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Extraordinary Administration v. Bankruptcy: The Italian Way to Economic Relief of Large Companies in Distress

By

Alberto Piergrossi
Piergrossi Studio Legale
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by Avv. Prof. Alberto Piergrossi

Summary


1. Introduction

In the last few years the Italian legislation on Bankruptcy Law regarding large companies in financial distress was amended and integrated several times. This was due to the opportunity to address the specific needs arisen in connection with some major insolvency cases involving Italian companies.

This paper addresses the evolution of the legal provisions regarding large companies in distress by analyzing the proceedings and the outcome of two insolvency cases concerning the Italian airline companies Alitalia and MyAir, which took place in the last two years.

The first part examines the provisions regulating Alitalia’s insolvency, while the second one focuses on the peculiarities of the MyAir case; the third part provides a brief comparison of the legislation applied in each case.

Part one: Alitalia

2. Factual Background

Since its foundation in 1946, Alitalia has been the national Italian airline, connecting almost 70 destinations worldwide and transporting as many as 28 million passengers per year. From the early 90s, the financial earnings of
Alitalia progressively declined, notwithstanding the transactions completed in the last few years, namely the alliance with SkyTeam and the acquisition of another major Italian airline group, Volare, which was then subjected to extraordinary administration.

Given the pivotal importance of air transportation, between 2006 and 2008 the Italian government intervened several times in order to carry out the privatization of the company. The Italian government took a very active role in choosing the consortium which would then run the company and in assuring that the insolvency proceedings of Alitalia would preserve the Italian roots of the company.

In order to obtain such results, the Italian government first issued a 300 million Euro loan to Alitalia, to ensure the continuous running of the company\(^1\). Later, it amended Italian Bankruptcy Law in order to better suit the needs of that particular company.

Alitalia was admitted to an extraordinary proceeding and was dismembered into two separate companies. A so called “bad company” inherited the debts of Alitalia, including the 300 million Euro debt and the outstanding debts towards its shareholders; viceversa, the more appealing assets of the company, namely the ones that would have allowed the company to continue pursuing the current business, were conveyed into a different legal entity in order to attract the highest number of investors\(^2\).

At the end of 2008, the assets of Alitalia were acquired by the Italian consortium CAI and, in 2009, 25% of the company’s capital was purchased by AirFrance – KLM. The “bad company” is however, as of today, in extraordinary administration and the related proceeding is still ongoing.

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\(^1\) This loan was explicitly exempted from any claw-back action during a specific time frame. Decree No.80 of April 23, 2008, “Misure urgenti per assicurare il pubblico servizio di trasporto aereo”; “Urgent Measures in order to Ensure the Public Service of Air Transportation”.

3. The Alitalia Decree

The Italian legislator amended various times the provisions that regulate the insolvency of major companies. Such changes were usually determined by the incumbent financial crisis of major Italian companies such as Parmalat and, as discussed above, Alitalia.

The prior Italian legislation on insolvency of large companies (hereinafter “Legge Marzano”; Law No. 39 of February 18, 2004), which was adopted after the Parmalat default, was applicable to companies with more than 500 employees and with debts amounting to at least Euro 300 million. According to this law, the company was entitled to apply to the Ministry of Economic Development in order to be admitted to a special extraordinary administration proceeding and for the appointment of a trustee who shall not only run the company, but also submit a restructuring plan to the court. The trustee was furthermore entitled to request the extension of the extraordinary proceeding to other companies of the insolvent group and to submit a plan of composition with creditors.

The above legislation was profoundly amended in 2008 at the time of the insolvency of Alitalia, in order to adjust to the peculiarities of Alitalia’s case the provisions first created to deal with Parmalat’s insolvency. The so-called Alitalia Decree (Legislative Decree No. 134 of August 28, 2008) was drafted


4 Law No. 39 of February 18, 2004, “Misure urgenti per la ristrutturazione industriale di grandi imprese in stato di insolvenza”; “Urgent Measures for the Industrial Restructoring of Major Companies in Insolvency”.

5 The number of employees shall be calculated considering all the groups’ companies.
and implemented in 2008. It contains provisions which either amend the Legge Marzano (and are applicable to all companies) or add some provisions to the Legge Marzano which apply only to companies operating in essential public services (therefore those provisions do not apply to any other business sector). Lastly, the Alitalia Decree contains some provisions which apply only to Alitalia and that have not been included in the Legge Marzano.

The Alitalia Decree applies to companies complying with the requirements set forth by the Legge Marzano, namely: more than 500 employees and debts amounting to more than 300 million Euro. Moreover, the Alitalia Decree has extended the sphere of application of the previous provisions by admitting to this proceedings companies that intend to implement restructuring plans and companies that seek to transfer their assets. This last option has therefore widened the scope of the applicable provisions and the alternatives available to the trustee and to the government in order to regain the financial and industrial equilibrium of the insolvent company. This flexibility was specifically tailored to address the needs of Alitalia, which could regain such equilibrium only through the sale of its profitable assets, given that its economic and industrial distress was the result of an endemic crisis which lasted for more than two decades. The proceeding regulating the transfer of the company's assets was changed in order to allow the trustee to establish a private negotiation between the insolvent company, i.e. Alitalia, and any potential buyer. The buyer participating in the private negotiation must guarantee the capability to run the business continuously and to rapidly intervene in remedying the default. Given the confidentiality of the negotiation, the legislator has established a requirement for the price of the sale; said price shall not be lower than the market price determined through an assessment of the company's value performed by an independent expert. Evidently the decision to negotiate vis-à-vis private buyers may harm the many creditors of Alitalia by indirectly limiting the economic return, which could have been maximised thought a public competitive bidding.
To facilitate the transfer of the company’s assets, the Alitalia Decree provides that, in case of emergency, the sale could take place before the declaration of the state of insolvency made by the competent tribunal. Furthermore, the trustee and the buyer can agree on a partial transfer of the assets and autonomously define the ones which will be included in the going concern to be sold. In addition, the Decree explicitly establishes that any permits, authorizations and licenses necessary to continue the business of the company, e.g. the authorization given to Alitalia by the Italian Civil Flight Agency (ENAC), are automatically renewed for six additional months, even if the company is insolvent, and that they would be automatically transferred to the buyer of the company’s assets.

The Alitalia Decree has also determined the inapplicability of the antitrust provisions on concentrations to operations which took place before June 30th, 2009. Such provision therefore sets an exception to the standard proceedings, by requiring the parties to simply notify the Antitrust Authority (instead of acquiring its prior consent) and by limiting the power of the Authority to intervene and regulate the operation. The Antitrust Authority can prescribe the measures and integrations which it deems necessary; nonetheless, measures concerning monopolies shall be implemented after a grace period of three years at the minimum. The only lasting control over the antitrust aspects of the operation would be guaranteed by the European legislation on the matter.

The admission to this proceedings and the appointment of a trustee is granted by the Ministry of Economic Development and by the Prime Minister, who have also the power to define the measures to be taken in order to reach the envisaged purposes. Those powers given to the Executive Branch confer to it a much stronger power of intervention compared with the previous situation.
The Alitalia Decree encloses two more provisions, specifically tailored on Alitalia’s needs, that have raised a lot of concern among scholars. The first provision holds the company’s directors, managers and statutory auditors harmless for any action related to the book-keeping of Alitalia performed between July 2007 and the entry into force of the Decree, in consideration of the preeminent public interest and the necessity to assure the continuous operation of the business. As a result, any claim based on such actions could only be brought against the company itself. The second provision establishes that certain shareholders and the bondholders of the company are entitled to benefit from the fund destined to the victims of financial frauds (this provision however was repealed in 2009). The two above cited provisions regulate exclusively the insolvency proceedings of Alitalia and, consequently, they have not been included in the Legge Marzano, which regulates the extraordinary administration of all major companies.

Although these latter provisions have not been included in the Legge Marzano, the effect on Italian legislation of the Alitalia Decree is quite obvious. The government has gained a stronger and deeper control over the extraordinary proceedings, while the creditors and the Antitrust Authority have been confined to a corner due to the private negotiation and the partial derogation from the general antitrust regulation. However, the Decree has introduced some flexibility in the proceeding by extending it to companies operating in essential public services and to corporations that intend to transfer their assets.

Part two: MyAir

4. Factual Background

MyAir is an airline company founded in 2004 in Italy by some managers of Volare Group, a holding company controlling a few Italian airline companies
which were admitted to extraordinary administration in 2004 pursuant to the Legge Marzano. MyAir was based in Northern Italy and served approximately 30 destinations, both national and international, transporting 1.4 million passengers per year. In 2009, MyAir employed more than 200 people.

In the Summer of 2009, the company’s financial distress increased rapidly. The company defaulted on the payment of airport’s tariffs and taxes and subsequently the Italian Civil Flight Agency (ENAC) revoked the licences granted to MyAir, therefore grounding the company. The revocation of the licence was decided after MyAir did not comply with the requirements set forth by the Agency, which prescribed a financial restructuring of MyAir aimed at guaranteeing the payment of essential services. After a few months, the Agency suspended MyAir’s certification as a flight operator, therefore definitively grounding the airline. As a result, MyAir lost all its airport slots and air routes.

At the annual 2009 shareholders’ meeting for the approval of the Balance Sheet of 2008, it became obvious that some data had been misrepresented and that the company had accumulated losses for more than 70 million Euro. The company, now grounded and under investigation by the Italian tax authority, was declared insolvent and admitted to extraordinary administration in October 2009.

During the extraordinary administration proceedings, several attempts were made in order to either reach arrangements with creditors or to lease the company’s going concerns to a new-co, which would partially take over MyAir’s business. This deal, however, never came through, since the new-co did not have the requirements nor the financial capabilities to enter the airline business.
A deeper analysis of the company’s books showed that the actual debts of MyAir amounted to 200 million Euro and that such debts had been accumulated over a four-year time span. As a result, the managers, the accountants and the advisors of the company have been investigated for bankruptcy fraud.

In consideration of all the above, MyAir was declared bankrupt in January 2010.

5. The Legislation

The legislation which governs the extraordinary administration proceedings is the so called “Legge Prodi Bis”. This law, issued in 1999, aims at conserving the assets of the company which are pivotal for the resumption and conservation of the business. Only companies, such as MyAir, which have more than 200 employees and debts amounting to 2/3 of the profits reported in the Balance Sheet and of the revenues obtained in the last business year, can be admitted to the proceedings. The existence of the Legge Marzano, which was applicable to the Alitalia case, implicitly limits this proceeding by setting a maximum amount both for employees (maximum 499) and debts (less than 300 million Euro).

The proceedings set forth by the Legge Prodi Bis is divided in two phases. During the first part, the tribunal, after declaring the company insolvent and appointing a trustee, declares whether the company shall be declared bankrupt or shall be admitted to the extraordinary administration proceedings. Only after the latter positive decision, the tribunal shall admit

the company to the extraordinary administration proceedings. The beginning of such proceedings is therefore not automatic, but related to the existence of some requirements which will be analyzed hereinafter.

The state of insolvency of the company is declared by the tribunal upon request of the creditors, the prosecutor, the tribunal or the company itself. The proceedings requires the insolvent company to show solid perspectives of recovery of its financial and industrial equilibrium. The recovery may take place through the transfer of company's assets, through an economic and financial restructuring or, for companies operating in the essential public services, through the transfer of goods and contracts pertaining to the company.

Afterwards, the trustee appointed by the tribunal drafts a report on the causes of the insolvency of the company and on its perspectives to recover its financial and industrial equilibrium. This report and other relevant information pertaining to the prospect of recovery are then examined by the tribunal, which must decide whether the company shall be admitted to the extraordinary administration proceedings or must be declared bankrupt.

In the case of MyAir, the tribunal rejected the admission to the extraordinary administration and declared the company bankrupt. The decision of the tribunal was undoubtedly influenced by the fraud investigation which involved MyAir’s managers and consultants and by the inability of the company to regain any industrial and financial equilibrium. By being grounded, MyAir lost all its slots and air routes (which were possibly its most valuable assets) and also any possibility to restart its business. Obviously, those aspect were examined by the trustee and the tribunal and were crucial in the latter's decision to declare MyAir bankrupt, given the absence of any perspective of recovery of the business.
Part Three: Alitalia and MyAir, A Comparison

As explained above, the outcomes of the insolvency proceedings which involved Alitalia and MyAir have been rather dissimilar. Alitalia is now severed into two different companies, one acquired by the Italian consortium CAI and one in extraordinary administration. MyAir instead was first declared insolvent and later declared bankrupt.

The different outcomes of the two cases partially derive from the different legislation applicable to the two corporations. Alitalia was subject to the Legge Marzano, which regulates the insolvency of major companies, while MyAir was subject to the Legge Prodi Bis, which regulates the insolvency of large companies having between 200 and 499 employees.

Although the regulations applicable to the two companies were different, there are plenty of similarities between the two airline carriers; they both had numerous employees and were unable to generate profits through their business.

The similarities, however, end there, since, in the case of Alitalia, the legislator has introduced an ad hoc body of laws with the intent, very much criticized, of preserving the assets and the employees of the company. The Alitalia Decree has in fact eased the acquisition of the company through the establishment of a private negotiation proceedings and the possibility to autonomously define the assets to be included in the going concern to be transferred. The derogations to the antitrust legislation and the extension of the permits and licenses necessary to continue the business of the company facilitated the transfer of the company’s assets and so did the 300 million Euro loan issued by the Italian government.

The provision concerning permits and licenses is of particular interest in the MyAir’s case. The Italian Civil Flight Agency (ENAC) withdrew MyAir’s license to fly on a mere 24-hour notice, although the company had been known – as
subsequently it was discovered – to be in financial distress since a long time, and it implemented such withdrawal on July 24, 2009, right in the middle of the Summer holidays (when low-cost companies make higher profits). It is not only the timing of the withdrawal that sets a difference of treatment between MyAir and Alitalia, but also the financial and industrial implications deriving from it. It is indeed evident that a grounded airline carrier, which is bound to lose its slots and air routes, has few chances to recover its economic and industrial equilibrium, much to the detriment of its creditors and employees.

MyAir’s management undoubtedly contributed to the company’s financial collapse by supposedly committing a bankruptcy fraud in forging the company’s books. As a result, MyAir’s managers, accountants and advisors will be further investigated, without receiving the benefits accorded to Alitalia’s directors, managers and statutory auditors for any action related to the book-keeping of Alitalia.

Nonetheless, the main point of concern regarding the differences between the Alitalia and the MyAir proceedings regards the rights of creditors and employees. During Alitalia’s insolvency said rights were taken into consideration and partially safeguarded, while in MyAir’s insolvency they were not. As of today, the employees and the creditors of MyAir have received little or no protection; therefore the inequality of treatment evidenced above affects them very much.