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An Overview of Italian Bankruptcy Legislation
for Large Insolvent Companies

By

Lucio Ghia
Studio Legale Ghia
Rome

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AN OVERVIEW OF ITALIAN BANKRUPTCY LEGISLATION FOR LARGE INSOLVENT COMPANIES

by Avv. Prof. Lucio Ghia

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1. Historical framework

My dear colleagues, I would like to present to you today a general overview of "The Extraordinary Administration," the Italian bankruptcy procedure for large insolvent companies. In order to explain this procedure and its evolution over the past 20 years, we must first make clear that the presence and participation of the Italian State as a shareholder in private companies has a long history.

The creation and important successes of the Italian Reconstruction Institute, an institution that rose from the ashes of the Great Depression of the 1930s, contributed to the restoration of Italian industry, on life support after the crash of Banca Romana and by the profound reorganization that followed from it, making clear the need for the separation between business and bank.

It would take too long to retrace the steps of the long journey taken by the Italian State, with the advent of nationalized banks, formed to support the government's direct control of entire economic sectors, both industrial and commercial, with the goals of promoting our country's development, fostering social stability, and safeguarding employment, which was seen as the social value represented by business, especially in the form of the large company.

For these reasons the Italian State, even to this day, holds shares in many companies. And thus it is the case that state intervention in the national economy has a strong effect

on Italian Bankruptcy Legislation for medium and large companies, even though their equity and social capital is entirely privately-owned.

The principal focus of modern insolvency legislation and of business debt restructuring practices no longer rests on the liquidation of insolvent entities but rather on the remodeling of the financial and organizational structure of debtors experiencing financial distress so as to permit the rehabilitation and continuation of their business.

The aim of the Extraordinary Administration procedure is to preserve the business entity, both in its value as a whole and in its value as a group of individual assets. The corporate restructuring will represent a practicable and attractive choice only if there exists the real opportunity to retrieve the company's financial and economic viability.

The presence of contracts, the competitiveness of the product, and its marketability are factors that cannot be dispersed through a liquidation procedure. Separated from the company as a whole, immaterial goods such as "know-how," qualified workers who can produce a quality product, commercial goodwill, recognizable trademarks, patents, and industrial designs greatly lose their value.

This legislation still considers the value that the activity of an individual insolvent company provides to a group of companies of which it is a member, and it allows other insolvent companies of a group to join a procedure already put before the Extraordinary Administration.

In that case the Extraordinary Commissioner, proposed by the Minister of Economic Development, and nominate by the Court also, may request the extension of the procedure of the Extraordinary Administration to the other groups companies affected by a widening crisis or those to which the crisis already extends.

Of course, this centralized management that normally would take the form of a procedural consolidation, in some cases would assume the features of a substantial consolidation. As a safeguard against his own interests and his position of considerable advantage, the Commissioner must take into account that his plan of reorganization would be subject to the opinion of the Supervisory Committee and the authorization of the Minister of Economic Development.

2. The Expanding Role of Amendments to Italian Extraordinary Administration Law

The realization of numerous and important privatizations initiated at the end of the 1980s with the suppression of the Ministry of State Participation, has over the years diminished the presence of the State in business. At the same time it has made legislation regarding crises of large private businesses necessary. The Extraordinary Administration procedure thus was enacted by Legislative Decree No. 270 of 8 July 1999 "Extraordinary administration of large companies in crisis," better known as the "Prodi Bis Law."

Under this statute, specific criteria must be met by the debtor company to qualify for that procedure. In particular, a company is eligible if it:

1) Has employed at least 200 employees during the year preceding the commencement of the proceedings;
2) Has debts (including guaranteed obligations) at least equal to 2/3 of its balance sheet assets and of its profits during the last financial year;

Has serious prospects of attaining viability through a disposal or restructuring plan.

The competent court declares the company's state of insolvency.

If the company satisfies the above-mentioned criteria it can file in Court a petition for admission to the Extraordinary Administration process. Its admission would occur in two-stages.

First, after having sent a copy of the petition filed by the Company to the Ministry for Economic Developmnet, which must give its acceptance and propose the name of the Extraordinary Commissioner, the Court must determine whether the petitioning company is insolvent.

If it finds that the company is insolvent, once obtained the approval of the Ministry for Economic Development, the Court must then confirm the appointment of the Extraordinary Commissioner already proposed by the Minister of Economic Development. Within 30 days from his appointment, the Commissioner shall prepare a

report which contains a description of the causes of insolvency and an assessment of the company's prospects for recovery. The report must be filed in Court and in the Ministry for Economic Development, which must give its approval. Once obtained the Ministry's acceptance, if the Court, relying on the Commissioners' report, decides along with the Ministry's Control Committee that there are realistic prospects of recovery through a disposal or restructuring plan, the petition will be admitted to the Extraordinary Administration process.

Within 15 days from the appointment of the Extraordinary Commissioner, the Ministry shall appoint the Surveillance Committee, which is composed by technical experts and creditors.

In this second stage the company is managed by the Commissioner. The process can only continue if the company shows real prospects of recovering economic stability either through a program of sale of businesses, which must be completed within one year, or by means of a recovery plan, which can last no more than two years.

If the conditions above are not or cannot be satisfied, the Court initiates insolvency proceedings. Avoidance actions under bankruptcy law may be brought only in a disposal plan scenario.

The claims originated after the declaration of insolvency are pre-deductible. In an economic context where obtaining new financing is extremely difficult, the pre-deductibility of claims is an important solution. In particular, a claim is pre-deductible if it must be satisfied before every other secured claim ("privilegio generale").

In 2003 the Italian government passed emergency legislation on insolvency procedure in the form of Legislative Decree No 347 of 23 December 2003, subsequently amended by Law No 39 of 18 February 2004 (also known as the "Marzano Law"), which introduced urgent measures for the restructuring of major companies. The focus of the proceedings was shifted from liquidation to corporate reorganization and restructuring.

The purpose of the amendments was to streamline the standard procedure of extraordinary administration by reducing the administrative burden and extending the time limits of recovery plans, providing for a speedier admission to the special

insolvency regime for companies meeting certain requirements. The new procedure appears more flexible than the previous one.

Specific criteria must be met by the debtor company to gain access to this procedure. In particular, a company is eligible if it:

1) Has employed at least 500 employees during the year preceding the commencement of proceedings;
2) Has debts (including guaranteed obligations) at least equal to Euro 300,000.

Where there is a group of companies, once the parent company has been admitted to the procedure under Marzano Law, the insolvent subsidiaries of the group may be joined to the same procedure of the parent company even if they don't meet the above-mentioned criteria.

3. Procedural notes

If the company satisfies the above-mentioned criteria, it may file a petition directly to the Ministry of Industrial Activities for admission to the extraordinary administration procedure, rather than to the Court (the company, however, must also notify the competent Court in the jurisdiction in which it's registered of its petition for the declaration of insolvency). The Ministry will immediately issue a decree admitting the company to proceedings and will appoint a Commissioner. Later the Court will declare the company insolvent on the basis of the debtor's financial conditions (the Commissioner must prepare a report that shows the balance sheet of the company and other relevant financial information within 60 days of the ministry's decree). The company will be managed by the Commissioner.

Decree No. 347/03 requires the recovery plan to be a plan for the reorganization and restructuring of the enterprise that is capable of implementation within two years. The special Commissioner, however, may require the disposal of assets or going concerns in order to restructure the company (and the Ministry may grant authorization). If the Ministry rejects the plan and an asset disposal program is not an option, then the Special Commissioner can apply to the competent Court for a declaration that the

extraordinary administration procedure should be discontinued in favor of the company's liquidation.

I should mention that the Extraordinary Commissioner may provide, as part of the restructuring plan, the payment of creditors through a composition agreement, that is, an agreement between the debtor company and the creditors ("Composition with creditors") that provides for the restructuring of the company's debt in any form, including a debt-for-equity exchange and the transfer of the company's assets to an assignor. The creditors in the proposal may be subdivided into classes with proper consideration given to the nature of their claims, provided that the fair treatment principle is respected. Furthermore, the plan could establish the differential treatment of creditors in different classes. Such agreement has to be approved by creditors representing the majority of claims admitted to vote or, if different classes of creditors exist, by the vote of creditors representing the majority of claims admitted in each class. However, the Court may ratify the proposal, notwithstanding its rejection by one or more classes, provided that (a) creditors holding a majority of the debt approved the proposal, (b) a numerical majority of the classes has approved the proposal and (c) in the court's judgment, creditors in dissenting classes would not receive more under any other feasible restructuring alternative (similar to "cram down power" in US Bankruptcy Law). Once ratified, the Composition is binding on all creditors. The Special Commissioner is also entitled to exercise any avoidance actions in case of a restructuring plan scenario, because they are instrumental to the restructuring plan.

After the Law Decree No 134 of 28 August 2008, the Italian Government passed Law No 166 of 27 October 2008 which proposed a set of rules that integrate the insolvency procedure enacted in 2003 (the Marzano Law) after the collapse of the Alitalia Airline company. The law of 2003 allowed the Commissioner to initiate the liquidation of assets only if the restructuring petition filed by the debtor was rejected. The new law, however, enables the Commissioner to immediately sell the assets without having to wait for a rejection of the restructuring petition.

Moreover, with regard to debtor companies offering public services, the amended law introduced some new provisions:

1) The possibility that the petition for the admission to the Extraordinary Administration procedure could be filed by the office of the Italian Prime Minister and not only by the Ministry of Industrial Activities

2) The Extraordinary Commissioner may identify a buyer of the company's assets through private negotiations among parties that could guarantee continuity and an expeditious intervention (the price for the sale, however, cannot be lower than the fair market value);

3) Merger and acquisitions related to the sale agreement must be disclosed to the Antitrust Authority. No authorization, however, is required for transactions executed by 30 June 2009, provided that such agreements serve public interests and provided that the parties supply "…. Behavioral guidelines designed to prevent risk of price-fixing and other contractual conditions that place an undue burden on consumers." Should the Antitrust Authority consider it necessary, it may prescribe appropriate changes;

4) With the Ministry's approval, the Extraordinary Commissioner could sell, before the declaration of insolvency, profitable parts and liquidate their debt while continuing to do business.

5) Finally, for a period of six months following the admission of the insolvent debtor to the procedure set forth in the Marzano Law, the debtor company may maintain any relevant authorizations, certifications, or other licenses necessary to carry out its activity.

4. Extraordinary Administration: goal of the proceedings

The purpose of the Extraordinary Administration is to reaffirm the importance of rescuing a company in financial trouble. It is a restructuring procedure that aims to satisfy creditors' claims while protecting the business. In particular, such proceedings aim at preserving the trading and market position of the insolvent company, facilitating the restructuring of the debts and granting creditors protection.

The Extraordinary Administration is, in general, used by companies of considerable economic and social importance to Italy. It preserves the company's residual technical, commercial, and occupational assets and value.

In order to maintain the ordinary practice of commercial activity, the judicial commissioner, appointed by the Ministry of Economic Development and by the Court, governs the insolvent company and assumes management of the company.

Thus, the management of the company is overseen by the administrative authority, whereas legal rights are protected by the judicial authority. The subdivision of powers between the administrative and judicial authorities is typical of the Extraordinary Administration process. The complex relationship among the Ministry, the Commissioner, and the competent Court is an interesting topic that would merit its own separate presentation.

The Judicial Commissioner during the Extraordinary Administration procedure – as long as the restructuring plan needs to be realized, before the adoption of a disposal plan – may maintain any relevant authorization, certification, or other license necessary to engage in business.

In this general overview I have attempted to explain how the various amendments introduced over the past decade or so are part of an organic set of rules that constitute the Extraordinary Administration procedure. These rules are integrated in the main body of the Italian legislation concerning bankruptcy procedures for large companies in the Extraordinary Administration Procedure (Prodi Bis Law and Marzano Law). Such changes are made because every law has to be up to date.

5. A snapshot of the companies subject to Extraordinary Administration and some relevant figures

There are 360 companies subject to law n.39/2004 (Marzano) and to decree n.270/99 (Prodi Bis). Of this number, 215 companies are part of 73 business groups and they employ 39,119 people. In 49 (out of 73) of these cases the companies were sold to third parties and 15,343 employees were transferred.

The other 145 companies, which employ 32,191 workers, are part of large enterprise groups. 15,980 of these employees were relocated in the transferring companies.

It seems, therefore, that our social welfare system, even in the midst of a crisis affecting large companies, is able to provide support, for a considerable period of time (over three years) to over 50% of the employees who have lost their jobs. In this case public assistance (INPS) has provided salaries, wages, and benefits for about 18,000 workers and their families. And these benefits, on average, constitute 80% of the workers' final salaries. This makes the employees a class of creditors completely different from other creditors of companies subject to Extraordinary Administration, who represent about 30 billion Euros of credit.

6. The New Finance

New financing, which is always a delicate theme, is often indispensable in the liquidation process and necessary to enact reorganization plans. The responses and the solutions to obtain such financing, as in all complex problems, must be contemporaneous, numerous, and activated simultaneously.

A proper time frame for its realization constitutes an essential condition for successful reorganization.

The "best practices" that the history of crises of large companies in Italy has revealed to us, demonstrate: that the analysis of the composition of claims permits not only the prioritization, the proration, and the discounting of debt payments, but it also provides the company with leverage to continue engaging in business. Interested parties can agree to the conversion of credit into equity in the new company, which often ends up buying the assets of the company in Extraordinary Administration while continuing to engage in business and maintaining a relationship with the company in Extraordinary Administration.

The pre-deductions, which suppliers have in case of the continuation of activity of a company in extraordinary administration, provide good legal protection. The Commissioner, according to the plan whose feasibility has been evaluated by the

Ministry of Economic Development, calls upon institutional creditors (Banks and Financiers) to make new financing available, especially on the basis of the following legal provisions.

In more complex and serious cases, the involvement of the government in the role of mediator has produced excellent results at the “round table” of the Presidency of the Council of Ministers, encouraging the involvement of local institutions, banks and financiers.

Naturally, these mediation sessions seek to resolve these cases without disturbing the rules of the free market and without providing “State-Aid,” which is prohibited by the EU community.

But the new financing must be based on an adequate revision and reduction of costs to make them sustainable in relation to the planned course of activity. These are not only cuts related to the work of good administrators in time of normal business conditions, but may consist of even deeper cuts, made necessary by the relevant social and regional impacts of a large business in crisis.

The reduction of energy costs for a company which exercises intensive energy activities, for example, could be obtained through Extraordinary Administration with the help of relevant local, regional, provincial and municipal institutions who could agree to concentrate on the enterprise in crisis, the savings resulting from alternative energy sources (solar, wind, or thermal energy).

Naturally an agreement with the unions regarding the phases and content of the plan is indispensable because a strong cohesion between the management of the company in crisis and the employees is an essential condition for successfully overcoming the crisis and also for achieving new finance.

7. Enterprises in Crisis and State Intervention

With Ministerial Decree n. 319/2004 (Official Gazette n. 10 of 14.05.2010) and Law Decree 35/2005 (which became law n.80/2005, Official Gazzette, n. 111 of 14.05.2005), the Government created and implemented a fund for the financing of

interventions by the State to rescue and restructure large enterprises in difficulty, in accordance with the recommendations of the EU regarding State aid.

In these last years, the fund was approved to receive 100 million Euro; the CIPE decision of 18/12/2008 n.110 (Official Gazzette, n. 69 of 24.03.2009) provided the functioning guidelines to the fund. Access to the fund is reserved to enterprises organized as corporations, under the following conditions:

(i) the enterprises find themselves in difficulty, as defined in paragraph 2.1 of the EU guidelines on state aid used to rescue and restructure companies in crisis (C244/2004);

(ii) for the company in difficulty, under art. 2.1 paragraph 10, letter C of the EU guidelines, it is necessary that it find itself in conditions that justify the initiation of bankruptcy procedures for insolvency under domestic law, which include:

- Having no less than 50 employees, calculated according to the criteria of the Decree of the Ministry of Productive Activity, issued on 18/04/2005, and falls under the definition of a medium or large-sized company;
- Not operating in the sectors of coal or steel production or agriculture.

All proceedings must be concluded within 30 days for the provision of rescue funds and within 60 days for the provision of restructuring aid; such terms start from the authorization by the European Commission of State Aid.

Rescue aid consists in State guarantees on loans already disbursed, or, otherwise, on new loans. The aid cannot last for more than six months and it can be applied to the adoption of extreme measures, even structural measures, such as the immediate closing of a subsidiary or the cessation of unprofitable activities.

The aid can even consist in the direct loan by the Ministry of Production Activity. It must be repaid in six months and it must respect the principle of “one time” aid.

If a restructuring plan is presented within the required time (six months), the terms of loan repayment or of the discontinuation of the guarantee are extended until a decision is adopted by the Commission regarding the approval of the plan.

The program should not violate the E.U. common interests and should apply compensatory measures for the eventual distortions in the market. The Commission is empowered to impose specific obligations or measures regarding these topics.

Even in this case the principle of the “one time” aid must be applied in order to avoid that companies with no future continue to “live” only through the repetition of aid.

The restructuring aid precondition consists in the existence of a plan for restoring the long-term profitability of the company that, normally, must also provide for its financial restructuring. The companies that obtain aid for their restructuring, must contribute financially to the global cost of the operation, with its own funds, through the sale of nonessential assets, and by seeking external financing at market rates. Such aids to the restructuring are considered acceptable if they are no more that 50% of the global cost for the large company, 40% for the medium-sized company, and 25% for the small company. The E.U. Guidelines also include a simplified procedure for aid that does not exceed 10 million Euro, although it excludes the request of the State aid during the first three years of the company’s life.

Regarding the general conditions of authorization, the rescue aid must:

- consist in credit guarantees, or loans;
- be discontinued or repaid within 6 months of the first installment of the loan to the company;
- be motivated by grave difficulty and not have a negative effect on other Member States;
- be accompanied, upon notification by the State within six months from the authorization, by a plan of restructuring/liquidation, or proof that the loan has been completely repaid and/or that the guarantee has been terminated;
- be limited to the amount necessary to maintain the companies activity in the period for with the aid was authorized. The necessary amount provided, which must be based on the company’s need for liquidity, also because of its losses, will be set based on the formula described in the Guidelines. Requests for aid greater than the need calculated according to the formula, must be duly explained.

The aid may be requested and granted even in cases of Extraordinary Administration of large companies. The law applicable provisions are:

- The law decree of 8 July 1999 n.270 (Prodi bis Law) (art. 4. comma 2). “New discipline of extraordinary administration of large companies in the state of insolvency in the sense of article 1”
- The law decree n. 319/2004 (Marzano Law). The beneficiary company other than the one mentioned in art. 11 of the Community Guidelines, must demonstrate sharply declining sales, the decline of cash flow and the increase of debts. Furthermore, under art.25, letter b) of the Community Guidelines, the aid must be motivated by grave social difficulties. In these cases, according to the requirements of point 25, letter a) of the Community Guidelines, the aid consists in cash aid or in State guarantee on lines of credit. The guarantee is always limited to a period of six months from the disbursement or the obtainment of the guarantee by the beneficiary. Moreover the line of credit must be granted at a rate of interest comparable to the rates given to “healthy” companies and greater than the rate determined for Italy by the EU Commission.

Once the request of the beneficiary company is approved, the EU Commission notifies the Ministry of Economic Development and the Ministry of Economy and Finance of the reasons for its recommendations. The MEF shall monitor the implementation of the requirements of ministerial decree n.319/2004 regarding the State guarantee of the requested financing.

This paper is just a summarized description of this complex regulation which, during these last 10 years, has been implemented in order to discipline the crisis and the new finance of large insolvent groups.

There is lot more to speak on this topic, but unfortunately our time together is limited.

I thank you for your attention.

Lucio Ghia