Chapter 1

Introduction

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Having for many years been a relatively unfashionable matter for legislatures, corporate rescue has recently come under increasing attention, with a spate of reforms having taken place globally, and plans for reforms in a wide range of other jurisdictions. Governments and international interest groups[1] have realized the important role that corporate rescue can play in supporting businesses that are viable but experiencing temporary difficulties, preventing difficulties from arising in the first place and bolstering the economy.

Recent developments have taken place in three main areas:

(a) Comparative law studies by international organizations;
(b) Reforms to domestic insolvency procedures; and
(c) Increasing adoption of conflicts of laws agreements between multiple states, driven by internationalization.

It is not possible in a book of this size to consider all recent developments in detail. The primary focus of the book is on reforms to domestic insolvency procedures, although some attention is also paid to developments in relation to conflict of laws.

1. For example the European Union; UNCITRAL (Legislative Guide on Insolvency Law, adopted 25 June 2004); the OECD; the World Bank (compilation of Principles and Guidelines for Effective Insolvency and Creditor Rights Systems and a Global Insolvency Law Database); Group of 22, 'Report of the Working Group on International Financial Crises' (1998) (a list of principles for insolvency regimes and relations between debtors and creditors); Asian Development Bank Regional Technical Assistance Program for Insolvency Law Reform (TA No. 5795-REG).

Katarzyna Gromek Broc & Rebecca Parry, *Corporate Rescue,* pp. 1–18.

This introduction is intended to provide an overview, to place the chapters of this book in context and to indicate other reforms that have taken place but which are not considered in this book. Firstly the need for tailored, well functioning, corporate rescue laws will be considered. Attention will then turn to developments in each of the three categories above.

I. THE NEED FOR TAILORED, WELL-FUNCTIONING, CORPORATE RESCUE LAWS

Corporate rescue laws have long been recognized as a necessary alternative to liquidation. They operate on the basis that the value of the company is greater if it, or its business, is preserved as a going concern than if its assets were to be sold on a piecemeal basis. This preservation of value potentially benefits a range of stakeholders in the company. It can benefit investors in the company, whose investment may be preserved; its managers and employees, who may retain their jobs; its creditors, who may receive a greater proportion of what they are owed than they would if the company was liquidated. However the balancing of the interests of these different groups presents complex questions. It is clear that differences in political, social, cultural and economic environments will necessitate a diversity of approaches to the balancing of these interests.[2] Therefore, a scheme of corporate rescue laws that is suitable for use in one country will not necessarily suit the business environment in another country. In addition, under the umbrella term of 'corporate rescue' we can include a variety of approaches, including 'reorganization', 'reconstruction', 'composition' or a takeover of the company or its business. Considerable effort has been devoted to the study and design of corporate rescue systems and such laws have become a priority in well-developed insolvency systems.

Formal corporate rescue procedures generally assist by providing struggling companies with a period of respite from the claims of creditors and providing a framework for the restructuring of the company's business and for negotiations with creditors. The system must shield businesses that are struggling but viable, so that they may be restored to financial health yet, in doing so, it should achieve a balance so that it does not provide them with so much protection that they gain an unfair competitive advantage over rival businesses.[3] A structured process should

2. For a discussion of a novel approach in Canada see J. Sarra, *Creditor Rights and the Public Interest, Restructuring Insolvent Corporations* (University of Toronto Press, 2003).
3. This is an aspect of corporate rescue that has been most frequently commented upon in the United States, where the phenomenon of 'strategic bankruptcy' has been identified: see Kevin J. Delaney, *Strategic Bankruptcy: How Corporations Use Chapter 11 to their Advantage* (Berkeley: University of California Press, 1992) and Mahmoud Salem and Opal-Dawn Martin, 'The Ethics of Using Chapter XI as a Management Strategy' (1994) 13 *Journal of Business Ethics* 95. See also R.B. Sobol, *Bending the Law, The Story of the Dalkon Shield* (University of Chicago Press, 1991). The dangers of this type of behaviour have not been noted particularly in other countries: Bruce G. Carruthers and Terence G. Halliday, *Rescuing Business* (Oxford University Press, 1998), p. 362. However as corporate rescue laws worldwide become more generous the potential for strategic bankruptcy may arguably increase. This is a matter requiring further research.
4. O. Hart, 'Different Approaches to Bankruptcy' Harvard Institute of Economic Research Discussion Paper 1903 (September 2000).
5. S. Claessens, S. Djankov and A. Mody, 'Resolution of Financial Distress: An Overview' in S. Claessens, S. Djankov and A. Mody (eds), *Resolution of Financial Distress* (World Bank, Washington D.C., 2001).
6. For a study of how the level of creditor rights and judicial efficiency in a country may influence the rate of bankruptcy filings see S. Claessens and L.F. Klapper, 'Bankruptcy Around the World: Explanations of its Relative Use' (2005) 7 *American Law and Economics Review* 253.
7. The European Bank for Restructuring and Development has noted a correlation between the effectiveness of a country's bankruptcy laws and the level of foreign direct investment in that country: [Spring 2000] *Law in Transition* 43. See also R. La Porta, F. Lopez de Silanes, A. Shleifer and R.W. Vishny, 'Legal Determinants of External Finance' (1997) 53 *Journal of Finance* 1131.
8. For example, in the UK, Insolvency Act 1986, s. 214 (wrongful trading).
9. For example, in the UK, Company Director Disqualification Act 1986, s. 6, discussed in detail in A. Mithani (ed), *Mithani: Directors' Disqualification* (Butterworths, London, looseleaf). There is a lack of consensus in Europe regarding the circumstances when disqualification is appropriate, however, with other jurisdictions confining disqualifications to cases where the director has been involved in criminal activities.

determine what happens to the firm: this process may entail a decision by a court; bargaining among creditors; or the employment of a debt for equity swap to create a homogenous class of shareholders in place of diverse classes of creditors;[4] or it may be triggered automatically.[5] Suitable procedures should be available for businesses of all sizes that are viable but in need of assistance. As noted above, the system must achieve a suitable balance between the rights of the debtor, its creditors and other stakeholders.[6] Predictability regarding what will happen if a business gets into financial difficulties is of wider economic importance, since it will enable investors and creditors to plan their dealings with the company. This predictability can encourage investment and lending that might not otherwise take place.[7] A lack of stability would bring an increased risk of a sudden withdrawal of investment, in particular in countries that are reliant on foreign investment, potentially triggering an economic crisis.

The approach of the system to directors and shareholders can also have an impact on the chances of success of corporate rescue efforts. Sanctions against directors who allow their companies to trade while insolvent, causing losses that might otherwise have been avoided, can be used as a deterrent. For example the director might be ordered to pay compensation to creditors,[8] or he might be disqualified from acting as a company director for a period of time.[9] The fear of potential liabilities of this nature can potentially shock directors into seeking help at an early stage of their company's difficulties. However any such penalties must be kept in balance with the need to support entrepreneurship, in particular so that entrepreneurs are not deterred from responsible risk-taking and from trying again if their business has failed. It has also been suggested that a system that leaves

shareholders with nothing of the company's value in cases of liquidation may deter early employment of insolvency procedures and Lead the shareholders to support the directors in taking on excessively risky projects in an attempt to trade out of difficulties.[10]

Corporate rescue laws are important not only as a means of resolving crises in relation to individual struggling firms. Corporate rescue laws can assist in the resolution of systemic financial crises. The East Asian financial crisis in 1997 was exacerbated by a lack of adequate insolvency procedures, which hampered reorganization efforts in relation to struggling businesses. Inadequate bankruptcy laws, in particular corporate rescue laws, were in place to provide companies with breathing space and to facilitate financing by granting priority to fresh advances to enable the company to overcome its difficulties. Naturally, in cases where the economy is in crisis, further measures might include an exchange rate guarantee, so that investors have greater certainty about the value of the firm, and creditors can better assess the appropriate level at which to accept settlement of what they are owed. The Mexican FICORCA[11] and Indonesian INDRA[12] systems provide successful examples of such schemes.[13] State intervention may be necessary to support the banking sector. Following the Asian financial crisis, asset management companies were commonly employed to relieve banks of the burden of non-performing loans.

A principled approach to state intervention in financial difficulties of companies is generally necessary. This intervention is particularly important in the context of emerging economies, where formal proceedings are inadequate, and can take the form of mediation with creditors,[14] and assistance with negotiations, or the provision of guidelines to structure dealings with creditors.[15]

The state can also play a role in both emerging and developed economies through the provision of investment, loans, loan guarantees or other financial assistance to key businesses that are in financial difficulties.[16] Such intervention can help to contain the financial crisis and minimize the impact on the economy,

10. O. Hart, 'Different Approaches to Bankruptcy' Harvard Institute of Economic Research Discussion Paper 1903 (September 2000).
11. *Fideicomiso para la Cobertura de Riegos Cambiarios* (The Trust Fund for the Coverage of Exchange Rate Risk).
12. Indonesian Debt Restructuring Agency.
13. For details see World Bank, *Global Development Finance* (World Bank, Washington D.C., 1999), pp. 89–90.
14. For example the Jakarta Initiative Task Force was established after the Asian Financial Crisis to accelerate debt restructuring through mediation and facilitation.
15. For a discussion of relevant issues in emerging market economies see R.A. Gitlin and B.N. Watkins, 'Public Sector Participation in Corporate Debt Restructuring: Practical Aspects of Government Programmes' [Spring 2000] *Law in Transition* 6.
16. For a detailed discussion of bailouts see C.D. Block, 'Overt and Covert Bailouts: Developing a Public Bailout Policy' (1991–2) 67 Ind LJ 951 and more recently B.E. Gup (ed.) *Too Big to Fail: Policies and Practices in Government Bailouts* (Praeger, Westport, Connecticut, 2004). See R.B. Reich, 'Bailout: A Comparative Study in Law and Industry Structure (1984–5) 2 Yale J on Reg 163 for an examination of four case studies.

by preserving jobs and enabling continued dealings with the distressed enterprise by suppliers and customers. However, financial assistance from the state entails some of the burden of the company's financial difficulties falling on the public purse, and this entails increased taxation. In addition the availability of such financing may encourage inefficiency in firms, who may come to expect that they will be bailed out of future crises. The provision of state aid to firms in difficulty can also be viewed as frustrating a natural feature of a competitive market, which is the exit of inefficient firms. Therefore it is necessary for any such assistance to be tightly regulated, so that it is only applied in cases where there is a genuine need. Ideally the assistance should be temporary, limited to what is necessary in order to facilitate reorganization, and should be a one-off event.[17]

More widely it should not be forgotten that corporate rescue laws do not operate in a vacuum. Such laws can provide a cure for economically troubled companies; however the general legal infrastructure has a part to play in *preventing* financial difficulties, through effective corporate governance processes.[18] Mechanisms may be employed for the provision of information[19] and advice to business managers[20] so that they may know when their business is in difficulties and can be guided as to what steps are appropriate for them to take. Controls may also be placed on unwise borrowing and lending, in particular to prevent an accumulation of short-term loans, as a safeguard against financial difficulties.

II. COMPARATIVE LAW STUDIES BY INTERNATIONAL ORGANIZATIONS

Globalization of investment has been a significant driving force behind many reforms. In particular, international financial organizations such as the World Bank and International Monetary Fund have played a key role in pushing for reforms to

17. In the European Union the provision of state aids to struggling companies must fall with in the Community Guidelines on State Aid for Rescue and Restructuring Firms in Difficulty OJ, C 244, 1 October 2004, p. 2.
18. The collapse of Enron and similar financial scandals emphasize that effective corporate governance is a key means of prevention of future crises in relation to publicly traded companies.
19. An innovative French system describes warning signals that business managers may detect from their relationships with for example their bankers, employees, customers and suppliers: <http://www.entreprisepreventionn.com>, 5 May 2006. A. Bricard, 'Support to businesses facing financial difficulties- the Centres for Information and Prevention (CIP) in France', speech given at a European Commission Conference on insolvency and fresh start – Brussels, 28 March 2006, text available at <http://europa.eu.int/comm/enterprise/entrepreneurship/support_measures/failure_bankruptcy/confpres.htm>, 5 May 2006; discussed in N. Mourlot, 'Les six signaux qui doivent vous mettre en état d'alerte', (2005, September) 237 *L'Enterprise* 94.
20. The Netherlands *Ondernemersklankbord* <www.ondernemersklankbord.nl>, 5 May 2006 is a body comprised of business experts, such as retired entrepreneurs, which provides advice to small and medium sized businesses, including advice in relation to insolvencies.

domestic systems of insolvency. Reforms to domestic bankruptcy laws are regarded as a necessary part of a strengthened international financial architecture.[21] In particular these laws play a role in well functioning domestic markets, which are seen as a necessary part of a well functioning global economy.

The World Bank has issued *Principles and Guidelines for Effective Insolvency and Creditors' Rights Systems*. This document was prepared in collaboration with the IMF, the Organization for Economic Cooperation and Development, UNCITRAL, the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, International Finance Corporation, INSOL International and the International Bar Association. These principles have been used as benchmarks for the assessment of domestic systems of insolvency laws. The Principles are complemented by a *Legislative Guide on Insolvency Law*, issued by UNCITRAL in 2004. This Guide is designed to include the key elements of an effective insolvency law, and to provide a detailed series of recommendations giving guidance on the content of insolvency laws, including a variety of discussions and approaches. A consolidated document containing the World Bank Principles and the UNCITRAL Guide has been produced.[22]

The consolidated document covers a wide range of factors relating not only to insolvency laws, but to the general environment of lending and enforcement, including institutional and regulatory frameworks. It extends to the credit environment, including collateral and enforcement mechanisms; and risk management through credit information systems and the encouragement of informal workouts, in addition to formal insolvency laws that achieve an appropriate balance between liquidation and reorganization, and an ability to convert one type of proceedings into the other. This contextual approach is important since the design of a system of corporate rescue laws cannot be considered in isolation from the social, political, economic and cultural environment in existence in each country.

The World Bank Principles in relation to reorganization proceedings emphasize that:[23]

> 'The system should promote quick and easy access to the proceeding; assure timely and efficient administration of the proceeding; afford sufficient protection for all those involved in the proceeding; provide a structure that encourages fair negotiation of a commercial plan; and provide for approval of the plan by an appropriate majority of creditors.'

21. The issue of sovereign bankruptcy, which many have argued is a necessary feature of the international financial architecture, in place of bailouts employed in relation to nations in the past, lies outside the scope of this book.
22. Available at <http://siteresources.worldbank.org/GILD/ConferenceMaterial/20774191/ICR_Standard_21_Dec_2005_Eng.pdf>, 14 April 2006.
23. World Bank, *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*, C14.1.

A modern system of reorganization is identified as being the creation of an environment with a number of key features:[24]

- a flexible approach for the formulation of a plan with requirements as to fairness and the prevention of commercial abuse;
- identification of the process for voting on, and approval of, the plan;
  - here the guidance states that creditors may be provided with voting rights proportional to their claims; the votes of insiders should be scrutinized and treated in a manner that promotes fairness; the approval of the plan should be based on clear criteria and should be aimed at achieving fairness among similar creditors; priorities should be recognized and a principle of majority acceptance should be applied; that opposing creditors should be offered a dividend at at least the level that they would be entitled to receive in liquidation; that the court should normally defer to majority vote in giving confirmation and that if no plan can be agreed within a given time period, the debtor should enter liquidation;
  - recognition of relative priorities and majority acceptance, while offering opposing creditors or classes a dividend equal to or greater than they would likely receive in a liquidation proceeding;
- procedures for the implementation of the plan, subject to suitable supervision, and possible amendment of it;
- provision that this plan is binding on creditors, including dissenting minorities;
- appropriate procedures to deal with instances of fraud;
- swift closure of the proceedings upon the completion of the plan and provision for the enterprise to then be able to carry on its business normally.

This approach provides guidelines but is not prescriptive about details. As noted above, national differences relating, for example, to the treatment of creditors and employees mean that a 'one size fits all' approach cannot be achieved in this area of law.[25] Compliance with the Principles can only therefore provide reassurance to creditors and investors regarding the basic format of the laws so that a consideration of the specific format of the laws in each country must be considered in planning lending or investment decisions.

The Principles also recognize that informal processes can enable an agreement to be reached with particular creditors and can be an appropriate and efficient means of resolving difficulties.[26] Although they are not considered in

24. Ibid, C14.2–6.
25. In this regard it is perhaps notable that the European Union chose to adopt the open method of coordination in relation to insolvency laws, compared with the maximum harmonization approach envisaged for areas of consumer protection and capital market laws e.g. EU Directive on the Distance Marketing of Consumer Financial Services (2002/65/EC); and the EU Prospectus Directive (2003/71/EC).
26. See J.A.A. Adriaanse, *Restructuring in the Shadow of Law, Informal Reorganisation in the Netherlands* (Kluwer Law International, Deventer, 2005).

accurately reflected in the reform of the law. As observed, it is important to recognise the different characteristics and to appreciate how these may affect the corporate governance structure of each country.[54] In promoting investor confidence, Cyprus should evaluate the rescue regimes of other existing systems and implement a formal corporate rescue system. In doing so, the economic, political and cultural traditions should be taken into consideration. As the example of New Zealand shows, given that large companies are uncommon, it might be more efficient to adopt a rescue procedure which is inexpensive and accessible for all debtors and creditors.[55]

However, even if rescue provisions are not implemented in the legislation, other means should be established which promote rescues outside of interference by legislation, as for example education and facilitation through guidelines drafted by the Central Bank of Cyprus and professional bodies. Rules of conduct can be prepared that encourage informal rescues, especially between large companies. Several other jurisdictions with similar cultural characteristics[56] and with no formal corporate rescue procedures are currently reforming their insolvency laws to include rescue procedures. Cyprus should do the same. It is hoped that the financial crisis of Cyprus Airways, which resulted in major and unfortunate consequences for the Cypriot economy, should provoke discussion on this issue, resulting in reforms in this area. The country is in a good position to benefit from the wealth of experience of insolvency laws in leading economies and a reform of its rescue procedures is overdue. With reforms to rescue procedures taking place throughout Europe, Cyprus should act soon so that it does not fall behind its main trading partners in the development of sophisticated insolvency laws, thus ensuring that the jurisdiction is better viewed by overseas investors. Otherwise, the country's international reputation could suffer as well as the reputation of its financial and legal infrastructure.

54. J. Solomon, A. Solomon, *Corporate Governance and Accountability*, (John Wiley and Sons, 2004), p. 147.
55. D. Brown, *Report for the Ministry of Economic Development* (International Insolvency Institute, 2000) available at <www.iiiglobal.org>, 1 May 2006.
56. As for example, India, Korea, Hong Kong, Malaysia and a number of Eastern European countries. In addition, Thailand and Indonesia have recently introduced formal corporate rescue provisions.

Chapter 4

England and Wales: Administration Orders

Rebecca Parry

This chapter provides an analysis of developments that have taken place in England and Wales since the far-reaching Enterprise Act 2002 reforms came into force.[1] The 2002 reforms effected dramatic changes to the corporate rescue system and a series of significant further developments has followed, in particular in relation to the manner in which the courts have balanced the interests of stakeholders under the legislation. The English courts have also played a central role in important developments in international insolvencies, with the courts finding ways to support consolidated proceedings in relation to insolvent corporate groups, often to the consternation of observers in mainland Europe.

This chapter will begin with a brief overview of the new format administration procedure,[2] before going on to highlight the key developments that have emerged in cases that have been brought before the courts since the reforms took place.

1. For discussion of the reforms see also S. Frisby, 'In Search of a Rescue Regime: The Enterprise Act 2002' (2004) 67 MLR 247; I.F. Fletcher, 'UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements – The Insolvency Act 2000, The White Paper, and the Enterprise Act 2002' (2004) 5 EBOR 119; R.J. Mokal, *Corporate Insolvency Law* (OUP, Oxford, 2005); J. Armour and R. Mokal, 'Reforming the Governance of Corporate Rescue: The Enterprise Act 2002' [2005] LMCLQ 28.
2. Special administration regimes apply in relation to water companies (Water Industry Act 1991, Ch. I, Pt. II and ss 23–25); railway companies (Railways Act 1993, s. 59); air traffic companies (Transport Act 2000, s. 29); London transport public-private partnerships (Greater London Authority Act 1999, ss 210 and 220–221); and building societies (within the meaning of Building Societies Act 1986, s. 119). These regimes will not be discussed in this chapter.

Katarzyna Gromek Broc & Rebecca Parry, *Corporate Rescue*, pp. 57–92.

I. OVERVIEW OF THE ADMINISTRATION PROCESS AND THE 2002 REFORMS

The corporate rescue procedure of administration was first introduced as part of substantial reforms to the UK insolvency procedures in 1985–1986, which took place after a protracted process of review.[3] Administration is an insolvency practitioner led process that enables the company to arrange its affairs under the aegis of a moratorium.[4] This moratorium takes effect upon the application for administration being made[5] and operates to prevent persons with claims against the company from taking action against the company pending the granting of the administration order. During the moratorium the company cannot be wound up.[6] The permission of the court, or the administrator, must be obtained if a creditor wishes to enforce his security, to repossess goods held by the company under a hire-purchase agreement, or to take other similar steps.[7]

The initial impact of the administration procedure was disappointing, as was the impact of the company voluntary arrangement procedure that was introduced under

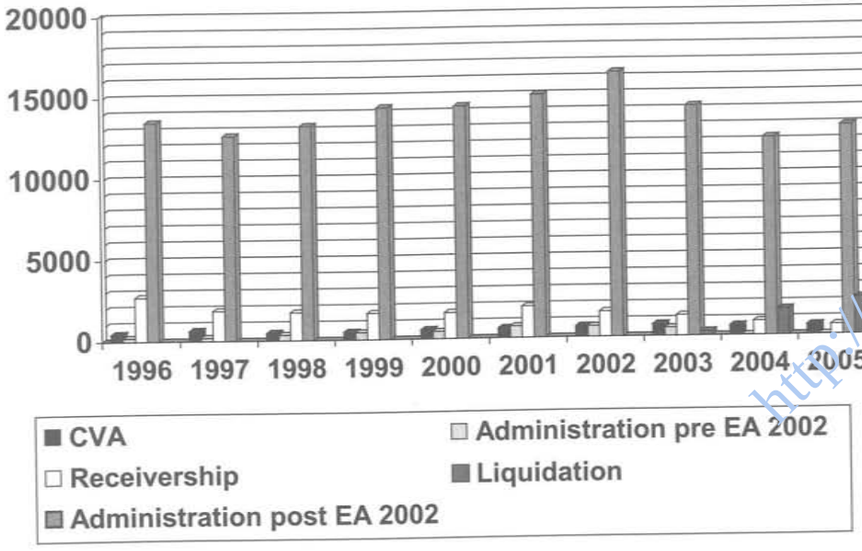
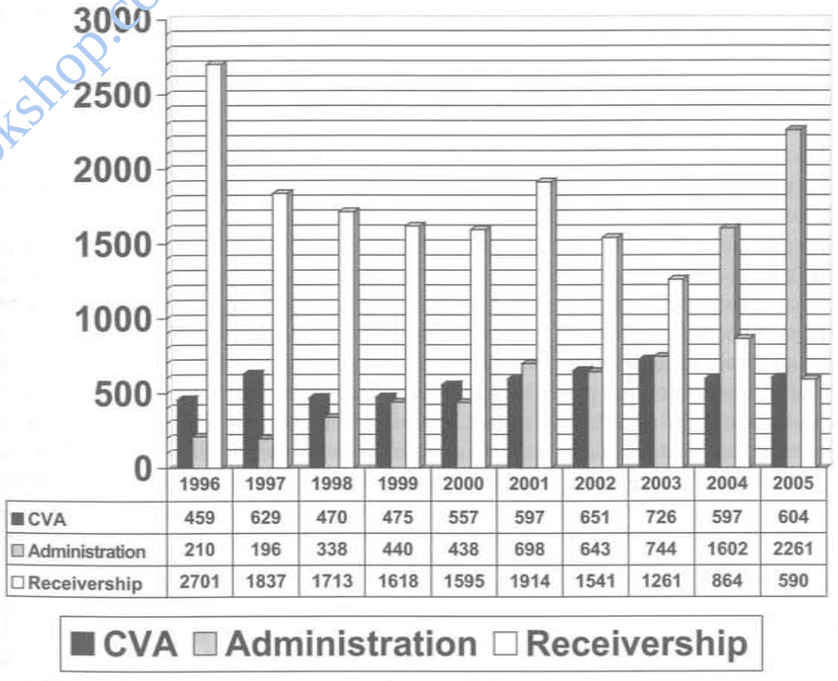


Figure 4.1. Frequency of Insolvency Procedures

3. *Insolvency Law and Practice Report of the Review Committee*, Chairman Sir Kenneth Cork. Cmnd 8558 (London: HMSO, 1994 reprint), Ch. 9.
4. IA 1986, ss 10(1), 11(3), and now also Sch. 2B, para. 43, inserted by EA 2002. The impact of the moratorium on creditors is considered in D. Milman, 'Moratoria on Enforcement Rights: Revisiting Corporate Rescue' [2004] Conv 89.
5. IA 1986, s. 10(1) and now also Sch. 2B, para. 44, inserted by EA 2002.
6. Ibid., Sch. 2B, para. 42, inserted by EA 2002.
7. Ibid., Sch. 2B, para. 43, inserted by EA 2002.

the same reforms.[8] These procedures were implemented in only a small proportion of formal corporate insolvency proceedings recorded each year. In part this disappointing impact was attributed to the dominance of administrative receivership, a procedure that could be initiated by a floating charge holder and which could be used to block the appointment of an administrator. Anecdotal evidence suggested that a floating charge holder would tend to use this procedure wherever it was an available option, in preference to the other, more collective, insolvency procedures.[9]

The 2002 reforms limited the availability of administrative receiverships in cases where the floating charge was granted after 15 September 2003 to a group of very narrow exceptions.[10] In place of administrative receivership the floating charge holders are given an entitlement to appoint an administrator, under a revamped administration procedure. However the holders of floating charges that were created prior to 15 September 2003 are still able to implement the administrative receivership procedure, if they wish to do so. The impact of the reforms will therefore increase over time as more charges are created. However the early



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
CVA	459	629	470	475	557	597	651	726	597	604
Administration	210	196	338	440	438	698	643	744	1602	2261
Receivership	2701	1837	1713	1618	1595	1914	1541	1261	864	590

Figure 4.2. Frequency of Rescue procedures

8. See K. Gromek Broc, in this volume, p. 105.
9. H. Anderson, 'Seismic Change in the UK' (2002) 21 *International Financial Law Review* 41.
10. Listed in IA 1986, ss 72B to G and Sch. 2A.

indications are that their impact on the pattern of corporate rescue proceedings has been significant. Since the 2002 reforms the number of administration orders has increased substantially and the number of receiverships has declined. Moreover the number of creditors' voluntary liquidations[11] has declined relatively sharply.

Although this statistical shift may be attributed in part to some features of the administration procedure that will make it attractive to company managers, in preference to liquidation, even in cases where the company is beyond salvage,[12] a potential distortion that will be considered further below,[13] it is also an indicator that the rescue culture is taking a greater hold. If this is the case the 2002 reforms represent a significant turning point, since a cultural reluctance among managers to seek help at an early stage has been an important factor in the previous under-use of the corporate rescue procedures.

II. ADMINISTRATION FOLLOWING THE ENTERPRISE ACT 2002

The reforms to administration have made this procedure more streamlined and less dependent on the courts. Whereas previously an administrator could only be appointed by court order, the 2002 Act inserted additional provisions into the Insolvency Act 1986 that enable administrators to be appointed under an 'out of court' process, either by the company or by the floating charge holder.[14] This latter process compensates the floating charge holder for the loss of the right to appoint an administrative receiver. The out of court processes enable the administration procedure to be implemented with speed, combating one of the disadvantages of old style administration in comparison with administrative receivership.

Although the provision enabling the floating charge holder to appoint an administrator may be criticised for potentially leaving too much power in the hands of powerful creditors one key advantage is that the floating charge holder, typically the company's banker, is likely to be in possession of greater information than other creditors and likely to have enough at stake to wish to take action at an early stage. The provision thus potentially combats what has been one of the stumbling blocks to the implementation of administration, noted above, namely the reluctance of managers to admit that the company is in such financial difficulties that it needs help. Moreover it places greater emphasis on attempting to rescue the company,[15] when there had been no such obligation under administrative receivership.

11. IA 1986, s 84 sets out the circumstances in which a company may be wound up voluntarily. A voluntary liquidation is a creditors' voluntary liquidation if the directors are unable to make a declaration of solvency: IA 1986, ss 89–90. A solvent company is not eligible for administration: IA 1986, Sch. B1, para. 11.
12. See L Linklater, 'New Style Administration: A Substitute for Liquidation' (2005) 26 Comp Law 129 and A. Keay, 'What Future Liquidation in Light of the Enterprise Act Reforms' [2005] JBL 143.
13. At pp. 84–86.
14. IA 1986, Sch. 2B, paras 10–13, inserted by EA 2002.
15. Under the system of priorities regarding the purposes for which an administration order can be obtained, under IA 1986, Sch. B1, para. 3(1) , inserted by EA 2002.

Appointment by the Courts

The procedure for appointment through the courts starts with an application made by one or more of a specified list of persons,[16] including the company, the directors of the company, and one or more creditors. Notice of the application must be given to specified persons, including the floating charge holder.[17] The court may, upon this application, make an administration order if it is satisfied that the company is, or is likely to become, unable to pay its debts and that the administration order is reasonably likely to achieve the purpose of administration.[18] The wording, in using the terms 'may', 'likely' and 'reasonably likely' sets a relatively low standard of probability.

The wording order is in many respects the same as under the original IA 1986, s. 8(1), which still applies in relation to appointments under the terms of charges created before the cut off date. Both under the old and new provisions the court must be 'satisfied' that the company cannot pay its debts. However one change from the original provision is that the court previously had to 'consider' that it was 'likely' that the purpose of administration would be achieved; whereas under the new provision the court must be 'satisfied' that the administration order is 'reasonably likely' to achieve its purpose.[19]

The use of the phrase 'reasonably likely' would seem to set a lower test than under the original provision which was simply 'likely'. In the context of IA 1986, s 8(1)(a) the interpretation of the term 'likely' generated a lot of case law. One interpretation was that the term required a 'real prospect' that one or more of the stated purposes might be achieved[20] and this interpretation has been applied in some cases under the new legislation.[21] However, the term was interpreted more restrictively by Jacob J in *Highberry Ltd v Colt Telecom Group Plc (No 2)*.[22] In that case the learned judge interpreted the term as requiring the state of affairs to be 'more likely than not' to occur and to not merely require a real prospect of that outcome. In particular Jacob J was of the view that '[t]o expose the company to all the expense, danger, and problems associated with administration is a serious matter' and that, 'Parliament would not, in light of this, have envisaged the taking of such a risk in cases where there was only a real prospect of that outcome being achieved'.[23] It might be added that in *Re Harris Simons Construction Ltd* Hoffmann J had considered that 'section 8(1) only sets out the conditions to be

16. IA 1986, s. 7(4)(b) and Sch. B1, paras 12(1) and 38, inserted by EA 2002; and FSMA 2000, s. 359.
17. Ibid., Sch. B1, para. 12(2), inserted by EA 2002. Additional courses of action that the court may take are listed in para. 13(1).
18. Ibid., Sch. B1, para. 11, inserted by EA 2002.
19. Ibid., Sch. B1, para. 11, inserted by EA 2002.
20. *Re Harris Simons Construction Ltd* [1989] 1 WLR 306. This interpretation was influenced by the use of the term 'real prospect' in the Report of the Review Committee on Insolvency Law and Practice (HMSO, 1982), (Cmnd 8558), para. 508 in a passage recommending the introduction of the administration procedure.
21. *Re Redman Construction Ltd* [2005] EWHC 1850 (Ch), para. 12.
22. [2002] EWHC 2815; [2003] BPIR 324.
23. [2002] EWHC 2815; [2003] BPIR 324, para. [25].

satisfied before the court has jurisdiction . . . [it] still retains a discretion as to whether or not to make the order'.[24] Under this approach the learned judge considered that, even if the case satisfied the jurisdictional threshold, the court could decline to make an order if, taking account of all the circumstances, that seemed appropriate.

The wording has changed from requiring the court to 'consider' that it was likely that the purpose would be achieved to instead require the court to be 'satisfied' that the order is reasonably likely to achieve its purpose. In the *Harris Simons*[25] case Hoffmann J was of the view that to 'consider' requires a lower standard of persuasion than to be 'satisfied'. On this basis the new wording would seem to require a marginally higher standard of belief.

The court must be satisfied that the company is or is likely to become 'unable to pay its debts', a term which is defined as requiring that either the company cannot pay its debts as they fall due, or that it is insolvent on a balance sheet basis.[26] However, under a 'special case' procedure a floating charge holder may apply to court for an administration order without the need to demonstrate that a company is or is likely to become unable to pay its debts, as is otherwise required.[27] An order will only be made, however, if the court is satisfied that the applicant would be entitled to appoint under the out of court procedure, outlined below.[28]

Appointment Out of Court

The 2002 Act introduced two 'out of court' methods of appointment. One method enables the holder of a floating charge to make an appointment;[29] the other enables the company or its directors to make the appointment.[30] The speed with which these procedures can be implemented is one of the strengths of the new regime, since it enables a company to gain the benefit of the moratorium at an early stage and this may be crucial to the chances of survival for the company.

If the floating charge holder is to make the appointment their security must have become enforceable;[31] their security interest, or interests, must relate to the whole, or substantially the whole, of the company's property;[32] and the instrument creating their security must provide the power to appoint an administrator, or administrative receiver, or equivalent.[33]

24. [1989] 1 WLR 306, p. 371.
25. [1989] 1 WLR 306, p. 371. However it is arguable that more is required if one is to 'consider', since one can be persuaded of something to ones satisfaction but for one to 'consider' it is arguably necessary to hold a belief.
26. Under IA 1986, s. 123 and Sch. B1, para. 111(1).
27. IA 1986, Sch. 2B, para. 35, inserted by EA 2002.
28. Under the procedure set out in IA 1986, Sch. 2B, para. 14, inserted by EA 2002.
29. IA 1986, Sch. 2B, paras 14–21, inserted by EA 2002.
30. Ibid., Sch. 2B, paras 22–34, inserted by EA 2002.
31. Ibid., Sch. 2B, para. 16, inserted by EA 2002.
32. Ibid., Sch. 2B, para. 14(3), inserted by EA 2002.
33. Ibid., Sch. 2B, para. 14(2), inserted by EA 2002.

Although an out of court appointment may also be made by the company, or its directors, the floating charge holder potentially has a key role to play in such appointments. The floating charge holder must be given notice of the intention to appoint an administrator.[34] In addition the floating charge holder may apply to the court to have their own choice of administrator appointed[35] and the court shall agree to this request unless the court thinks that, in the circumstances of the case, it is right to refuse.

Under both 'out of court' appointment processes it is necessary for 'notice of intention to appoint' to be filed at court, together with a statement from the administrator consenting to act and stating that an objective of the administration is likely to be achieved.[36] The administrator will be appointed automatically upon the notice being filed with the court. In order that these notice requirements do not unduly delay the commencement of administration it has been provided that notice can be made by fax at times when the court is closed and that the appointment shall take effect from the time of the fax transmission.[37] This notice should include a statement of full reasons why it would have been damaging to the company or its creditors if the appointment had not been made in this way.[38]

Purpose of the Administration

Prior to the Enterprise Act 2002 reforms an administration order could only be obtained for one of a list of four purposes, namely: attempting to ensure the survival of company, and the whole or any part of its undertaking, as a going concern; obtaining the approval of voluntary arrangement; obtaining the sanctioning of a compromise or arrangement under the Companies Act 1985, s. 425; or effecting a more advantageous realization of assets than would be possible under winding up.[39] These purposes did not provide clear direction as to the preferred outcome of the administration.

The 2002 Act reformed the list of purposes for which an administration order may be obtained in a manner that prioritizes corporate rescue. Under the new regime the order may be made for one of three specific objectives, arranged in a hierarchy:[40]

34. Ibid., Sch. 2B, para. 26(1), inserted by EA 2002.
35. Ibid., Sch. 2B, para. 36, inserted by EA 2002.
36. Ibid., Sch. 2B, paras 18 and 19 (appointments by the floating charge holder) and paras 29 and 31 (appointments by the company or its directors), both inserted by EA 2002.
37. IR r. 2.19 and FORM 2.7B.
38. IR r. 2.19(8).
39. IA 1986, s. 8(3).
40. IA 1986, Sch. 2B, para. 3(1), inserted by EA 2002. As originally envisaged the hierarchy placed a stronger emphasis on rescuing the company. The Enterprise Bill referred to 'a single overarching purpose' of rescuing the company (*Notes to the Enterprise Bill* [2001–02] HCB 115-EN, para. 608). This objective was to be pursued by the administrator in all cases where it

Chapter 11

Insolvency Procedures in Italy

Prof. Alberto Jorio

I. THE REGULATION OF LEGAL PROCEDURES PRIOR TO THE 2005 REFORM – BANKRUPTCY

Until 2005, the system of bankruptcy procedures in Italian legislation was founded on Decree no. 267 of 16 March 1942, which regulated bankruptcy,[1] the procedures

1. On bankruptcy procedures see G. Santini, F. Bricola, F. Galgano (eds), *Commentario Scialoja-Branca, Legge Fallimentare* (Zanichelli, Bologna-Roma); G. Lo Cascio, *Diritto Fallimentare* (Giuffrè, Milano, 1996); L. Panzani (ed), *Il Fallimento e le Altre Procedure Concorsuali* (Utet, Torino, 1999–2000); V. Andrioli, 'Fallimento (dir.priv.)' in *Enciclopedia del Diritto*, vol. XVI, (Giuffrè, Milano, 1967), p. 264; U. Azzolina, *Il Fallimento e le Altre Procedure Concorsuali* (2nd edn, Utet, Torino, 1961); G. Bonelli, *Del Fallimento*, (Milano, 1938); A. Bonsignori, 'Il Fallimento' in Galgano (ed), *Tratt. Dir. Comm. e dir. Pubblic. Econ.*, X (Cedam, Padova, 1988); A. Bonsignori, *Diritto Fallimentare*, (Utet, Torino, 1992); A. Brunetti, *Diritto Fallimentare Italiano*, (Roma, 1932); V. Cuneo, *Le Procedure Concorsuali* (Giuffrè, Milano, 1988); G. De Ferra, *Manuale di Diritto Fallimentare* (2nd edn, Cedam, Padova, 1968); F. Ferrara jr. and A. Borgioli, *Il Fallimento*, (Giuffrè, Milano, 1995); L. Guglielmucci, *Lezioni di Diritto Fallimentare* (Giappichelli, Torino, 1998); G. Ruisi, P.F. Censoni, A. Maffei Alberti, A. Jorio, G.U. Tedeschi, 'Il Fallimento', in W. Bigiavi, *Giur. sist. civ. e comm.* (2nd edn, Utet, Torino, 1978); G. Lo Cascio, *Il Fallimento e le Altre Procedure Concorsuali* (2nd edn, Giuffrè, Milano, 1995); A. Maffei Alberti, *Commentario Breve alla Legge Fallimentare* (5th edn, Cedam, Padova, 2000); G. Mazzocca, *Manuale di Diritto Fallimentare* (3rd edn, Jovene, Napoli, 1996); U. Navarrini, *Trattato di Diritto Fallimentare* (Bologna, 1934–1935); P. Pajardi, *Manuale di Diritto*

Katarzyna Gromek Broc & Rebecca Parry, *Corporate Rescue*, pp. 241–256.

for compositions with creditors[2] and supervised administration,[3] as well as the procedure of compulsory administrative liquidation.[4]

This was a law that dated back many years, indicating the substantial immobility of the Italian legislator and the difficulties faced by this system in understanding the need for a modern solution to business crises.

The assumptions for the application of the dispositions regarding bankruptcy were both subjective and objective.

Starting with the subjective assumptions, the law of 1942 only allowed bankruptcy proceedings to be applied in the presence of an enterprise that was not a small company. This therefore excluded farmers and entrepreneurs, who could be defined as small businesses according to the Italian legal system. The law was also applied to companies, either partnerships or companies with share capital, but excluded companies carrying out agricultural activities.

Consumer bankruptcy was unknown in the Italian legal system.

Fallimentare (5th edn, Giuffrè, Milano, 1998), P. Pajardi, *Codice del Fallimento*, (Giuffrè, Milano, 3rd edn, 1997); L. Panzani-Colombini, *Il Fallimento. Profili Applicativi* (Utet, Torino, 1999); R. Provinciali, *Trattato di Diritto Fallimentare*, (Giuffrè, Milano, 1974); R. Provinciali, G. Ragusa Maggiore, *Istituzioni di Diritto Fallimentare* (Cedam, Padova, 1988); B. Quatraro, *Manuale delle Procedure Concorsuali Minori*, (Giuffrè, Milano, 1981); G. Ragusa Maggiore, *Istituzioni di Diritto Fallimentare*, (2nd ed, Cedam, Padova, 1994); G. Ragusa Maggiore, C. Costa, *Il Fallimento*, (Utet, Torino, 1997); E. Ricci, *Lezioni sul Fallimento*, I, (2nd edn, Giuffrè, Milano, 1997); II, (1st edn, Giuffrè, Milano, 1998); G.U. Tedeschi, *Le Procedure Concorsuali*, (Torino, 1996); S. Satta, *Diritto Fallimentare*, (3rd edn, Cedam, Padova, 1996); F. Vassalli, *Diritto Fallimentare* I, (Giappichelli, Torino, 1994); II, 1, (Giappichelli, Torino, 1997); A. Jorio, *Le Crisi d'impresa. Il Fallimento* (Giuffrè, Milano, 2000).

2. On procedures for composition with creditors see A. Bonsignori, *Del Concordato Preventivo*, in *Comm. Scialoja-Branca. Legge fallimentare*, sub artt. 160 ss, Zanichelli, Bologna-Roma, 1979; G. Lo Cascio, *Il Concordato Preventivo* (Giuffrè, Milano, 1976); A. Maisano, *Il Concordato Preventivo delle Società* (Giuffrè, Milano, 1980); A. Jorio, *I Rapporti Giuridici Pendenti nel Concordato Preventivo* (Cedam, Padova, 1973).
3. On supervised administration see A. Bonsignori, 'Dell'amministrazione Controllata' in F. Bricola and F. Galgano (eds), *Comm. Scialoja-Branca. Legge Fallimentare* (artt. 187–193), (Zanichelli, Bologna-Roma, 1992); A. Maffei Alberti, 'Commento alla l. 24 luglio 1978, n. 391', in *Nuove leggi civili*, 1978, 1525; A. Maffei Alberti, *Amministrazione Controllata: una Procedura da Abolire*, in *Giur. comm.*, 1985, I, 96; A. Gambino, 'I Gruppi nelle Procedure Concorsuali Minori' in *Giur. comm.*, 1993, I, 368; P.F. Censoni, *Gestione Commissariale e Funzione dell'amministrazione Controllata* (Giuffrè, Milano, 1994).
4. On compulsory administrative liquidation see A. Bonsignori, 'Liquidazione Coatta Amministrativa' in *Commentario Scialoja-Branca. Legge Fallimentare* (Zanichelli, Bologna-Roma, 1974); R. Costi, 'Attività Creditizie e Procedure Concorsuali. Un Profilo di Socializzazione del Rischio di Impresa' in *Pol. dir.*, 1975, 517; U. Belviso, *Tipologia Normativa della Liquidazione Coatta Amministrativa* (Jovene, Napoli, 1973); U. Belviso, 'La Liquidazione Coatta Amministrativa nel Quadro di una Riforma delle Procedure Concorsuali', in *Giur. comm.*, 1979, I, 249; G. Volpe Putzolu, 'La Crisi dell'impresa di Assicurazione', in Various Authors, *Problemi dell'impresa in Crisi*, in *Studi in Onori di G. Ferri*, (Cedam, Padova, 1983), 777.

Turning to the objective assumptions, bankruptcy was applied where there was a situation of insolvency, understood as the debtor's inability to meet his (its) own obligations punctually.[5]

The connotations of bankruptcy were essentially to sell off assets, and in most cases it aimed to sanction the definitive expulsion of the insolvent enterprise from the economic scenario.

Within the ambit of the proceedings, the 1942 law allowed the business to continue, but only if this was in the interest of the creditors and this requirement indicated the mistrust within the legal system towards the continuation of business after the start of bankruptcy proceeding[6]

Bankruptcy was declared in an order which appointed the judge responsible for directing and supervising the procedure, as well as the official receiver, a private professional figure who was given the task of selling off the company's assets and carrying out the legal initiatives aimed at enforcing the bankrupt company's credit rights and the claims of creditors to recover the assets belonging to the bankrupt company; the whole process was therefore aimed at furthering the interests of the creditors to obtain the best possible satisfaction from the sale of the bankrupt company's assets, under the direction of the judge appointed. It should be said that the procedures were always excessively long and offered rather poor results.

In the law of 1942 the legal structure of bankruptcy experienced an accentuation of its unofficial nature: creditors, who had once been the central figures in the proceedings and the initiators of its progress, became the mere users of the proceedings, the recipients of the results determined in their favour through the initiatives taken by the legal bodies to recover and sell off assets.[7]

5. E. Micheli, 'Il Processo di Fallimento nel Quadro della Tutela Giurisdizionale dei Diritti' in *Riv. dir. civ.*, 1961, I, 1; G. Rossi, 'Equivoci sul Concetto di Insolvenza', in *Dir. fall.*, 1965, I, 175; M. Bione, 'Della Dichiarazione di Fallimento' in *Comm. Scialoja-Branca. Legge Fallimentare, artt. 1–22* (Zanichelli, Bologna-Roma, 1974); A. Amatucci, *Temporanea Difficoltà e Insolvenza* (Iovene, Napoli, 1979); G. Pellegrino, *Lo Stato di Insolvenza*, (Cedam, Padova, 1980); U. Piccinini, 'L'insolvenza' in Greco (ed), *Diritto Fallimentare* (1994), 124; F. Vassalli, 'La Nozione di Insolvenza (alla Luce dei Recenti Interventi Legislativi, Sulle Imprese in Crisi)', in *Problemi Attuali dell'impresa in Crisi, Studi in Onore di Giuseppe Ferri* (Cedam, Padova, 1983); G. Terranova, *Lo Stato di Insolvenza*, in G. Ragusa Maggiore C., Costa (eds), *Le Procedure Concorsuali, Il Fallimento* (Utet, Torino, 1997), 221; E. Ruggeri, *Il Presupposto Oggettivo delle Procedure Concorsuali*, in G. Lo Cascio (ed), *Diritto Fallimentare* (1996), 214; P.F. Censoni, 'Il Presupposto Oggettivo del Fallimento. Lo Stato di Insolvenza', in L. Panzani (ed), *Il Fallimento e le Altre Procedure Concorsuali* I (Utet, Torino, 1999–2000), 16.
6. G.C. Rivolta, *L'esercizio dell'impresa nel Fallimento*, (Giuffrè, Milano, 1969); G.C. Rivolta, *L'affitto e la Vendita dell'azienda nel Fallimento*, (Giuffrè, Milano, 1972); F. Semiani Bignardi, *Il Curatore Fallimentare Pubblico Ufficiale*, Padova, 1965; M. Sandulli, *Esercizio dell'impresa nelle Procedure Concorsuali e Rapporti Pendenti*, in *Giur. comm.*, 1995, I, 196; F. Pellegrino, 'Acquisizione, Custodia ed Amministrazione delle Attività Fallimentari; Esercizio Provvisorio dell'impresa' in G. Ragusa Maggiore and C. Costa (eds) *Il Fallimento*, II, Torino, 1997, 383; G. Olivieri, 'L'esercizio Provvisorio dell'impresa nel Fallimento' in L. Panzani (ed), *Il Fallimento e le Altre Procedure Concorsuali* (Torino, 1999–2000) IV, 129.
7. A. Jorio, *Le crisi d'impresa*, (Giuffrè, Milano, 2000), p. 1.

Traditionally, the par condicio creditorum principle of equal treatment of creditors has constituted the pivotal principle of Italian bankruptcy law, which in this sense follows on from the Medieval and Renaissance statutes through which the par condicio gradually gained acceptance as a rule designed to protect the merchant's creditors, contrary to the criterion of chronological priority enforced in the context of civil law.

The so-called revocatory action represented the legal instrument for re-establishing the par condicio: it was used to redistribute the damage arising from the entrepreneur's insolvency among a wider circle of subjects who had had relations with the bankrupt company.[8]

II. THE PROCEDURES OF COMPOSITION WITH CREDITORS AND SUPERVISED ADMINISTRATION

In the 1942 law, the Italian legal system allowed the crises affecting enterprises to be settled using procedures aimed at reaching a composition with the creditors.

The insolvent entrepreneur could request that procedures for composition with creditors be started, by means of which he proposed to satisfy no less than 40 per cent of his debts together with full payment of all preferential creditors. The court evaluated the admissibility of the request and, if approved, allowed the entrepreneur to draw up a proposal for creditors who were called upon to give their consent. If the majority of creditors agreed to undergo a reduction in payment, the court had to evaluate the regularity of the procedure and the appropriateness of the proposal, comparing it with the possible outcomes of bankruptcy proceedings; therefore, the court could reject the proposal even if it had been accepted by the majority of creditors. On the contrary, if a majority of consenting creditors was not reached (calculated by value and number of creditors), the composition procedure could not continue and bankruptcy would be declared.

In the procedure involving supervised administration, on the other hand, an entrepreneur who was in difficulty but able to overcome the crisis in the space of two years at most, could ask the court to order a respite of debt for a maximum of two years.

8. U. Santarelli, *Per una Storia del Fallimento nelle Legislazioni Italiane dell'età Intermedia* (Cedam, Padova, 1964), 337; P. Rescigno, 'Contributo allo Studio della *Par Condicio Creditorum*', in *Giur. comm.*, 1984, I, 88; V. Colesanti, 'Mito e Realtà della *par Condicio*', in *Fallimento* (1984), 46; B. Inzitari, *Sistema del Concorso e Modelli di Garanzia nell'esperienza Italiana e Straniera*, in *Dir. fall.*, 1991, I, 540; P. Pajardi, *Radici Ideologiche del Fallimento* (P. Milano, 1992), 33; G. Terranova, 'Effetti del Fallimento Sugli atti Pregiudizievoli ai Creditori' in F. Bricola and F. Galgano (eds), *Comm. Scialoja-Branca, Legge Fallimentare* (arts 64–71) (Zanichelli, Bologna-Roma, 1993); A. Maffei Alberti, *Il Danno nella Revocatoria* (Milano, 1970); A. Maffei Alberti, 'La Funzione della Revocatoria Fallimentare' in *Giur. comm.*, 1976, I, 362; M. Libertini, 'Sulla Funzione della Revocatoria Fallimentare: una Replica e un'autocritica' in *Giur. comm.*, 1977, 84.

The drawbacks of these two procedures were obvious:

- In the case of composition with creditors, the claims of preferential creditors had to be fully satisfied under all circumstances; and a minimum of 40 per cent had to be guaranteed to all unsecured creditors, without distinction, without being able to subdivide creditors in classes characterised by similar interests, and therefore without the possibility of avoiding bankruptcy by offering a percentage of payment that, even if less than 40 per cent, was still better than the outcome of a possible bankruptcy.
- Supervised administration required the immediate demonstration of a reliable possibility of complete recovery and full payment of all creditors at the end of the procedure: this was something that is relatively difficult to achieve.

III. COMPULSORY ADMINISTRATIVE LIQUIDATION AND SPECIAL ADMINISTRATION OF LARGE-SCALE ENTERPRISES

The 1942 Italian law also envisaged, and continues to envisage, a procedure for administrative liquidation that applies to companies with special characteristics (insurance companies, co-operatives, etc.). The availability of this procedure, whose final aim is the liquidation of the enterprise and its elimination from the market, is not necessarily determined by the existence of insolvency, but also merely by the presence of severe management irregularities that make it obligatory for the company to be wound up. Its administrative nature derives from the acknowledgement that the state administrative authorities that control the management of these companies should intervene using measures to sell off the assets. In the event of insolvency, the law prescribed (and continues to prescribe) that the liquidation of assets and their distribution to creditors should largely take place following the rules for bankruptcy.

There are still special provisions for insolvency in the banking and financial sectors. These types of insolvency are regulated by a special law that concerns the crises affecting banks: in addition to the insolvency of banks, Italian banking law also regulates the insolvency of subjects that may be broadly defined as financial intermediaries.[9] This procedure is largely administrative and involves the strong

9. D.Lgs. 1.9.1993, n. 385; F. Capriglione, *Commentario al Testo Unico delle Leggi in Materia Bancaria e Creditizia* (Cedam, Padova, 2001); R. Costi, *L'ordinamento Bancario* (Bologna, 2001); G. Boccuzzi, *La Crisi dell'impresa Bancaria* (Milano, 1998); Various Authors, *Banche in Crisi*, 1960–1985, (Laterza, Bari, 1987); A. Nigro, *Crisi e Risanamento delle Imprese: il Modello dell'amministrazione Straordinaria delle Banche* (Giuffrè, Milano, 1986); S. Bonfatti, *La Liquidazione Coatta delle Banche e Degli Intermediari in Strumenti Finanziari. Presupposti Soggettivi ed Oggettivi* (Giuffrè, Milano, 1998).

presence of the Bank of Italy, which nominates the subjects in charge of managing the insolvent enterprise, its liquidation and the distribution of the proceeds from the sale of assets to creditors.

Leaving aside particularly sensitive economic sectors for which it was necessary to adopt special rules and, above all, where management of the crisis had to be supervised by the administrative authority (the Ministry of the Economy or the Bank of Italy), it can be generally stated that the propensity of bankruptcy law primarily to consider the interests of the creditors and to place the survival of the enterprise in second place has, over time, become outdated. Perception of this failure to consider the economic interests of protecting production units led to the use of procedures such as composition with creditors and supervised administration, in place of those provisions envisaged under the law: these procedures were quite frequently used to protect companies in difficulty.[10] But the rigidity of these procedures impeded their more widespread application.

This prompted the conviction that a different procedure should be developed for crises of particular importance, whose prime aim should be to save the enterprise, even if it was insolvent. The law concerning the special administration of large companies in crisis was passed in 1979.[11] The chief aim of this law was to bring about the sale of the company to third parties whenever possible; the proceeds of this sale were destined for the creditors.

This new law was the subject of extensive criticism. Firstly, because it entailed a change in the priorities that traditionally formed the basis of bankruptcy proceedings; secondly, owing to the shortage and ambiguity of the instruments identified by the law to accomplish the desired results. Last but not least, the law was criticized because of the distorting effects brought about by the competition that might result from state subsidies allocated in favour of enterprises undergoing this procedure.

10. A. Gambino, 'Sull'uso Alternativo della Procedura di Amministrazione Controllata' in *Giur. comm.*, 1979, I, 237; G. Tarzia, V. Colesanti, A. Maffei Alberti, M. Libertini, V. Bruno, 'L'uso Alternativo delle Procedure Concorsuali' in *Giur. comm.* 1979, I, 274.

11. L. 3.4.1979, n. 95; A. Gambino, 'Profili dell'esercizio dell'impresa nelle Procedure Concorsuali alla luce della Disciplina dell'amministrazione Straordinaria delle Grandi Imprese' in *Giur. comm.*, 1980, I, 564; A. Gambino, 'Tutela del Debitore e dei Creditori nelle Procedure Concorsuali Conservative dell'impresa' *Giur. comm.*, 1982, I, 716; A. Gambino, 'Limiti Costituzionali dell'iniziativa Economica nella Crisi dell'impresa' in *Giur. comm.*, 1988, I, 487; G. Oppo, 'Profilo Sistematico dell'amministrazione Straordinaria delle Grandi Imprese in Crisi' in *Riv. dir. civ.*, 1980, I, 233; L. Lanfranchi, 'La Tutela dei Creditori Anteriori nell'amministrazione Straordinaria delle Grandi Imprese in Crisi', in *Giur. comm.*, 1983, I, 770; V. Colesanti, A. Maffei Alberti, P. Schlesinger, 'Provvedimenti Urgenti per l'amministrazione Straordinaria delle Grandi Imprese in Crisi', in *Le Nuove Leggi Civili* (1979); Calavaglio, 'L'amministrazione Straordinaria' in S. Satta, *Diritto Fallimentare*, n. 1 above; E. Ricci, 'La Tutela dei Creditori dell'imprenditore nell'amministrazione Straordinaria: Problemi di Legittimità Costituzionale' in *Fallimento* (1984), 102; Various Authors, *La Riforma dell'amministrazione Straordinaria* (Vallardi, Roma, 2000); G. Tarzia, 'I Creditori nell'amministrazione Straordinaria' in *Giur. comm.*, 1982, I, 731.

In 1999 amendments were made to the law on special administration (with legislative decree no. 270 of 8 July 1999)[12]. The assumption for the application of this procedure was no longer based, purely and simply, on the extent of the insolvency, but instead on the existence of tangible prospects for restoring the economic equilibrium of the enterprise. This restoration normally takes place through the sale to third parties of the entire company or parts of it that can still trade on the market. The law also outlines the possibility of the complete recovery of the company, which should in this case return to the entrepreneur and resume normal activities after the restructuring process carried out by the temporary administrator; but this is an hypothesis that is likely to take place all too rarely.

If the conditions do not exist for the sale of the production units, even in part, the procedure of special administration must give way to traditional bankruptcy proceedings, managed and controlled by the courts.

One condition for the application of the procedure of special administration is that the enterprise must have more than 200 employees. This prompts the belief that for crises of a certain size in which at least part of the production unit will be sold on the market, the applicable procedure will not be traditional bankruptcy but special administration instead.

Crises affecting large-scale production units (especially Parmalat) in recent years have led to the inclusion of the issue of special regulations in the procedure of special administration, which anticipated certain aspects of the reform of the bankruptcy procedures which shall be outlined below.

IV. EXTRAJUDICIAL SETTLEMENTS

Alongside these traditional procedures of a judicial or administrative nature, there have always been extrajudicial settlements. These are characterised by their greater flexibility and a virtually infinite range of possible solutions concerning the particular situations to be settled using this type of composition. Generally speaking, these compositions are piloted by the group of banks involved in the company crisis and normally the results of these compositions, in those cases where an agreement was reached and executed, are better than those achieved through judicial or administrative procedures, both in terms of the percentage of creditors satisfied and also the speed of satisfaction. For this reason, it is clear that the banking system has always aimed at the juridical recognition of these private procedures.

Although no regulations along the lines of the 'London Approach' exist in Italy, the banking system is taking steps to define a uniform approach to dealing

12. D.Lgs. 8.7.1999, n. 270; G. Lo Cascio, *Commentario alla Legge sull'amministrazione Straordinaria delle Grandi Imprese Insolventi* (Giuffrè, Milano, 2000); A. Castagnola and R. Sacchi, *La Nuove Disciplina dell'amministrazione Straordinaria delle Grandi Imprese in Stato di Insolvenza*, (Giappichelli, Torino, 2000).

Chapter 17

Cross-border Insolvency: the EC Regulation and the UNCITRAL Model Law

Kate Dawson

I. INTRODUCTION

It has seemingly become impossible to talk of business in the twenty-first century without mentioning in the same breath the word globalization. In the modern world, national boundaries provide little resistance to trade. Indeed the expansion of trade into new markets is generally welcomed. However, given the number of businesses that trade abroad, inevitably some will fail, and the presence of some foreign element can only compound the usual problems inherent in any insolvency situation. As globalization is a relatively new phenomenon, many states' insolvency laws are ill-equipped to deal with cross-border insolvencies.

Many jurisdictions, including the UK, have no statutory framework within which the courts[1] and insolvency practitioners must work in such cases, so to some degree their attitudes will dictate the administration of a cross-border insolvency and therefore its success. In addition, an efficient cross-border

1. Insolvency Act 1986, s. 426 does provide for assistance to be given by the UK courts to certain designated countries and territories. But the number of designated territories is limited and the provision falls far short of the framework provided by the Regulation or indeed the Model Law.

Katarzyna Gromek Broc & Rebecca Parry, *Corporate Rescue*, pp. 357–388.

insolvency requires cooperation from other jurisdictions and this is not always forthcoming. Consequently a comprehensive and successful cross-border liquidation is not always possible, especially where the entities involved are insignificant because in that case it is not economically viable to try to recover assets abroad.

In order to resolve this problem it became clear that some form of inter-state agreement had to be reached. This first occurred in a small way in the early part of twentieth century, as some bi- and tri-lateral treaties were successfully implemented, but by their nature they are now outdated since foreign trade is not limited to specific geographical areas.[2] A more wide-reaching agreement was needed, adapted to the nature of modern trade. The EU took up this challenge four decades ago, but it is only recently that the decades of work have come to fruition in the form of a Regulation.

There have been other attempts at international agreements relating to cross-border insolvency, most notably the UNCITRAL Model Law.[3] In many ways the Model Law covers much the same ground as the Regulation, although it is less stringent in its requirements of enacting states and so the EU Regulation would not be rendered ineffective by the adoption of the Model Law. Moreover the reception of the Model Law has been somewhat muted, as few states have enacted its provisions thus far: only Mexico, Eritrea, Japan, South Africa, Poland, Romania, USA, the British Virgin Islands and, within Serbia and Montenegro, Montenegro.[4] The Insolvency Act 2000 by s. 14 gives the Secretary of state the power to enact the Model Law and yet only recently has action been taken by Great Britain to adopt it. The Model Law came into force on 4 April 2006 through the Cross-Border Insolvency Regulations.[5] Nevertheless there are still relatively few states in which the Model Law will apply and it is self-evident that an efficient framework for international cross-border insolvencies will be created only after many countries have implemented it.

It is apposite to stress that the purpose of the Regulation is not to harmonize the substantive laws of the EU,[6] although it may be that this is one small step along that road. Instead the Regulation reforms the private international law rules of the member states, without substantially altering the substantive provisions of their insolvency laws.[7] The Regulation applies to insolvency proceedings, whether the

2. For example, the Franco-Belgian convention, 1899; the Franco-Italian convention, 1930 and that between Belgium, the Netherlands and Luxembourg, 1961. The Nordic Bankruptcy agreement concluded between Denmark, Finland, Norway and Sweden in 1933 has also resulted in a more cohesive approach to the problem of cross-border insolvencies. See M. Bogdan, 'International Bankruptcy Law in Scandinavia' (1985) 34 ICLQ 49; M. Bogdan, 'The Nordic Bankruptcy Convention' in J.S. Ziegel (ed), *Current Developments in International and Comparative Corporate Insolvency Law* (OUP, Oxford, 1994), p. 701; and I.F. Fletcher, *Insolvency in Private International Law* (Clarendon, Oxford, 1999), p. 221.
3. For a full text of the Model Law and a guide to its enactment see <www.uncitral.org>.
4. This is correct as of 6 March 2006.
5. Insolvency Act 2000, s. 14 allows the Secretary of State with the agreement of the Lord Chancellor and the Scottish Ministers to introduce the Model Law via a statutory instrument.
6. Equally the Model Law does not attempt to harmonize the laws of enacting states.
7. Certain amendments have been made, see below p. 365.

debtor is a natural person or a legal person. Hence although the focus of what is said in the following pages is on corporate insolvency, much of it is relevant to personal insolvency. More specifically the preamble to the European Insolvency Regulation notes that its purpose is to create a minimum level of coordination and cooperation between the member states so that there is a more coherent approach to cross-border insolvencies, at least within the EU. This should prevent forum shopping, for example the practice by some creditors of proving for their debt in the jurisdiction where the law is most favourable to their claim. Perhaps this is of particular significance to the larger creditor. Such practices are unlikely to be undertaken by smaller creditors since they could not afford the extra expense of proving abroad or because they are unaware of the possibility of forum shopping.

The legislation is in the form of a regulation and so due to art. 249, formerly 189 of the Treaty of Rome, the legislation is directly applicable. It became a part of UK law (and of course the laws of other EU member states) without further action by Parliament. The legal status of a Regulation means that member states cannot pick and choose which aspects of the Regulation shall apply in their jurisdiction. Where there is any apparent conflict between a Regulation and domestic law, European law will take precedence. It should be noted that, unlike UK law, the provisions of the Regulation are to be the subject of review on a regular basis. According to art. 46 the Commission is to present a report on the application of the Regulation to the European Parliament, the Council and the Economic and Social Committee no later than 1 June 2012.

The Model Law will not override the Regulation and as a consequence when it comes into force there will be questions as to which legislative framework is applicable. This issue and others concerning the general workings of the Regulation and the Model Law will be considered in the following chapter. This will be done by discussing the Regulation and then assessing the extent to which the Model Law adopts the same pattern or departs from it. As the Regulation has been in force since 31 May 2002 there is more detailed discussion of its provisions and the relevant case law and a more cursory treatment of the Model Law, partly because it is yet to come into force and also because it replicates the Regulation to some degree.

II. THEORETICAL AND HISTORICAL PERSPECTIVES

Before discussing the provisions of the Regulation it is pertinent to consider the Regulation's history and its theoretical underpinning because this explains why the drafters of the Regulation adopted the modified universalist approach[8] to insolvency, and thus why the Regulation takes the format of main and secondary proceedings.

8. This relates to the interaction between main and secondary proceedings where the main proceedings have universal effect except in the jurisdiction in which secondary proceedings are opened.

It was in 1963 that a working party was set up to examine the need for a convention on insolvency[9] but it took many decades before an agreement became a reality.[10] The report of the working party was published in 1970[11] and was not well received.[12] This was due in part to the fact that it was based on the principle of the unity and universality of the insolvency proceedings. Unfortunately these concepts have sometimes been confused,[13] for instance the difference between the unity and universality of bankruptcy has not always been clear. Unity of proceedings implies there is only one set of proceedings. The universality of insolvency proceedings refers to the recognition of a set of insolvency proceedings in any other jurisdiction. These terms are not interchangeable because it is possible to have universality and plurality of proceedings.[14]

As stated above the principle of unity requires that there be only one set of proceedings. Any creditor must prove in that single set of proceedings regardless of where they are situated. Assets wherever situate must come within the jurisdiction of the single proceedings. In some ways it might appear that this universal application of the laws of one jurisdiction which apply to the insolvency proceedings would lead to equality of treatment. Undoubtedly that is why this was the favoured initial approach to the Convention. In reality since the security rights of creditors vary so widely within the EU, the legitimate expectations of creditors could be undermined if they have contracted in the belief that they have a security right recognized under English law, which is then not recognized under the law of the opening of the proceedings. It is possible to argue that with the expansion of large law firms, now having branches across the EU, it would be possible for contracting parties to seek the advice of lawyers as to what would happen in the different jurisdictions, in the situation outlined above.

But against this, it may be argued that this would necessarily create greater expense for the parties involved, which might be beyond the means of smaller companies. There is moreover, the matter of where that single set of proceedings

9. See M. Hunter, 'The Draft Bankruptcy Convention of the EEC' (1972) 21 ICLQ 682.
10. Insolvency is expressly excluded from the Brussels Convention 1968, now Regulation 44/2001.
11. E.Comm.Doc. 3.327/I/XIV/70-F, Explanatory Report, E.Comm.Doc. 17.775/XIV/70-F.
12. See M. Hunter above, n. 9; I.F. Fletcher, *Conflicts of Laws and European Community Law* (North Holland Publishing, Amsterdam, 1982), p. 187; D. Lasok and P. Stone, *Conflicts of Laws in the European Community* (Professional Books, Abingdon, 1987), p. 397; K. Lipstein, *The Law of The European Economic Community*, (Butterworths, London, 1974), p. 284; J.H. Farrar, 'The EEC Draft Convention on Bankruptcy' [1972] JBL 256 and J.H. Farrar, 'The EEC Draft Convention on Bankruptcy and Winding Up. A Progress Report' [1977] JBL 320 for criticism of the report of 1970. See also M. Hunter, 'The Draft EEC Bankruptcy Convention: A Further Examination' (1976) 25 ICLQ 310. See generally O. Borch, 'European Union Convention on Insolvency Proceedings' (1996) 24 *International Business Lawyer* 224.
13. H. Hanisch, 'Universality Versus Secondary Bankruptcy' (1993) 2 IIR 151.
14. Under the Regulation the effects of the opening of proceedings upon the debtor are as follows. Where main proceedings are opened they are said to have EU-wide effect and this is limited only by the opening of secondary proceedings. The main proceedings are recognized automatically. Where secondary proceedings are opened, they are territorial in their effect, but the proceedings are still recognized EU-wide.

should be issued. It is not inevitable, although it is often accepted as the norm, that a company's registered domicile will be the jurisdiction in which the main insolvency proceedings occur. Where there is only one set of proceedings it would be important for the company to be wound up in the jurisdiction to which it had a greater connection, which is not necessarily the law of its registered domicile. But the application of this principle can create a quandary for creditors since, although the law of the company's registered domicile is readily ascertainable, creditors may not be able to ascertain with certainty the state to which the company had its greatest connection, even with exhaustive enquiry. This is because the matter may be so evenly balanced that each of two or more jurisdictions is a sensible possibility, so that only the court can decide the issue, and indeed different courts might decide that issue differently. Obviously, within the EU, the ECJ can make a conclusive ruling, but that does not assist the creditor dealing with a company before it becomes insolvent, long before the court has had the opportunity to make a decision as to the proper jurisdiction to open the proceedings.

Thus it was realized that the unitary approach was not practical and so a compromise was eventually reached by the drafters of the Regulation. Nevertheless despite the fact the Regulation takes a modified universalist approach, in some EU states this will entail a fundamental shift in methodology for their courts, for example a jurisdiction such as France.[15] There is universality of proceedings under the Regulation, that is a decision in one jurisdiction would be recognized in another state in the EU. There would also be plurality of proceedings with a structure of main and secondary proceedings to reduce the possible conflict between jurisdictions. This would be achieved because the secondary proceedings would be subordinate to the main proceedings in certain respects. As this format suggests, an insolvency under the Regulation would consist of main proceedings which dealt with the assets of the company wherever situate except those that were in a jurisdiction in which secondary proceedings were opened. It is possible for there to be more than one set of secondary proceedings. For such a system to work effectively cooperation and coordination of the proceedings is crucial. In the following discussion there will be an analysis of how the Regulation seeks to bring this about.

In April 1980[16] an amended draft was published, but even after the changes introduced by the new draft, there was still hostility to the proposals.[17] Impetus for the implementation of an insolvency convention waned in the 1980s[18] and it was not until May 1989 that a new working party was set up to continue the project

15. See P. Omar, 'Cross-Border Insolvency Law and Practice in France' (2002) Insolv LJ 101, p. 111. For a discussion of the EU Regulation from a German perspective see M. Bütter, 'Cross-Border Insolvency Under English and German Law' (2002) *Oxford U Comparative Law Forum* 3, <http://ouclf.iuscomp.org/articles/buetter.shtml>.
16. Text published in English by the Department of Trade and Industry as Text of the EEC Draft Convention, April 1980.
17. The proposals were analysed by the Cork Committee in its Report of the Advisory Committee on the EEC Draft Bankruptcy Convention (1976) Cmnd 6602.
18. Because of the economic boom in Europe during that decade.

started two decades before.[19] A final draft of the Convention was finished in 1994 and was the basis for the version subsequently approved by the Council of Ministers in 1995.[20] Ultimately the Convention was not adopted but fortunately, rather than allow the project to fade into obscurity, the Convention was used as the basis for the Regulation.[21] An Explanatory Report on the Convention was drafted, the Virgos-Schmit Report.[22] It has not been formally adopted as an exposition of the Regulation[23] notwithstanding that as stated above the Convention is the basis for the Regulation. However limited reference may be made to the Report where appropriate. Indeed it is clear from the case law on the Regulation that the judiciary are willing to openly refer to the Report where it can aid interpretation, but the Report should not be regarded as a definitive guide to the Regulation.

References to the ECJ take time and money, neither of which are found in abundance in an insolvency case.[24] The preamble to the Regulation should therefore always be kept in mind when interpreting its provisions because it explains the purpose and aims of the legislation. Generally the provisions of the Regulation should be interpreted so as to facilitate the most efficient cross-border insolvency possible. More specifically cooperation is a fundamental tenet of the Regulation which will be undermined if frequent references to the European court are made.

The Model Law, in contrast, has not had such a turbulent history and was finished in 1997 and its Guide to Enactment was approved on 25 June 2004. No doubt this is due to the substantial effort put into completing the Regulation, as the Model Law follows to a large degree, the format of its European counterpart. The project was initiated by the United Nations Commission on International Trade Law (UNCITRAL) and the International Association of Insolvency Practitioners (INSOL). Nevertheless now that the Regulation is in force, it applies throughout the EU whereas the Model Law is enacted by individual countries and as has been stated above, very few countries have been persuaded to adopt its provisions. It may be that now the USA has formally accepted the Model Law and Great Britain is almost ready to do the same, that others will follow their lead. Certainly Australia and New Zealand have shown a determination to enact the Model Law in the near future. The Model Law does not benefit from a court to which questions of interpretation can be

19. See generally, J. Dine, 'Proposals for and EC Bankruptcy Convention' (1992) 7 IL&P 178. See also D.T. Trautman, J.L. Westbrook and E. Gaillard, 'Four Models for International Bankruptcy' (1993) 41 AJCL 573 for an examination of one of the later drafts of the Convention.
20. See P. Omar, 'An Introduction to the 1995 European Insolvency Convention' (1995–6) 2 RALQ 245 and P. Fidler, 'A Small Step Forward? The Draft EU Bankruptcy Convention' [1996] 1 JIBL 3. See also M. Bogdan, 'The European Union Bankruptcy Convention' [1997] 6 IIR 114.
21. See generally I.F. Fletcher, *The Law of Insolvency*, (3rd edn, Sweet and Maxwell, London, 2002), p. 829 et seq.
22. EU Council Document 6500/96, DRS 8 (CFC), 3 May 1996.
23. See *Re BRAC Rent-A-Car* [2003] 2 All ER 201 by way of example where the court openly referred to the Report.
24. See further I.F. Fletcher above n. 21, pp. 850–851, for an outline of the circumstances in which a reference may be made.

put. However CLOUT – Case Law On Uncitral Texts – does exist as a record of the outcome of cases that have been decided in any jurisdiction where the Model Law has been adopted. Art. 8 also maintains that regard must be had to the international origin of the Model Law and to the need to promote uniformity in its application and the observance of good faith. Whether this exhortation has any effect remains to be seen, but the consistent application of the Law is a necessity.[25]

Like the Regulation the Model Law adopts a format of one main proceeding whilst still allowing for secondary subordinate proceedings to be recognized, although the terminology is slightly different, as the Model Law prefers the term 'non-main proceeding' instead of secondary proceeding. Any other country which has adopted the Model Law must recognize proceedings that are opened where the debtor has its COMI[26] or an establishment. Thus similarities between the Regulation and the Model Law frequently occur, but there are some significant differences between the two, as we shall see.

III. EXERCISE OF JURISDICTION

Compatibility

A first question would be how do the two pieces of legislation interact? The Model Law according to art. 3 will not have precedence over the Regulation, so where the centre of main interests (COMI) of a company[27] is within the EU, the Regulation will apply. As for the UNCITRAL Model Law and s. 426 of the IA 1986 s. 426 only applies as between designated countries and territories within s. 426(11). Ireland is so designated but is the only EU country and therefore the possibility of conflict between the Regulation and s. 426 is very limited. But it is the case that s. 426 may still be utilized since art. 44(2)(b) states that the Regulation will not apply where there is any conflict between any agreement between the UK and the Commonwealth and the Regulation. Lastly the Model Law when adopted will not override s. 426. Instead assistance may be provided by s. 426 in addition to the Model Law.[28] The importance of all this is that s. 426 is not redundant, but it will be a rare case that seeks to apply the Model Law and s. 426.

Scope

With regard to the application of the Regulation it is perhaps easiest to discuss what is not covered by its provisions. Art. 1(2) states that the Regulation does

25. The guide to enactment also makes it clear that for the Model Law to be successful, enacting states should make as few changes as possible to its provisions, recital. 12.
26. See below p. 366.
27. For a definition of centre of main interests (COMI) see below p. 366.
28. See art. 7.