RESCUE CULTURE IN ITALY. THE RECENT INTRODUCTION OF KEY INCENTIVES TO COMPANIES IN CRISES TO RESTRUCTURE THEIR BUSINESS[1]

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1. The Italian insolvency law at the dawn of the modern economy.

The origins of the Italian insolvency law date back to the year 1942. Inspired by liberal economic ideology, the underlying concept of the law was that business activities should be regulated mainly by the market. This meant that financially distressed businesses were guided, as quickly as possible, towards winding-up so that their inefficiency did not spark "contagion", with knock-on effects for the efficiency of the market.

The winding-up of a "lossmaker" (as businesses that could no longer meet their obligations 'properly' were defined) - was reached by subjecting the distressed business to bankruptcy proceedings in court. This approach to insolvency was deemed the most efficient way of satisfying the lossmaker's creditors, once the business had been barred from the market.

To achieve this result, which was in fact seen as a tool to make the market more efficient, some instruments of "persuasion" were used (and still are, albeit with the adjustments examined later on) to discourage a business owner and the stakeholders from pushing for debatable bailouts of financially distressed businesses.

As for business owners, any "obstinate" desire to save their companies despite a financial distress situation was deemed a criminal offence if (and this was virtually always the case) the

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continuation of business activities worsened the distress (with respect to a more timely discontinuation of business). Such behaviour was a criminal offence, called "bankruptcy".

The stakeholders of a sole business owner, meanwhile, were "dissuaded" from helping to keep the insolvent business afloat in two main ways:

a) criminal liability action, since it was (and still is, apart from the adjustments discussed later on) deemed a criminal offence to provide additional guarantees in response to a request therefor from a creditor of an insolvent business owner in return for further financial support (this offence was and is called "fraudulent preference"); and

b) financial action, consisting of the cancellation of the transactions made by stakeholders in the immediate period running up to the insolvency. As a result of these provisions, when a business owner was declared bankrupt, stakeholders found themselves facing the following main risks:

a) any payments of sums receivable from the bankrupt had to (and still have to) be returned to the receiver;

b) despite having been paid for in full, goods purchased from stakeholders had to (and still have to) be handed over to the receiver;

c) goods sold to the bankrupt business owner were retained by the receiver, but the price received by the seller had to be returned to the receivership proceedings;

d) the guarantees received from the business owner of the insolvent company, which had impaired the company's assets, were (and still are) cancelled.

This option was (and still is) known as "clawback action".

The criminal liability action and financial action provided multiple deterrents to dissuade stakeholders from continuing to do business with an insolvent company (one particularly appropriate way of putting it is to 'quarantine' the business owner, rendering them unable to interact with the surrounding business environment in order to speed up the company's expulsion from the market and prevent its ailments infecting other companies).

2. The Italian insolvency law in the modern economy.

2005 marked the beginning of the reform of the Italian insolvency law (dating back to 1942), which has since undergone a continuous series of changes, culminating in a new and comprehensive reform project, which is currently being debated by the Italian parliament.

Recently (i.e. since 2005), Italian lawmakers have acknowledged the fact that prompt discontinuance of business produces more disadvantages than those caused by continuation of business activities, even in a situation of precarious efficiency (or even actual ineffectiveness).

Experience gained in the over 60 years since approval of the 1942 insolvency law has demonstrated that:

i) on the one hand, winding up a business did not bring appreciable financial results for creditors, because liquidation of the assets of a discontinued company generally produces disappointing returns; and

ii) on the other hand, winding up a business produces more detrimental effects than the financial damage caused to creditors. Indeed, discontinuance of business activity also produces:

- adverse effects on workers, because employment levels fall,
- adverse effects on the local economy, because it loses an actor with whom business could be done;
- adverse effects on the national economy, because the production framework is weakened.

For these reasons, the ideological approach to "business insolvency" has changed, transitioning from the pursuit of a financially distressed business's swift exclusion from the market towards its recovery wherever possible.

3. Aiming for business recovery.

Maintaining the ban on (non-standard) out-of-court settlements.

The aim of the 1942 Italian insolvency law was to achieve closure of an insolvent company as quickly as possible by subjecting the company to bankruptcy proceedings in court. Bankruptcy was not the only way to put an end to an insolvent business, since in the following situations:

a) the business owner had not committed any offences or non-compliances (and therefore met the "merits" requirement); and

b) the business owner was able to satisfy creditors to an appreciable extent (quantified by law at 100% of the senior debt, and at least 40% of the unsecured debt) - thereby meeting the "worthwhileness" requirement

the insolvent business owner could avoid bankruptcy by offering their creditors a composition arrangement. A "composition with creditors" (reserved, therefore, solely for business owners deemed "honest but unfortunate") constituted an alternative to bankruptcy. It was therefore, by nature, aimed at reaching a settlement (by selling all the business owner's assets and distributing the proceeds of this liquidation procedure among the creditors).

In cases where the insolvency situation was judged to be "reversible" - i.e. that it could be overcome through action of various kinds - bankruptcy could be avoided (i.e. prevented) by an application for company administration.

With the company administration option, a business owner asked the Court to grant a moratorium, or period of stay (no longer than 2 years), during which the payment of all outstanding debts was postponed. Thanks this moratorium (as a result of which all prior creditors were forced to wait until the end of the procedure before they could lay their claims or bring any legal action to obtain payment), the business owner could enjoy of a moment of relief, with the procedure acting as "financial lung" with which to resuscitate their ailing business through restructuring.

Composition with creditors and company administration were called "insolvency proceedings offering an alternative to bankruptcy" and were the only options available to avoid bankruptcy proceedings.

In other words, the options available to prevent bankruptcy were "standard" institutions (composition with creditors and company administration), and there was no possibility of recourse to "non-standard" instruments (such as out-of-court proceedings), because in this case, if the proceedings had ended in bankruptcy, the fact that the commencement of the bankruptcy procedure had been delayed would have led to the application of penalties of a criminal nature and financial nature that had previously been envisaged as deterrents.

The new Italian insolvency law (the one introduced with the amendments of 2005, and gradually supplemented since then) retains this approach: the "proceedings offered as an alternative to bankruptcy" remain standard, although they have been (substantially) enhanced in terms of number and content. Consequently, it remains prohibited (in the sense explained above) for business owners to attempt to overcome (or settle) the financial distress situation through non-standard out-of-court solutions.

The reason for this approach (which is still, as mentioned, confirmed and reiterated in the reform project currently under debate before the Italian parliament) lies in the need to ensure compliance with general principles that Italian lawmakers hold as inalienable within the scheme of attempts to overcome (or settle) a financial distress situation.

4. The 'lowest common denominator' required in the new options available to financially distressed businesses in Italy: certification of the recovery plan.

Also in the current Italian insolvency law, bankruptcy can be avoided (or prevented) solely through the use of a "standard" procedure, i.e. corresponding, in the assumptions and contents, to one of those envisaged (and, therefore, "allowed") by this law.

At the moment there are three options available to financially distressed companies in Italy:

(i) the "**Certified Recovery Plan**" (Article 67, third section, subsection d) of the insolvency law);

(ii) **the "Restructuring Agreement**" (Article 182-bis, et seq. of the insolvency law);

(iii) **the "Composition with creditors"** (Article 160, et seq. of the insolvency law).

All three of these procedures share one aspect, the certification of the plan to govern (or settle) the financial distress situation by an independent expert.

The Italian insolvency law stipulates that the basis of any procedure intended to govern (or settle) a financial distress situation must be reviewed by an independent expert who:

(i) ascertains the "accuracy of the accounting data" used as a basis for the plan with which the business owner intends to overcome (or settle) the financial distress situation; and

(ii) ascertains the industrial and financial feasibility of the plan underlying the solution that the business owner is offering its creditors.

5. The removal of "deterrents" in the event of attempts to overcome (or settle) the financial distress situation involving recourse to standard arrangement options open to businesses in this situation

The business owner's acceptance of the submission of the plan prepared to overcome (or settle) the financial distress situation to review by an independent certifying expert (who ascertains the truthfulness of the accounting data and the feasibility of the recovery program) involves - regardless of the route chosen (of the three envisaged) - inapplicability of the "deterrents", which apply, however, if the business owner decides, instead, to resort to a non-standard out-of-court solution:

a) the criminal liability deterrent, in the sense that even in the event of subsequent bankruptcy

(i) any worsening of the distress does not constitute a prosecutable offence; and

(ii) any preferential treatment of one or more creditors does not constitute a prosecutable offence; and

b) The financial deterrent, in the sense that the sales, purchases, guarantees, payments, and in general any actions carried out as part of a plan and/or an agreement and/or a composition with creditors are not exposed to clawback action - in the event that the situation ends in bankruptcy-, not even if, theoretically speaking, all the conditions are met for clawback action to be taken.

Attempts to avoid (or prevent) bankruptcy are no longer discouraged through criminal liability and/or financial deterrents, because bankruptcy is no longer viewed as the best solution for businesses in financial distress situations.

6. **Incentives to take the arrangement options available to financially distressed businesses.**

Italian lawmakers soon realised that simply removing the criminal liability and financial deterrents against the continuance of business alone, without envisaging recourse to the standard arrangement options, was not enough to ensure the success of the new procedures introduced to deal with financial distress situations.

The presence of the "lowest common denominator" required, i.e. the certification of the plan to overcome (or settle) the financial distress situation by an independent expert, actually ended up becoming a brand new deterrent, due to the undesirable effects that meeting this condition could produce (directly or indirectly).

The involvement of an independent expert - i.e. one with no ties to the business owner and/or any other party in any way concerned by the implementation of the plan (including the main creditors, such as, usually, banks) - whose duty is to ascertain the accuracy of the accounting data (and the feasibility of the plan), may represent a deterrent against the adoption of the new procedures open to financially distressed businesses, due to the following factors:

a) the business is faced with an additional - and often considerable - cost (for professional services); and - above all -

b) the embarrassment potentially generated by the independent expert's activities in the event that problematic information is revealed in terms how performance and financial aspects are presented externally (and to members of the company) by the management (especially since the expert's activities also include assessment of the appropriateness and effectiveness of the values attributed to the items in the assets and liabilities statement, and not merely an actual calculation of the relative amounts).

In addition to removing the deterrents, Italian lawmakers have therefore also introduced measures intended to act as incentives for business owners.

These incentives consist of the various benefits offered to the business owner (in addition to the aforesaid elimination of the deterrents) when they decide to use one of the (three) arrangement procedures envisaged by the insolvency law for financially distressed business in order to overcome (or settle) the distress situation .

It should nevertheless be stressed that the incentives are not the same for all three of the options envisaged.

The incentives differ in that they increase progressively in impact and content, within a 'tiered' approach; the first procedure offers certain incentives, the second option provides certain supplementary incentives (i.e. the same as the first, plus others); the third procedure offers certain additional supplementary incentives (the same as the first, the same as the second, and still others) - some of which consist of an increase in the effectiveness and scope of the incentives common to all three procedures.

The underlying logic to this tiered approach to the incentives corresponds to an increasing involvement of the legal system within the procedure.

In other words, the number and impact of the incentives increase in direct proportion to the increasing role of (and consequently guarantees offered by) the legal system.

Where there is no involvement of the legal system (the certified recovery plan option), the incentives are minimal.

When the legal system starts to have some involvement (the restructuring agreement option), the incentives increase.

Where the role of legal authorities becomes more intense (or, one might say, invasive) - "composition with creditors" - the incentives increase still further.

The owner of a financially distressed business is therefore faced with a choice as to the level of judicial control they are willing to accept in attempt to overcome (or settle) the distress situation, taking into account the fact that greater judicial control means greater incentives (and therefore a greater likelihood of the plan's success).

This, however, is only one aspect of the circumstances.

The incentives we are considering involve not only the business owner, but also the stakeholders, i.e. suppliers; customers and clients; and banks, because they affect the way the relations between one and the other are governed.

The choice of which option is most worthwhile for the business therefore, is not based solely on the business owner's judgement, but also, and very often more so, on the stakeholders' opinions (especially banks), because they may be more willing to cooperate in an attempt to overcome (or settle) the financial distress situation in the event of use of a particular procedure (among the three theoretically available); and likewise may be less willing to cooperate in the event that the business owner chooses a different procedure. Obviously, the business owner cannot simply ignore its stakeholders' opinions (especially the banks').

7. The certified recovery plan.

7.1 Subjective and objective requirements.

The Italian insolvency law does not expressly specify what parties are allowed to adopt the certified recovery plan option, or the situations in which businesses can have recourse to this option.

However, the law specifies that the aim of the plan is to restore "*the business' financial balance*" and as a rule this means that:

a) this procedure cannot be used in situations where business activities are likely to cease (and therefore, typically, in receivership situations); and

b) this option is only available to "business owners", i.e. owners of an actual business, and not, therefore, to individuals who do not qualify as such according to Italian law (such as, for example, professionals, employees, consumers);

Conversely, the law does not specify certain attributes of the business owned, for example whether it is:

a) small or large;

b) in trade (as defined in the Italian Civil Code) or in agriculture;

c) "ordinary" or "special". Regarding the last aspect, it must be taken into account that banks and other financial or insurance brokers can make use of this option even though, generally speaking, they are not eligible for "ordinary" insolvency proceedings (i.e. they cannot be declared bankrupt), but may be subjected to "special" procedures, such as compulsory (i.e. court-ordered) receivership.

7.2 Proceedings and content.

The certified recovery plan option <u>does not entail any involvement of the legal system at all and, more specifically, neither</u>:

- for admission to the procedure;
- during the procedure;
- nor for any form of validation of the procedure.

This means that the certified plan is an out-of-court procedure, however it is a 'standard' procedure, because it involves - as mentioned - the work of an independent expert to certify the recovery plan.

The plan in question is normally, but not necessarily, an agreement with the creditors (or with certain creditors, for example - or, rather, usually - banks). This is possible (and usually occurs) because an agreement with the creditors (or with the more senior of these) is the most common way of attempting to overcome (or settle) a financial distress situation .

It does not have to be though, as other action may also be taken, such as, for example:

1) an agreement (not with creditors, but with a third party) to purchase a business unit, thereby contributing to the company's financial balance;

2) an agreement with a partner, resulting in an increase in share capital.

And it does not necessarily have to be an agreement with others, other options available could be unilateral actions, such as:

3) the disbursement of a funding to the company;
4) the contribution of one or more assets to the company.

In all these cases, the action taken as part of the plan cannot be deemed a criminal offence and is not exposed to the financial risk of clawback action (i.e. revocation in the event of bankruptcy).

7.3 Incentives.

In addition to the aforesaid removal of the criminal liability and financial deterrents, the preparation of a certified recovery plan also offers one (but only one) incentive, namely tax neutrality in the event of allowances granted by creditors.

In Italian tax law, if a business owner is granted a discount or an allowance from a creditor (who or which, in order to get paid, is willing to accept less than that actually due), then this amount generates a contingent asset, which is subject to tax. In other words, it is as if the debtor had recorded income from its business activities (amounting to the portion of debt relinquished as an allowance), on which normal tax should be paid.

If, however, the allowance represents the result of an agreement between the business owner and one or more of its creditors, as part of a certified recovery plan, such income is not subject to tax (if the plan is made public via filing with the business registry, because, generally speaking, the plan could also remain "confidential" i.e. secret), and this, obviously, represents a financial incentive.

8. Restructuring agreements.

8.1. Subjective and objective requirements

The insolvency law does not expressly state which parties are allowed to adopt restructuring agreements.

It states however that the said agreement can be submitted by a business owner in a financial distress situation: as a result, this option is only available to business owners, i.e. owners of an actual business, and not, therefore, to individuals who do not qualify as such according to Italian law (such as, for example, professionals, employees and consumers).

Conversely, the law does not specify certain attributes of the business owned, for example whether it is:

d) small or large;

e) in trade (as defined in the Italian Civil Code) or in agriculture;

f) ordinary or special; regarding the last aspect, it must be taken into account that banks and other financial or insurance brokers can make use of this option even though, generally speaking, they are not eligible for ordinary insolvency proceedings (i.e. they cannot be declared bankrupt), but may be subjected to special procedures, such as compulsory (i.e. court-ordered) receivership.

As regards situations in which this option can be adopted, the law refers to financial distress situations. This notion is not clearly explained by Italian law and business owners in the following situations are generally inclined to believe that they can use this option:

(i) businesses that are in a reversible situation (***financial distress***);

(ii) business that are in an irreversible situation (***insolvency***);

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8.2.Proceedings and content

The restructuring agreement foresees that the business owner enters into an agreement with creditors, the performance of which aims to overcome (or settle) the financial distress situation.

The agreement, however, is not standard because it features three very important points:

a) known deterrents of a financial and criminal liability nature have been eliminated;

b) the incentives already foreseen for the certified recovery plan have been added;

c) supplementary incentives have also been added to encourage the business owner to follow this option rather than the one represented by a plan.

To obtain the said supplementary incentives the following requirements must be met:

a) the agreement must be accepted by a number of creditors that represent at least 60% of the business owner's liabilities;

b) the agreement between the business owner and the said creditors must be approved (***ratified***) by the Court.

In this case, therefore, there is an additional final check by the Court, which is not foreseen by the certified recovery plan. For this reason, Italian lawmakers reward the use of the agreement option with the supplementary incentives.

An important clarification must be made.

If the agreement is ratified by the Court it produces the following effects:

a) it excludes the possibility of application of the deterrents of a financial and criminal liability nature that are normally applicable;

b) it generates the incentives already foreseen for the recovery plan;

c) it generates certain supplementary incentives (*below*);

d) it is binding upon all creditors who are part of the agreement (which, as stated above, must represent at least 60% of the liabilities);

e) it is not however binding upon creditors who are not part of the agreement; creditors outside the agreement must, therefore, be paid in full and promptly.

As stated, the judicial check foreseen is a final check.

The court, or any other legal authority, is not therefore involved in the previous stages; in particular, it is not involved in the negotiation stages and in the stage of entering into the agreement.

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8.3 The supplementary incentives of the restructuring agreement.

To encourage business owners to choose the restructuring agreement option in order to overcome (or settle) the financial distress situation, Italian lawmakers have made it easier for businesses to access credit.

A business in a financial distress situation normally has great difficulty in gaining access to credit (in particular with banks): to overcome this problem, Italian lawmakers have foreseen that certain loans granted to a business owner that enters into a restructuring agreement are secured by a special guarantee: ***preference over other creditors***

A credit secured by preference over other creditors means that it will be paid before the others, with preference over other creditors.

This encourages banks to fund businesses that have entered into a restructuring agreement, because said loans will be paid back before others and with preference over other creditors.

More precisely, the following types of financing are rewarded with the guarantee of preference over other creditors:

a) financing granted for the submission of the application for the ratification of the agreement;

b) financing granted after the submission of the application for the ratification and up to the ratification decision (if the authorisation has been obtained from the Court or if it is an urgent case);

c) financing granted to complete the agreement after it has been ratified.

9. Composition with creditors

9.1 Subjective and objective requirements

Unlike the certified recovery plan and the restructuring agreement, the composition with creditors option cannot be applied by all business owners.

Only business owners that are potentially subject to bankruptcy, are allowed to apply it, that is:

a) traders (in legal sense a business owner that carries out the following activities: production of goods or services, commercial or transport brokerage, bank or insurance activities or activities that are ancillary to the previous ones, excluding agricultural and light trade activities);

b) provided that they exceed a certain threshold of assets, debt, and turnover, as defined by the law.

As regards the situations in which these traders can adopt the composition with creditors option, the law refers to the financial distress situation also specified for application of the restructuring agreement (*above*).

9.2 Proceedings and content

Composition with creditors is a procedure in which the role of legal authorities (Bankruptcy Court) is intense in all the stages: initial, central and final.

Indeed:

a) the trader, even if the business is of a commercial nature and exceeds the thresholds established by the law, is not certain to be able to (propose and) enter into a composition with creditors, because the former must request the authorisation from the

Court beforehand (the law foresees that the trader must apply to the Court to be admitted to the attempt to enter into a composition with creditors);

b) Once the Court has granted the authorisation, the trader is not free to negotiate with the creditors in order to define the plan with which to attempt to overcome (or settle) the financial distress situation.

With the admission to the procedure, the Court in fact appoints a Judicial Commissioner and identifies a judge (the 'appointed judge'), with the task of checking the trader's activity.

The trader shall no longer be free to manage the business and shall be limited to ordinary management activities. To carry out any extraordinary management activity, the trader must be authorised by the appointed judge.

The trader must also carry out the negotiations with the creditors by means of a proceeding that is entirely executed in Court;

c) Once the Court has provided for the trader to reach a composition with creditors and once the creditors have, in theory, accepted the trader's proposal to overcome (or settle) the financial distress situation, the Court performs a final check. The agreement reached between the trader and the creditors as part of the composition with creditors proceedings is, in fact, once again submitted to the Court for review, for a final decision on its legitimacy (***ratification*** decision).

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As regards the content of the procedure for the composition with creditors, it is necessary to make an important premise.

As mentioned above, according to the 1942 Italian insolvency law, the company administration and the composition with creditors options constituted alternative proceedings to bankruptcy.

The company administration option was foreseen for businesses that had temporary difficulty in meeting their obligations, and it aimed for business recovery.

The composition with creditors was foreseen for businesses that were in an irreversible financial distress situation (**insolvency**) and was aimed at reaching closure or winding-up.

The 2005 reform of the Italian insolvency law amended the provisions of the two original alternative proceedings and established one single provision for business owners in temporary difficulty and for business owners in an irreversible distress situation (as stated, these two situations are both contemplated within the concept of financial distress situations).

The amended procedure has maintained the name 'composition with creditors' but it is not the same as the old composition with creditors, as the provisions of the original composition were integrated with the provisions of the old company administration, which no longer exists.

It is easy to understand however, that even though today there is just one procedure for composition with creditors, the effects are different depending on whether the aim is to recover or liquidate a business.

The two possible variations of the composition with creditors must foresee, in certain cases, different provisions: amendments made to the 2005 reform, up to today, have substantially reproduced the distinction there was in the past (between the recovery option of the company administration and the liquidation option of the composition with creditors), increasingly underlining the difference between the two variations of the current and single composition with creditors: to the point that the two variations have two different names:

a) Composition based on business continuity (recovery option, derived from the old company administration); and

b) Composition based on liquidation (business liquidation option, derived from the old composition with creditors).

That said, the contents of the proposal that the trader can make to its creditors, after having been admitted to the composition with creditors procedure, may vary: partial payment, deferred payment; conversion of payables into share capital of debtor's business; etc.

Furthermore, please note that:

a) the merits requirements that were required for the company administration and composition with creditors procedures before the 2005 reform are no longer required;

b) the worthwhileness requirement foreseen for the old composition with creditors (which foresaw the payment of 100% of the senior debt and 40% of the unsecured debt) is no longer required for the composition based on business continuity;

c) the worthwhileness requirement (which was completely abolished by the 2005 reform) for the composition based on liquidation is less severe than in the past, in fact now the assurance of the payment of 100% of the senior debt and 20% of the unsecured debt is sufficient.

9.3 The incentives of the composition with creditors

As mentioned, the composition with creditors proceeding takes places under the total and assiduous control of the Bankruptcy Court (through the activity of a Judicial Commissioner specially appointed by the Court, and of a judge that is specifically appointed to oversee each composition proceeding.

The Italian lawmakers therefore define the composition with creditors procedure as totally reliable.

Consequently, the Italian lawmakers provide that if a business owner chooses to adopt the composition with creditors (instead of the certified recovery plan or the restructuring agreement), the opening of the procedure shall:

a) exclude the possibility of application of the deterrents of a financial and criminal liability nature that are normally applicable;

b) generate the incentives already foreseen for the recovery plan;

c) also generate the supplementary incentives already foreseen for the restructuring agreement;

d) generate the additional supplementary incentives that are added to the incentives foreseen for the plan and for the agreement and that facilitate, even further, the attempt to salvage the business.

The composition with creditors envisages numerous additional supplementary incentives: the most effective ones are:

1. Binding nature of the will of the majority of creditors upon dissenting creditors

If the trader makes a proposal to overcome (or settle) the financial distress situation by resorting to the procedure of composition with creditors, the acceptance by the majority of creditors (consisting of a number of creditors that represent at least 50.01% of the unsecured liabilities) has binding effects also upon all other creditors.

This is clearly a great advantage, because in the event that the trader, for example, proposes to creditors to finally settle any debts by paying only 25% of the amount due, the acceptance by a certain number of creditors (a minimum number is not required) that hold at least 50.01% of the unsecured liabilities, would also allow the trader to extinguish the 49.9% of the unsecured liabilities of non-participating creditors by paying them only 25% of the amount actually due.

2. General nature of the preference over other creditors for all payables that arise during the composition with creditors.

The 2005 reform of the Italian insolvency law provides that all payables arising in relation to or during the composition with creditors <u>are given preference over previous payables.</u>

As a consequence, it is easier for the trader to maintain the relationships necessary to support the business activity, in fact the reward of implementing the preference over other creditors (that is to be <u>paid before and with preference</u> over others) is not only attributed to payables arising from financing (as for the restructuring agreement: *above*), but also payables deriving <u>from other agreements</u> (for example: employment agreements; goods or service supply agreements; etcetera): this means that the trader's usual stakeholders are encouraged to continue to support the former's business.

3. Right to choose between good and bad agreements.

The trader that chooses to solve the financial distress situation with the composition with creditors procedure has a further incentive: the choice whether to keep or terminate pending agreements. The trader shall obviously keep the favourable agreements and terminate the unfavourable ones.

This incentive translates into two principles:

(i) the stakeholder of a trader admitted to the composition cannot terminate the agreement entered into with the latter due to the opening of the said procedure. The opening of the composition with creditors is caused by the trader's financial distress: the contractual clauses (usually contained in all agreements) that provide for the termination of the agreement when one of the parties is subject to a composition with creditors cannot however be applied; and

(ii) the trader admitted to the composition however, has the right to terminate pending agreements, even if no claims have ever been raised against the stakeholder. Such power can be highly advantageous in situations in which the contractual services have become very disadvantageous for the trader admitted to the composition (for example, if there has been a drop in the prices of the products purchased by the trader, by terminating the agreement with the original seller, the former can buy the same products from other suppliers at lower prices).

9.4.The restoration underway and within the prospect of reform.

At a certain stage of the evolution of the Italian insolvency law, the composition with creditors procedure had become extremely favourable for traders.

A trader was in fact authorised to submit 'outrageous' proposals to the creditors which, if accepted by a majority (at least 50.01%), were binding also upon the dissenting minority (49.99%): proposals that could for example envisage:

(i) ridiculous payments (5%; 2%; 1% of unsecured loans); and

(ii) fail-safe solutions (proposals for the implementation of the plan to pay the creditors by selling the company to trader's friends, putting creditors in a take it or leave it situation).

This led to the abuse of this procedure, which resulted in the introduction by Italian lawmakers of restrictions on the use of the composition with creditors, aimed at ensuring greater protection for the rights of creditors.

These restoring innovations mainly include:

(i) the already mentioned obligation to ensure, in the composition based on liquidation the payment (of 100% of the senior debt) of at least 20% of the unsecured debt;

(ii) the right of creditors to submit ALTERNATIVE OFFERS. This means that if the composition proposal foresees that the business or a branch of the business or single assets are sold to a given party (a friend, or a relative, or a company of the same corporate group), each creditor may propose an alternative offer, which may be preferred to the original one proposed by the trader; and

(iii)the right of creditors to submit ALTERNATIVE PROPOSALS. This means that the trader's proposal, <u>in its entirety</u>, may be replaced by a different proposal, made by a creditor, and be accepted instead of the trader's proposal. This can have disruptive effects: for example, the trader may propose to the creditors a composition that foresees business continuity, and a creditor may submit an alternative proposal that envisages the termination and liquidation of the business: the creditors may accept the second proposal instead of the one made by the trader.

This is the current situation.

The Italian Parliament is however already approving a further reform. A key point of the reform will represent a revolutionary evolution for the Italian insolvency system: a trader shall no longer be the only party with the possibility to file proposals for composition, as it is today, (the trader, for example might not begin the procedure for fear of triggering opposing alternative offers or alternative proposals); creditors shall have the possibility to file proposals, even against the will of the trader concerned.

This will produce economic effects similar to the actual expropriation of the business, and lively discussions on the possibility of this revolutionary innovation are still underway.

I would be very pleased to have the opportunity in the near future to let you know the outcome of this debate.

Thank you for your attention.