Italy: bankrupts wind up in prison

Italian governments have introduced a range of procedures to avoid the difficulties of bankruptcy, explains *Mauro Battistella*

Insolvency procedures in Italy range from full blown bankruptcy – which always results in the liquidation of the company – to various procedures introduced to allow the company to reach a restructuring agreement with its creditors.

One peculiarity of the Italian regime is that directors of a bankrupt company often face criminal charges. Therefore, directors strive at all costs to avoid full bankruptcy, and are incentivised to try to make use of one of the various alternatives to bankruptcy that have been introduced in recent years.

There are two main pieces of legislation that govern corporate insolvency in Italy. The first is the *legge fallimentare* (bankruptcy act) of 1942, as modified by legislative decree 5/2006 and legislative decree 169/2007. The decrees of 2006 and 2007 marked a substantial reform of bankruptcy law, introducing the *accordi di ristrutturazione* (restructuring agreements) procedures for the first time and boosting the role of the *concordato preventivo* (pre-bankruptcy composition plan).

The second piece of legislation is the *nuova disciplina dell'amministrazione straordinaria delle grandi imprese in stato di insolvenza* (extraordinary administration for major undertakings act of 1999) also known as the new Prodi law. It is supplemented by law decree 347/2003 and modified by law 39/2004 (also known as the Marzano law). This provides a government-supported reorganisation plan for insolvent enterprises exceeding a certain size.

There are several judicial procedures that a company facing insolvency may be subject to. *Fallimento* (bankruptcy) remains the most common. But pre-bankruptcy composition plans and extraordinary administration are also frequently used.

A debtor in *stato di crisi* (state of crisis) can file a petition to the relevant bankruptcy court for a pre-bankruptcy composition plan, a court-ordered procedure designed to avoid bankruptcy. The company presents its proposed plan to pay its creditors to the bankruptcy court, which then appoints a delegate judge and a *commissario giudiziale* (judicial commissioner).

The commissioner supervises the management of the business and its assets and may also take over management if ordered to do so by the court. The court calls a creditors' meeting, typically within 30 days, in which the creditors are called to vote on the proposal. In the meantime, the debtor may propose that secured and preferred creditors are paid in part.

Italian insolvency law

Main procedures *fallimento, concordato preventivo, amministrazione staordinaria*
Outcomes range from liquidation to survival of the company as a going concern
Insolvency definitions *insolvenza* (inability to pay regular debts), *stato di crisi*

Throughout the process, the debtor continues to manage its business under the supervision of the judicial commissioner.

In cases where the debtor fails to fulfil the pre-bankruptcy composition plan, or in cases of fraud, full bankruptcy may follow at the court's or creditors' discretion. If the creditors do not approve the plan, the court will declare the debtor bankrupt.

From the point of view of creditors, a pre-bankruptcy composition plan often has the best outcome. The procedure is relatively quick, with plans usually approved in six months to one year. And recoveries are relatively high. Before the reforms of 2006 and 2007, companies were required to repay secured creditors in full and pay at least 40% to unsecured creditors under a pre-bankruptcy composition plan. That is no longer the case, but recoveries in the order of 30-40% for unsecured creditors and 60-80% for secured creditors are common.

A third procedure for a debtor that is in a state of crisis is to propose a reorganisation agreement to creditors. The bankruptcy court's involvement in this process is limited to matters such as verifying the regularity of the papers. The agreement, which can take many different forms as negotiated between the parties, needs to be approved by 60% of relevant creditors.

Extraordinary administration is a government-ordered procedure that is regulated outside of the bankruptcy code by a special act, and is devised for large enterprises or groups of companies employing no fewer than 200 people and with total debts equivalent to less than two-thirds of annual turnover. The purpose of the procedure is to work out a scheme so that the company

can get back on its feet or be sold as a going concern to a third party.

The proceedings are initiated by a decree of the bankruptcy court, issued in agreement with the ministry of industry. Between one and three commissioners are appointed, who run the proceedings under the supervision of the court and the ministry. The law also provides for the appointment of a surveillance committee, including one or two creditors. The business is usually permitted to carry out its normal day-to-day business and the procedure runs for a maximum of one year, which may be extended for a total duration not exceeding one year and three months.

A new procedure was introduced for the bankruptcy of Parmalat in December 2003, and has since been used for other companies, including Alitalia. The so-called Marzano law introduced a special set of rules for very large enterprises employing no fewer than 500 people and with an exposure of total debts equal to or higher than €300 million.

This procedure is a particular implementation of extraordinary administration, in which the ministry appoints an extraordinary commissioner with wide powers and significant discretion. In particular, the extraordinary commissioner may propose a restructuring plan, claw back payments made by the company before it went into administration or propose to the creditors a composition plan that would allow the company to exit the procedure.

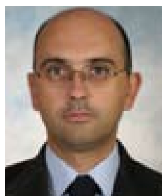
Around 35 companies a year have been subject to extraordinary administration; recent examples include luxury goods firm Ittierre and car parts maker Cablelettra.

The aim of the procedure is to keep companies operating and preserve employment. This is often at the expense of creditors and has contributed to low recoveries; for example, creditors saw only around 10% in the case of Parmalat.

By contrast with the procedures outlined above, bankruptcy takes place when a company is judged to be unable to pay its regular debts and always leads to its dissolution. At the request of one or more creditors or of the public prosecutor, the bankruptcy court enters a declaratory judgment (*sentenza*) ruling the debtor bankrupt.

Any creditor, including a foreign creditor, can file a petition, but it must be filed in the bankruptcy court of the district where the debtor has its main place of business in Italy. The debtor and any other interested party can appeal against the bankruptcy ruling, ultimately, to the supreme court.

Bankruptcy is not only the worst possible outcome for directors of a company – who can face several years in prison in some cases – it is also bad for creditors. Unsecured creditors usually recover little or nothing from bankruptcy and secured creditors get only a little more. The bankruptcy process usually takes at least six years and often as many as 10.



“Bankruptcy is the worst possible outcome for directors and creditors”
Mauro Battistella

After granting a request for bankruptcy, the court will appoint a bankruptcy trustee (*curatore*), together with a bankruptcy delegate judge (*giudice delegato*), who supervises the actions of the trustee. Bankruptcy law also provides for the formation of a creditors’ committee (*comitato dei creditori*) that advises the trustee and is granted veto power over certain decisions. From this point, all creditors’ actions and claims are automatically stayed and interest on unsecured claims ceases to accrue.

The bankruptcy trustee is charged with administering and liquidating the debtor’s estate under the supervision of the delegated judge and the creditors’ committee. Whereas before the reforms of 2006 and 2007 the trustee rarely took any action without the approval of the delegate judge or court, now the bankruptcy trustee enjoys significant discretion.

Initially, the trustee will take delivery of the estate, take all steps necessary to preserve the assets and prepare an inventory of assets. The trustee will prepare a list of all claims on the company. As an interim measure, the court may allow the continuation of the business for a determined period, if interruption could cause significant damage.

A key principle of Italian bankruptcy law is the so-called *par condicio creditorum*, which means that all creditors have an equal right to payment and that the proceeds of the debtor’s estate shall be distributed in proportion to the size of creditors’ claims. However, two groups of creditors enjoy preferential treatment: those with a security interest (*creditori ipotecari o pignoratizi*) and those with a preference by operation of law (*creditori privilegiati in senso stretto*). The latter include the tax authorities and employee salaries, as well as claims that arise after bankruptcy.

The equality principle actually applies to non-preferred creditors who have an unsecured claim. These creditors, known as *creditori chirografari* share pro rata in the amount available to them.

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