupt could not vote in the public elections and could not run for office. Now all these limitations have been abolished.

Of course, the debtor during the procedure must turn over all correspondence regarding the enterprise's business to the trustee and must cooperate with the trustee and the Court, including communicating his address.

4.6 The reform reduced the impact of the avoidable transfers discipline on enterprises. The great number of exemptions introduced by the law and also the limitation of the avoidance to the debtor's acts done in the six months before the bankruptcy opening (12 months for extraordinary acts) means that this discipline now is much less threatening to creditors. Therefore, the Reform decided to protect the certainty of transfers instead of the equal treatment of creditors. Many scholars do not like this choice and think that the Government decided to give a gift to the banks. Anyway, the choice is clear and now we must hope that in the future there will be the benefits: the reduction of the cost of bank financing and also the reduction of difficulties for the banking system to solve financial and economic crises.

5. The bankruptcy procedure is not the only procedure provided by the law in insolvency case. For the biggest enterprises, like in the Parmalat case, the law provides for extraordinary administration. This procedure has not been changed by the reform. It is not possible give a complete explanation of this procedure, other than to say that it is reserved to the biggest enterprises.

There are two different types of extraordinary administration, ruled by the Acts of 1999 (the Act 270/1999) and of 2003 (the Act 347/2003). In both cases, the Court has limited powers and the procedure is administered by an extraordinary administrator appointed by the Government. In the first proceeding, the Court may open the procedure on demand by the debtor or by the creditors, when the enterprise is insolvent and when there are at least 200 employees and indebtedness at least equal to 2/3 of the assets and to 2/3 of turnover. In the second case, the procedure (extraordinary restructuring) is opened by the Industry Ministry (the correct name is Productive Activities Ministry) on demand of the debtor. The Court has the power to stop the proceeding if insolvency does not exist. The requirements are at least 500 employees and indebtedness not less than 300 million euros.

The object of an extraordinary administration (the first procedure) is either a restructuring plan or a plan for disposal of a going concern. The object of the extraordinary restructuring is the restructuring. In this case, it is also possible to have a compromise with creditors providing for the division of creditors into classes and cram down. In the Parmalat case, the extraordinary administrator proposed a creditor's agreement assuring the assets transfer to a new company whose stocks were distributed to the creditors in payment of their claims.

In an extraordinary administration, an insolvency compromise with creditors is also available. An important difference between the two procedures is that in the extraordinary administration the claw back actions are available only in the plan

for disposal of assets as a going concern; in the extraordinary restructuring, the claw back actions are always available, including if the enterprise goes on with the restructuring plan. But the Constitutional Court, invested by the Parma Court in the Parmalat case, decided recently that claw back actions may go on only if the result is reserved to satisfy creditors and not for an enterprise restructuring.

In any event, it is important to observe that an enterprise's insolvency in Italy is different according to the dimensions of the debtor. For the little enterprises, the insolvency procedure is not allowed, as it was told before. For the middle enterprises the procedure provided by the law is bankruptcy, a liquidation procedure whose topics were affected by the Reform. For the biggest enterprises, the insolvency is settled through the Government intervention, with a limited power reserved to the Court.

May 2006.

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