THE ITALIAN SURVEY

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I) BANKRUPTCY IN ITALY: WHAT JURISTS ARE DEALING WITH

A strong wind of change blows from north-west on the old Italian Bankruptcy Law. Sixty years have passed, the structure appears to be still solid, the State law finds application through decisions of the Constitutional Court, case law and praxis used by Tribunals and Courts of Law.

Nevertheless, reality shows how useless the current framework can be.

Since last year, the Italian Government, understanding the need for changes, has built up a Commission of experts appointed by the Ministry of Justice. It is a "tough" job !

It is not at all easy to review a legal and procedural system while it is in function, when it was created in a different historical and cultural environment: the Italian agricultural society, during the second world war.

The same legal system today finds application in our industrial society, facing a world economy ruled by completely different needs, regulations and decisions.

Many jurists recommend North American and English Laws as models for the solution of Company crisis and dealing with insolvency. Such models, while apply perfectly to the culture of those Countries, to their markets and commercial uses, hardly adapt to the Italian contest.

Therefore, it is important to think about the most convenient way of changing our legal system in order to find, through these years of experience, the right solution to the problems and obstacles which cause today's dramatic results in terms of length and low efficiency in bankruptcy proceedings.

Some concrete data will clarify the situation:

- a bankruptcy proceeding in Italy has an average duration of seven years;
- unsecured creditors do not obtain more than 15% of their credits, which is nothing in term of revaluation of the amount involved.

For some time Italian Courts have been working in order to avoid these effects, which represent an important restrain to the Italian economy.

The “Risk of a Country” factor is determined by all these elements, which can be positive or negative, and which can encourage or discourage foreign investors to allocate their resources in a specific Country.

Any creditor, especially the Institutional ones such as Banks and Provident Funds, aims for certainty of the law and cannot stand his own capital, invested in unlucky business, remaining frozen ‘sine die’ in a too formal procedure whereas any decision, even the simpler one, needs to follow a very complicated path of petitions, legal opinions and authorisations.

The length of the proceeding is certainly due to the particular inflexibility of the system which impose the same accomplishment of various judicial activities involving structures, energies, time and money, no matter what is the real entity of the asset involved.

In order to give the right picture of the situation, it can be sufficient to think about how an inventory was drafted two hundred years ago: the named Clerk used to go to the bankrupt company and count the exact amount of pens, tables, chairs and tools part of his asset.

Nowadays it is more or less the same, even if sometimes the warehouse is electronically organised.

The entire inventory activity can reach such a cost, sometimes even higher than the real entity of the asset involved.

As we said, this inflexibility makes the bankruptcy procedure being far from the real needs and also not economically viable.

At the end of the day, the entire bankruptcy procedure is focused on selling the assets involved and distributing the revenue within the creditors as fast as possible.

Nevertheless, many obstacles stand in the way to make this kind of procedure faster!

It can be useful to give a short list of the major ones:

1) Costs and fees for the inventory activity (which take into consideration the number and the duration of inspections done by the clerk);
2) Clerk nomination who should be identified, by the Judge, on the basis of his own technical preparation. For example, in case of premises to be sold, the Judge should name an estate agent, expert in the evaluation of estates of a certain area (if the asset is located in Milan, the judge should point out an agent who has a wide knowledge of the value of estate in the city of Milan). Notwithstanding this elementary observation, most of the time Judges do not name estate agents nor just experts in estate markets, pointing out instead the professional he/she personally knows, or who is known in that specific Tribunal. In these cases, the named professional will evaluate the estate to be sold on the basis of his own knowledge which is not always close to the market value. Of course the professional is paid for his evaluation opinion, whose results will be totally useless for setting the bankruptcy procedure.
3) The way of evaluating the estate in order to find out its right sale price (which, as shown, is far from being the market one) will slow down the estate sale by auction. In fact, many auctions will be deemed necessary to decrease the evaluation done by the professional to the adjudgment price.
4) Another important obstacle is represented by the internal judicial aspects. It has to be highlighted that the actual bankruptcy law sees the same judge involved in the different phases of the bankruptcy:

- The same judge will deal with the preliminary investigation, when he will decide whether bankruptcy should or should not be declared;

- The same judge will deal with the bankruptcy proceeding itself, when he will or will not enter the different credits in the liabilities of a bankrupt corporation;
- The same judge will take a decision on the objections presented by creditors who would like to see their rejected credits be admit in the liabilities;
- The same judge will or will not authorise the Trustee in bankruptcy to set up a liability proceeding against the company executive and internal auditing, a case that most of the time will be brought before the same judge;
- And then, last but not least, the same judge, or a close colleague as it happens in the major Court, will decide on the action to prevent the diminution of the debtor's estate by his fraud.

It is clear that this role's confusion, this mix of authorising and judicial power, brings into the creditor (Italian or foreign) a deep uncertainty on what are the judicial roles!

The described framework appears monolithic and fixed. The jurists who have to deal with the current bankruptcy procedure, especially those who represent creditors' petitions and creditors' interests, frequently face this cruel and fixed reality: the interests, which the judicial proceedings should take into consideration and protect, are not related any more to their clients but become private staff of the insolvency procedure.

5) To continue talking about the procedural obstacle, it is necessary to mention the lack of a specific right/duty of information which, not expressly provided by the law, is sometimes a gamble that is difficult to win. Information such as the real entity of the assets, the time of their selling, the possibility of any allocation of revenues or the percentage of the allocation, even though essential for the annual budget of the creditor company, for loss anticipation and reserving, are very difficult to achieve. Such demands find no more than silence, difficulties in relating with the charged authority and lack of sensibility in those who should be the defendants of creditors and their interests.

The new procedure will have to build up a system where the Courts are closer to Markets, where debtors and creditors are closer to the Courts (even considering their opposite interests which should never be in contrast).

In this way, the final goal will be achieved by reviewing and defining the interests to be protected.

If in the past, the maintenance of the company, as a social relevant asset, was considered as the main interest, no matter its productivity, nowadays jurists strongly believe (while still discussing on the Statuto dei Lavoratori and its article 18) that the insolvent company has to be liquidated in order to avoid the "sickness spreading" in the internal market: bankruptcy means commercial unreliability, company economic and financial insolvency and lack of social economic trust.

These aspects (judicial and economic) are not independent: market rules do not allow bankrupt companies to live a virtual life.

Workers, in these days, are protected enough by several social security instruments; as we know, the last three months of salary, if not paid by the bankrupt entrepreneur, are paid by the provident Agencies, such as what is due for the termination of employment.

Therefore, the interest of keeping a working position which is not productive anymore is totally anachronistic and has to be removed.

In this case we can certainly follow the American model: the reforming law will have to consider the creditors' interests and more over the general interest, socially relevant, of maximising the insolvent company, as the most important to be protected by the bankruptcy proceeding.

Assets will have to find a concrete protection but at the same time will have to become easily disposable, to be put on the market to be quickly sold, so that the efficient selling process will guarantee the minimum spread between the assets evaluation and their sale price.

Procedural difficulties do not have to overcome these primary objectives.

Recently, the World Bank pointed out the concrete address lawmakers of each Country should follow: among the criteria used to evaluate a Country reliability, in order to determine its own rating, such as the cost of international investments and loans, there will be the necessity ofthe bankruptcy law efficiency and the creditors' satisfaction degree.

Time is short and the Italian lawmaker should not miss this opportunity to improve and adapt our bankruptcy legal system to the international standards.

II) THE NEW APPROACH

After this preamble on the limits of the current Italian bankruptcy procedure, lets try to outline the new trends which inspire the bill drafted by the Ministry Commission, which I am a member of.

I have to highlight that my paper is just a rough outline due to the fact that the bill is still object of studies and discussions and that Parliament still has and will always have the complete freedom to evaluate such an important bill, related to topics which have been at the bench for many years.

First of all the bill examines the company crisis, meaning with this term not only a bankrupt company and not even an insolvent company, but especially a disfunctional company which needs to set its financial affairs and its management. The Commission choice, at this stage, is to leave all the creditors/debtors relations out of Court.

The principle of freedom of contract and of composition, therefore, becomes priority over the traditional one, *par condicio creditorum,* where secured creditors are protected by civil code articles 2740 and 2741.

The bill does not provide, at this stage, equal treatment between creditors (secured or unsecured) being part of the same group when an agreement, whatever it is, has been reached by the debtor on a side and the creditors on the other.

Following this new approach, it is important to highlight the peculiar condition of major creditors such as banks. Nowadays, banks usually have to face higher sacrifices than minor creditors which, most of the time, succeed in being totally refunded.

In this case, there will not be a judicial proceeding yet but a pre-trial agreement: the debtor, supported by the creditors' majority (approval by 60% of bank creditors and 75% of other creditors is deemed necessary), deposits a company reorganisation plan to the Company Registry. Obviously, the plan will have to be supported by professionals' certifications confirming the data related to the debtor, its assets, to the creditors, and to the practicability of the plan.

Then, the debtor will have two months time to obtain the remaining creditors' approval. At this stage, and during the two months period, the debtor is protected by a special 'umbrella':

- Execution proceedings cannot be started or carried on;
- Actions to prevent fraudulent conveyances cannot be started;
- New cash-flow, when paid, will be considered, in case of later bankruptcy, such as a secured credit;
- All activities accomplished in accordance with the reorganisation plan, in case of later bankruptcy, will not have any criminal effect (criminal bankruptcy).

In such a way, the debtor will be pushed to make his company crisis public in a shorter time, maybe before it is too late.

The described framework has taken into consideration the previous experiences of pre-trial reorganisation plans, worked out by the banks especially in case of big company crisis, and of their failures followed by bankruptcy.

The Commission is still analysing how the agreement should be defined, whether considering as necessary a decision or a confirmation by the Court or not.

If no agreement is reached within two months after the plan deposit, the debtor and only him (not his creditors) can ask for the starting of a crisis proceeding. This represents a second opportunity, judicial only in part, that the Commission is still working on.

This semi-judicial approach is similar to the current "composition with creditors" proceedings: the debtor presents a formal request, supported by his budgets, account books, a list of creditors and a reorganisation plan; the Court appoints a Judge, a Referee and the creditors' committee.

The creditors' committee does not have to examine the plan contents and values. At the assembly, creditors will vote on the plan notwithstanding its dissonance with *par condicio creditorum*. Compositions between debtor and creditors are still allowed and the judge, if creditor majority of 2/3 is reached, can always compel dissenting creditors to accept the plan at the same conditions provided for the same category of creditors.

As you can see, some elements of the Anglo-Saxon cramdown arise in this second approach.

Together with the aforementioned approach, quite new for Italian procedural provisions – the judge will have his role redefined as a sort of public notary certifying the agreement existence -, there will always be a more traditional bankruptcy procedure with a winding up scope.

Nevertheless, even in this case, debtor and creditors may any time present a plan for the bankruptcy composition. Quite new elements arise:

- bankruptcy with no assets will be immediately closed without any examination of liabilities;
- the proof of debts will be lead by the investigation Clerk;
- the inventory of the bankrupt's estate will be carried on in a easier and faster way, following the company account books;

- assets will be sold immediately and bulk transfers will be preferred together with the sale of the whole company;
- all incorporeal assets such as projects, trademarks, patents and databases, will be protected in order not to loose their values, which sometimes happens in creditors fraud;
- credits will be assigned through factoring or securitisation.

The solutions offered by the bill are quite various, dynamic and modern. In synthesis:

- The Clerk increases his role and power;
- The right to fair information is possible and concrete;
- The creditors' committee looses its way of being just a formality but rises to become a body with important controlling tasks on the company (also in the "crisis judicial proceeding");
- The creditors' committee authorises extraordinary activity;
- The judge will play the role of composing disputes, disagreements but he/she will not lead the crisis solution; he/she will not be the entrepreneur judge anymore, but he/she will become the referee of a well-constructed procedure, more complicated but surely closer to the market needs;
- Last but not least, the "scaring" term to start actions to invalid fraudulent conveyances become shorter and moreover all the acts linked to the ordinary company management will not be considered 'fraudulent' anymore.

III) CONCLUSIONS

If our efforts are recognised and the bill approved by the Parliament, the Italian legislative survey will become closer to the market needs and to the guidelines already followed by other States. In particular I am thinking of the French "friendly composition", the French

“allert” proceeding, the American “cramdown” where the Judge intervenes just to impose a transaction, and the “pre-packaging solution” where the reorganisation plan is presented by debtor and creditors to the Judge, who will have to check only if the agreement was reached between the parties, without examining the plan contents, without appointing a referee to analyse the fairness of the plan or its practicability.

The law provisions will get closer to market, as I said, and the company crisis administration, more or less serious, will be kept out of Court.

Of course the market is not always the best physician! And sometimes, we do assist to market bankruptcy too: the market needs its own rules in line with the law models of the European Union.

We all are working in order to create new provisions ensuring

- Maximisation of assets;
- higher creditor satisfaction;
- decrease of number, time and costs of judicial proceedings most of the time not considering the values at the bench.