

International Insolvency Institute
Sixth Annual International Insolvency Conference

Saving the GOING CONCERN: Must the Crew Abandon the Ship?

Italian Bankruptcy Law recently underwent a major, substantial reform¹ which was aimed at accelerating and simplifying the procedures, also by making available new and flexible tools, while preserving the survival of the going concern and of its healthy assets as much as possible.

The Italian legislator was convinced that the main scope of bankruptcy law should be that of trying to solve the crisis of the going concern before its collapse, rather than to just administer the winding up of a distressed company or the collection of mismanaged credits. A modern bankruptcy law should be a set of rules that can effectively manage a business and economic relationship from the initial appearance of symptoms of a financial crisis either in the individual going concern or in the business community to which it belongs.

Other significant provisions of Italian civil and criminal law that were enacted in recent years and which may be relevant to our issue are: (1) the decriminalization of several corporate ("white collar") crimes, like fraudulent accounting and false communications to the market², and (2) the broadening of the directors' and officers' liability in the conduction of the company business and of their personal liability for wrongful or unlawful actions³.

The result of the combination of the above amended regulations is that the Italian legal system is indeed now offering more tools and a higher degree of flexibility and discretion, also to the directors and officers, for the positive solution of situations of crisis of the going concern⁴. At the same time, however, there has been a reduction of the judicial control over the bankruptcy procedures, which privileges extra-judicial agreements between the debtor and the creditors. This is not a risk-free situation, because it may encourage misbehaviour. It is also contrary to the trend which can be found in the U.S.A. and in many other countries, where the rule is to bring the crisis of the going concern under a stricter judicial control and supervision.

Also, the directors and officers of an Italian distressed company are still liable in the present system, both on a civil and a criminal level, in case something goes wrong in a relatively large number of instances. This risk is even increased today

¹ Legislative Decree No. 5 of January 9, 2006, which implemented the principles contained in Law Decree No. 35 of March 14, 2005, converted into Law No. 80 of May 14, 2005, and which will come into force on July 16, 2006, i.e. six months after the date of publication on the Italian Official Gazette of January 16, 2006.

² Legislative Decree No. 61 of April 11, 2002, which also amended the text of Articles 2621 to 2641 of the Italian Civil Code.

³ Amended corporate sections of the Italian Civil Code, mainly Articles 2380 to 2396, pursuant to Legislative Decree No. 6 of January 17, 2003 ("Reform of Company Law").

⁴ Examples of more effective tools are (1) a new agreement with creditors ("concordato preventivo"), which is now available as soon as the company faces a financial crisis without waiting for its becoming distressed; (2) the waiver of previous burdensome conditions of admissibility of "concordato preventivo"; (3) the possibility of filing a petition with the court for approval of an out-of-court restructuring agreement entered into between the debtor and the creditors; (4) the shortening of the preference period for the receiver to bring claw back actions for the voidance of certain payments and transactions occurred prior to the bankruptcy declaration and the exemption of certain transactions from the claw back rules.

in light of the reform of Italian Bankruptcy Law, since it is the consequence of a lack of harmonization with it of certain civil and criminal provisions. It discourages the involvement of directors and officers in the attempt of saving the distressed going concern. This is contradictory to the provision of new tools and additional flexibility and discretion that the amended Italian Bankruptcy Law now offers.

If we want to avoid that the crew abandons the ship, which should obviously be our goal, certain additional changes and provisions should be introduced into the Italian legal system.

It is appropriate that the higher degree of flexibility and discretion for the directors and officers and, in general, for all the parties involved in an Italian insolvency procedure be preserved and encouraged. This is a prerequisite of the ability to devise and implement solutions, on a case by case basis, aimed at saving the going concern.

An effective recovery plan should also involve all those who represent the various interests in conflict in a situation of distress, like banks and institutional investors, suppliers and trade creditors, customers, small individual investors, workers and employees.

The contribution of professionals who are experienced in the restructuring of distressed companies could also be helpful.

The above operations should however remain under the control and the supervision of the judiciary, in order to prevent mismanagement.

A thorough and accurate revision of all provisions of law (both civil and criminal) on liability of directors and officers should be made to bring the system into balance (also in an international perspective) in two ways: (1) to reinstate criminal liability for those corporate crimes that were decriminalized in 2002; and (2) to harmonize the other old civil and criminal liability provisions with the new set of rules of the amended Italian Bankruptcy Law.

Directors and officers who operate, also in a creative manner, within the framework and the limits of the new tools and who do so without violation of law and in compliance with the judicial supervision and control, should cease to be liable, irrespective of the outcome of their efforts.

This should be a sufficient incentive for the crew not to abandon the ship and to lead it to safe waters, thus being instrumental in a serious and effective attempt at saving the going concern.

Milan, Italy, May 15, 2006.

Alberto Piergrossi