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The Italian reorganization procedure for large undertaking and its conflict with the European Treaty on the Competition

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1. Introduction

By way of introduction I will first briefly describe the Italian bankruptcy law system and then specifically explain the reorganization procedure for the large undertakings and its conflict whit the European Agreement on the Competition, which shall be the bulk of this lecture.

The Italian bankruptcy law system is creditor oriented and provides for five procedures: three procedures have the function to wind up the assets of an undertaking; two procedures have the function to reorganize an undertaking.

The fundamental bankruptcy law was enacted in 1942 and it is still in force. This law is based on three basic principles: 1- the trader is the subject of the all procedures; 2- when the trader is insolvent his assets must be liquidated by a receiver to satisfy the creditors according to the principle of par condicio creditorum; 3- when the trader is on the threshold of insolvency he may utilize a recovery procedure which is intended to return him to a state where he is able to pay his creditors.

In substance, the logic behind the bankruptcy system, which is also the basis of this fundamental law, is the preference of the option of liquidation instead of reorganization when the trader is insolvent. This logic explains also because the trader is only the subject of the procedures and not his undertaking.

However currently in Italy, like in other European States, this traditional logic is changing. The new logic prefers that an undertaking recovers rather than having it liquidated in case the trader is insolvent. Those who adhere to this logic believe that keeping firms in operation is a purpose of bankruptcy law. Therefore, according to this new logic, the subject of the recovery procedure would be the undertaking and not the trader. The only time the liquidation procedure would be utilized is if the recovery procedure is not feasible. Nonetheless this new logic is still a theory and not yet in practice. Currently, the government is working on how to modify the Italian bankruptcy law accordingly.

Therefore, now in Italy the main method to solve the commercial insolvency is the liquidation of the trader's assets and this liquidation can be carried out by the Court, by private agreements between debtors and creditors or by administrative Authority.

In particular the liquidation by an administrative Authority is applied to specific types of undertakings, for example: banks, insurance companies, financial companies and investment trusts. The reason for this administrative liquidation is that the above undertakings are supervised by administrative powers even when they are not insolvent.

This political choice is blamed in Italy by a part of the doctrine because some believe that the insolvency of any undertaking must be resolved within the market and not within the administrative system. In this respect, the Italian system is a mixed economic system which is still based on the economic freedom of individuals and the power of the State, and this is evidenced in the above procedure.

Instead according to another part of the doctrine, this system is justified by the fact that these undertakings are very particular because their activity involves public interests, for example the interest of the savers.

Therefore, in this opinion, it is necessary to resolve the insolvency of these undertakings within the administrative system to defend these interests better.

As I said above, the Italian system provides also for two other types of liquidation procedures by the Court or by agreement between debtor and creditors under the control of the Court. The liquidation by the Court is a procedure which is applied to sole trader and business associations which are insolvent, that is unable to pay their debts regularly. This procedure is directed to wind up the assets of trader and to distribute the result of the liquidation among creditors according to principle of par condicio creditorum.

In this procedure the Court has a relevant role because it manages the procedure, appoints an individual judge, who solves particular issues and disputes during the procedure, and a receiver who provides for carrying out the procedure. In general, I can say that the Court guarantees the creditors' right during this procedure.

Instead when the liquidation of the assets of an undertaking is carried out by private agreement between creditors and debtor the Court has a limited role, because it approves this agreement only. In particular the Court verifies if this agreement is in keeping with bankruptcy law and creditors' interest; only thereafter does the agreement become valid and enforceable. Therefore both these liquidation procedures protect the creditors' interests only.

In regard to the procedures which have the function to rescue an undertaking, the size of the undertaking is relevant, because only if the undertaking is large a particular procedure can be applied. This procedure, translated into English is called extraordinary administration and is applied in the presence of Court and administrative organ.

On the contrary when an undertaking is not large and is temporary insolvent it is possible to require a recovery procedure which is carried out by the Court only. In this case the trader remains in possession of the undertaking and he is supervised by the Court for a period of two years. Within this period the undertaking must return to the market and the trader must return to a state where he can pay his creditors regularly. If these conditions are not met, the trader may propose an agreement with his unsecured creditors for paying a percentage, not less than 40%, of the debts, otherwise the trader will be declared bankrupt by the Court.

2. The European Control System on the State Aids

After this short description of the Italian bankruptcy law system, I will dedicate the bulk of this lecture on the reorganization procedure for large undertaking and its conflict with European Agreement on the Competition. But I think that it's necessary to present a preliminary evaluation about the European Control system on the State aid which distorts or threatens to distort the competition, because the Italian reorganization procedure for large undertaking was declared by European Committee unfair State aid and, therefore, incompatible with the European Treaty.

In respect of this, it appears that the Italian bankruptcy law system borders on other areas of law, such as in this case competition law; therefore according to a modern evaluation of the issues which arise from the bankruptcy law for large undertaking it is relevant to examine the relationship between bankruptcy and competition law.

There are tow reasons why there is a system which controls States: firstly, to avoid a subsidy race between Member States which could cause a waste of public money; and, secondly, to guarantee the cohesion between the Member States. The European Committee is the competent Authority to verify that States do not violate the rules regarding the state aids regulated by Articles 87 and 88 of the Community Agreement.

The European Committee has three functions :

1) it proposes remedies to improve the market;

2) it orders State to modify aid given to undertakings if such aid is in violation of the European Agreement;

3) it verifies if each new State aid is in conflict with the European Agreement and during this verification process each State can not give such new aid before that the Committee decides the matter.

The role of the State aid control has become very relevant after the completion of the single market and the abolition of the barriers for the European businesses.

In this context the Member States could use aids to limit the competition and to protect their national industry. Therefore, the State aid control system is necessary to guarantee the integration process in the European market and to ensure that the former restrictions on competition are not replaced by State aid which would cause adverse effects on the common market.

This purpose of European Community justifies the provision contained in Art. 87 of the EC Treaty, which set out the prohibition of State aid, save some exceptions. According to Art. 87 each aid granted by Member State or through state resources in any form whatever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall be incompatible whit the common market.

This article is based on the principle of compensatory justification according to which a State aid can be authorised by European Committee only if it is kept in line whit the general interest of Community.

The system of discretionary exceptions confers upon the Committee the power to evaluate whether aid is compatible or not with the common market. The exceptions contained in this article are the following: 1- aid to promote the development of regions which have an abnormally low living standard or serious underemployment; 2- aid to promote important projects of European interest or to remedy a disturbance in the economy of a Member State; 3- aid to facilitate the development of certain economic activities or areas; 4- aid to promote culture and heritage conservation.

In general, these exceptions are based on the principle that State aids can be authorised when they are intended to remedy market failure. But these remedies must not be in contrast with the community market interest.

Indeed, the first option would be that to address market failure directly, and not to grant state aid to compensate for it. Therefore, the state aid would be the second option when the direct measures are not feasible. In this situation the state aid should have the function to remedy market failure only and not to enable an undertaking recipient to exploit its trading position at the expense of its trading competitors. In other words the state aid is strictly necessary to alleviate macroeconomic problems according to the European purposes and any microeconomic inefficiency resulting from the granting of the aid should be accepted.

In this context it is important to understand when a public measures is regarded as a state aid. According to the European Committee a state aid is relevant, when it favours a particular firm or industry and it results in financial cost to the government or its agencies.

This concept of State aid had a relevant role in the declaration of incompatibility of the reorganization procedure for large undertaking with the European Treaty on the Competition, because, like we will see, the former structure of this procedure entailed heavy costs to the State.

In order to understand in detail the reasons of this incompatibility it's important to evaluate two points: the political reason to introduce in our system a recovery procedure for large undertakings and the structure of the procedure used before the reform enacted in 1999.

3. The political reason underlying the procedure for large undertaking

The political reason of this procedure was to defend a plurality of interests which is involved in the insolvency of a large undertaking and in particular employment, the balance market in some areas of production, the level of the price et cetera. These reasons were very urgent during the seventies because this period was characterized by shrinkage in production, sales or service, high losses and low profits, a high level of unemployment: in short the seventies suffered a great recession. Moreover it's possible to state that this procedure was an expression of the Italian mixed economy system characterized by the direct public intervention in economy through public authorities endowed with strong administrative powers, which could also be

used in the cases of large undertaking insolvency. The progressive change of this economic system, after the completion of the single European market, influenced the structure of the recovery procedure for large undertakings leading it to an open economy based on free competition.

Apart from the historical and political reasons of this procedure, it's undoubted that the insolvency of large undertaking causes more adverse effects than the insolvency of a normal undertaking and the social and economic costs of it are relevant. But the main issue is that to verify that the conditions, which allow to recover an ailing undertaking, are present, because there is the risk of keeping an undertaking in operation though it is not capable of being rescued.

This question was underlying to the reorganization procedure for large undertaking according to the former law, enacted in 1975, because this procedure was applied to large undertakings without a preliminary verification on their capability to remain in business. Therefore this procedure became often a technical tool for delaying the liquidation of the assets and the satisfaction of creditors.

4. A brief account on the structure of the former procedure

The structure of the former procedure was based on the simultaneous presence of the Court and the Public power through the Ministry of Industry: the Court had the function to declare the insolvency and to guarantee the creditors right; the Ministry of Industry had the function to appoint one or three extraordinary commissioner and to supervise on the entire procedure. This structure reflected also the idea that the commercial insolvency could be solved better by entrusting to the Courts the defence of creditors' and third party right and to Administrative Power the management of the procedure, above all when the insolvency concerns a large undertaking.

The fundamental characteristics of the said procedure were two. First of all the application of the procedure depended on the size of the undertaking only and according to the former law an undertaking was considered large when two conditions existed: number of the employees had not be less than three hundred and the amount of debts had not be less than thirty five billion of Italian old lire and not greater than certain percentage of the paid up share capital.

Moreover the continuation of the business activity, though it was regarded as a possibility by the law, nonetheless was authorized by the Ministry of Industry even if it resulted in heavy costs to the creditors and State resources. Therefore, by the virtue of former law, large undertakings were sheltered from the risk of bankruptcy without any consideration as to whether or not they could remain in the market.

Together with these aspects concerning the special regime for the insolvency of large undertakings, the above law showed some elements clashing with competition law because it provided for some benefits which limited competition, resulted in costs to State resources and which was only justified by the unfair purpose of maintaining the undertaking in activity.

In particular these elements were the following: 1- State guarantee in favour of the debts incurred by the undertaking as a consequence of the continuation of business; 2- fiscal benefits in favour of firm transfers concerning the undertaking under procedure; 3- discretionary power granted by law to the Ministry of Industry in regard to the continuation of activity in a situation in which the undertaking should have been declared bankrupt; 4- use of the avoiding power to unfairly continue of activity.

5. The decision by the European Committee

The European Committee, facing this Italian situation, declared (decision 2001/212/CE) that the above procedure was incompatible with European Treaty because it provided for State aid which constrained the competition within the common market. The European Committee determined the above elements as proof of this incompatibility and observed that the special regime for large undertaking was not justified by any exceptions contained in Art. 87 of the European Treaty.

In particular the European Committee (in keeping with two prior decisions of the Court of Justice, concerning the Italian procedure for large undertaking and which had defined the State aid concept) highlighted the shrinkage of the competition which descended from the fact that keeping an undertaking in business did not properly consider the market situation and the viability of undertaking. Therefore, the continuation of activity appeared as an unfair means to maintain large undertakings in the market artificially at the expense of their trading European competitors.

This Committee's decision is in compliance with the idea that the market economy is based on the concept of free competition. According to this principle, an undertaking may remain in the market only if it is able to satisfy two conditions: 1) if the undertaking can cover its production cost by using its own money; 2) if the undertaking can improve its products in accordance with costumers needs.

On the contrary, if States were allowed to assist companies financially, it would alter the market balance. State aid also impedes the bankruptcy of the relevant undertakings and therefore competitor traders could not assume their position in the market.

The Italian Legislator anticipated this Committee's decision and, had already by virtue of two prior decision of the Court of Justice, modified the recovery procedure for large undertaking in compliance with the European Community law in 1999 by law no. 270. In designing this new law the Italian Legislator made a distinction between restructuring aid and rescue aid elaborated in a Commission letter to the Member States on 24 January 1979 and confirmed in Community Guidelines on state aid published in 1994. Therefore for correctly understanding the new law on recovery procedure for large undertaking it's necessary to explain this distinction.

Restructuring aids promote adjustments for changing capital and labour conditions of an undertaking and are defined by a feasible and coherent plan to restore the viability of the recipient undertaking. The conditions to authorize this type of aids are the following: 1- the viability of undertaking can be restored; 2- the aids must be in proportion to the restructuring costs and benefits; 3- the undertaking recipient must reduce its capacity proportionally to the aid received if there is some distortion in competition; 4- the restructuring plan must be implemented by the recipient undertaking and any instruction by the Commission must be respected. In substance, restructuring aids perform their function when the recovery of the viability is already implemented, so they have an important function to maintain the recovery of an undertaking for a long time.

On the contrary the Rescue aids are aimed at keeping the undertaking temporarily in operation when it is in an ailing situation due to liquidity crisis or technical insolvency, while an analysis of the causes of these difficulties can be performed and an appropriate plan to remedy this situation can be designed. Therefore this kind of aids is addressed to maintain an undertaking in business during the time necessary to devise a rescue plan which must be

feasible, coherent and in compliance with the specific situation of the undertaking.

Therefore, according to this distinction between restructuring and rescue aids and the provision contained in the Art. 87 of European Community Treaty, which sets out the prior review on any new aid by the European Council, the new law provides for two relevant aspects:

1. said procedure may apply to an undertaking only if it is capable to remain on the market. While the former procedure did not consider an undertaking's ability to remain in the market.
2. the plan for restructuring and continuing the undertaking, which provides for some State aids (for example State guarantee o tax exemption) must be communicated to the European Council for its approval. European Council will only approve the plan if it is in line with European Community Agreements on the regulation of state aid in regard to free competition in the European Market according to articles 87 and 88 of such Agreement.

6. The new procedure for large undertakings

After this introduction, I will explain the main characteristics and the function of the new recovery procedure for large undertakings.

I will describe the above procedure in the following order:

- an outline of the structure of the procedure;
- the conditions of the procedure;
- the petitioners and the competent authority to declare the insolvency of a large undertaking;
- the organs of the procedure;
- the effects of this declaration with respect to the undertaking, creditors, contracting parties and operation which damage creditors;
- the content and the function of the plans;
- the conclusion of the procedure.

6.a An outline on the structure of the procedure

First of all I will describe the structure of the procedure briefly, because it will assist in understanding the later evaluation. The structure of the procedure is based on two phases. The first phase is commenced by a declaration of insolvency and it is intended to observe the condition of the undertaking and to assess if the undertaking is able to recover the economic balance of its activity. In this phase the Court, which already has declared the undertaking insolvent, decides on the future of the undertaking.

After this observing phase, the decision of the Court, which begins the latter phase, may be to attempt the rescue of the undertaking, if it is able to recover the economic balance of its activity, or to wind up the undertaking if said condition is not present.

Like we will see later, these tow phases cause different effects and are characterized by different organs because the function of these phases is different.

Now I can explain the conditions of the procedure specifically.

6.b Conditions

The law provides that three conditions must be satisfied and verified by the Court. The first condition is in regard to the size of the undertaking, because the Court will only submit large undertakings to this procedure.

According to the law, an undertaking is considered to be large if it has at least two hundred employees and the amount of its debts must not be greater to 2/3 of the value of its assets and income of the undertaking.

The reason to submit a large undertaking to this procedure, rather than to a bankruptcy procedure, is that the insolvency of a large undertaking has adverse effects on a multitude of interests and in particular: creditors, employment national products, the balance in the market. For these reasons this procedure is directed to recover large undertakings, according to a recovery logic which is also evident in other European Countries, for example: in Germany and in France.

Another condition is that a large undertaking must be insolvent. According to bankruptcy law the insolvency exists when an undertaking is unable to pay its debt regularly.

In this situation a large undertaking may be submitted to the recovery procedure as long as it is possible to verify the third condition. This last condition is that a large insolvent undertaking must be able to recover the economic balance of its business; in other words the undertaking must be capable of being rescued.

In this respect it would seem that the law contradicts itself, because the insolvency is a not the temporary incapability to pay the creditors, therefore the logical consequence should be that an insolvent undertaking could never be rescued. But this statement is erroneous for two reasons.

First of all the law takes in consideration the insolvency like an external display of an ailing situation concerning the undertaking, which can be caused by a several reasons, for example: bad luck, crop failure, unexpected tort liability, dishonesty, et cetera. But these reasons do not exclude that the undertaking has, as a whole or as a part, the capability to return to the market after a restructuring period through a specific and collective procedure. Therefore, there is no clash between insolvency and capability to be rescued.

Moreover, like we will see later on, the law provides that the undertaking under procedure, discharged from its debts, can be sold to a new trade. In this way the undertaking may return to the market if it has a value which has not been lost due to the insolvency: for example if its productive plant may be modified according to a new market situation. In other words the preservation of the profitable parts of an undertaking is not in clash with the insolvency; on the contrary it is an advantage to the employees, the commercial community and the general public, above all when the undertaking is large.

In light of this evaluation it appears that the logic of this procedure is more in line with competition than the former procedure discussed, because the recovery attempt is possible only if a large undertaking has the ability to remain in the market. While according to the former procedure the recovery of a large undertaking had to be attempted without any review on its capability to remain in business, now a specific condition to apply the new procedure is the assessment of the capability of the undertaking to be rescued.

6.c Petitioners and competent Authority

An application for this procedure must be made by a way of a petition to the Court having jurisdiction to wind up the undertaking. The location, of

where the principal office of the undertaking is, will determine which Court has jurisdiction.

A petition for this recovery procedure may be presented : by the undertaking itself (sole trader or business association); by any of its creditors or by public prosecutor. Nevertheless the Court could itself declare the insolvency of a large undertaking without a specific petition presented. This declaration by the Court is important because it proves that the procedure protects the public's interests and not only the creditors' interest.

Like we said above, the commencement of this procedure is always preceded by an insolvency declaration by the Court and after this declaration the Court must verify the conditions to apply the recovery procedure or to commence the winding up procedure. In particular, after the insolvency declaration, the Court must verify if the undertaking is able to recover its business balance and it decides on this central point by a report prepared by the commissioner appointed by the Court. If the Court, after this assessment, considers that the undertaking is able to recover its economic balance and so to remain on the market, the Court will then commence the recovery procedure; otherwise it will commence the winding up procedure.

In substance, this early phase of the procedure is intended to observe the specific condition of the undertaking and this new procedural method is in compliance with the idea that the judicial decision on the undertaking's future must account for both the specific economic and financial situation of the undertaking and the market conditions. Only in this way does the recovery procedure not become an useless means to keep the undertaking in operation without any profitable perspective.

Therefore the declaration of the insolvency belongs in this early phase of the procedure and this declaration has a specific content which is the following: appointment of a specific judge for the procedure; appointment of one or three commissioners according to the recommendation of the Ministry of Industry; fixing the terms by which the creditors must file their claims; decide if the management of the undertaking is left to the trader or if it is committed to the commissioner.

6.d The organs of the procedure

With regards to the organs of the procedure the distinction between the first and the later phase of the procedure is relevant. In the first phase of

the procedure the organs are the following: the Court which has declared the insolvency; the judge who is appointed by the Court and one or three commissioner.

The Court and the appointed judge have the function to defend the creditors' and the third parties' rights involved in the procedure. In particular the Court is competent to hear any claim which derives from the procedure and the contestations against any measures adopted by the appointed judge. In his turn the appointed judge is competent with regards to the measures adopted by the commissioner.

Moreover both the Court and the appointed judge have a relevant role in determining the debts of the undertaking and in dividing among the creditors any money which derived from liquidation of the assets.

But in this first phase the commissioner has a crucial role not only because the Court may appoint him to manage the undertaking, but also because the commissioner must draft a report about the conditions of the undertaking, the causes of the insolvency and the capability of the undertaking to be rescued; and he must do that within a limited period of thirty days from the date of the declaration of insolvency. Enclosed with this report is a list of the assets of the undertaking and the creditors with the indication of the amount due to them. The Court is not bound by this report, because it may orders another technical assessments, but the Court generally follows this report.

Moreover this report, at the same time it is submitted to the justice's clerk, must be sent to the Ministry of Industry which will provide its opinion. On the commissioner's report also creditors may present their opinions, through a mechanism which accomplish a debate about the future of the undertaking. But the final decision is always of the Court.

This phase of the procedure is very relevant, in a juridical respect, because it involves the issue regarding the decision maker on the future of the undertaking. The Italian legislator has chosen to grant the Court for this power and so in regard to the ailing large undertaking's future the decision has a judicial character. The creditors have not right to vote neither upon the report of the commissioner nor upon the plan of the procedure, because they only have the faculty to express observation about these acts only. In this respect this procedure has a significant difference in comparison with the recovery

procedure for a normal undertaking, because in this latter case the creditors have the right to vote upon the proposal filed by the debtor.

The reason for this difference arises from the fact that the recovery procedure for large undertakings involves general interests, therefore the decision on ailing large undertaking cannot be determined by the creditors' vote. Indeed the creditors have a limited role in the procedure which does not allow them to take part in the judicial and political decisions during the procedure.

In the latter phase of the procedure, which is commenced by the decree of the Court in favour of an attempt to rescue the undertaking, three relevant organs become involved at this stage. These organs are the following: Ministry of Industry, extraordinary commissioner and inspection committee.

The Ministry of Industry (which now is said Ministry for productive activities) is the organ which supervises the entire procedure in this phase. This Ministry is empowered to appoint the extraordinary commissioner and the inspection committee, to authorize the extraordinary measures of the commissioner, to keep watch over the management of the undertaking by the commissioner, to authorize the accomplishment of the plan drawn up by the commissioner.

In substance the Ministry is an political and administrative organ which witness that in part this procedure responds to the logic of a mixed economy, according which the market can not balance the complex conflict of interests which arises from an insolvent large undertaking. This is also evidenced by a specific provision of the law n. 270, according to which the plan must be drawn up by the commissary in compliance with the governmental addresses of industry politics.

The extraordinary commissioner is an executive organ which has the functions to manage the undertaking and the assets of the trader and to carry out the plan which he has drawn up. The extraordinary commissioner replaces the trader and this entails problematical issue when the undertaking is a business association, because in this case it's necessary to border the commissioner's power with respect to the association organ's power. I can say that the commencement of the phase, which is intended to rescue the undertaking, causes a suspension of the business association's organ with regard to the management powers of the undertaking and the assets, which is now entrusted to the commissioner only.

On the contrary the powers which concern the structure of the business association are still maintained by the competent organs: board of directors and general meeting. In substance, the commissioner does not become an agent of the business association, but he remains an organ of the procedure to whom the law commits the management of the undertaking and the assets of the trader to ensure the success of the rescue attempt. This aspect is of utmost important, because it demonstrates that the recovery procedure does not alter the legal structure of the business association but limits the function of the organs insofar as it's necessary to rescue the undertaking.

Finally the law provides for an inspection committee consisting of three or five members chosen among the creditors and bankruptcy law experts. This organ has a consulting function with regard to the contents of the plan drawn up by the commissioner. This committee may suggest amendments or integrations of the plan to improve its contents and the measures for recovering the undertaking and for payment in favour to the creditors. Moreover this organ has the ability to audit the accounting of the undertaking and the documents of the procedure, and to request explanations to the commissioner.

6.e The contents and the function of the plans

According to new law the purpose to recover the economic balance of the undertaking can be carried out by two alternative plans: an economic and financial reorganization plan which can last no longer than tow years; or a plan for the productive plant transfer which can last no longer than one year.

First of all, it's important to say that these plans have a common function. Indeed both these plans have the function to recover the economic balance of the undertaking so that it can remain in the market. The difference between these plans is based in part on their contents.

If the procedure has adopted the restructuring address the plan must contain the following elements: the forecast on the capitalization of the business association under procedure; the turn over of the management; the time and the method to satisfy the creditors by a voluntary arrangement to reduce the amount of the debts or to determine new expiry dates for the debts. This is the particular content of the reorganization plan which concerns both the structure of the undertaking and the amount of the debts.

On the contrary if the procedure has adopted the transfer plan of the productive plant, this plan must indicate the modality to transfer it and the forecast in regard to the satisfaction of the creditors.

The plan is the basic mean to manage the ailing situation concerns a large undertaking and it allows to design the solutions which can be adopted in regard to the productive plant and the onerous situation. But, like I said above the creditors haven't right to vote upon these plans whose approval depends from the Ministry of Industry.

6.f The effects of the procedure

The evaluation about the effects of the procedure must take into account the structure and the function of the procedure, because these tow elements influence the effects of the procedure. First of all I will explain the effects with regard to the structure of the procedure, distinguishing the early and the later phase of the procedure, which I described above. Another aspect of my evaluation will be the analysis of the effects upon the trader, creditors, pending contracts, and operations in damage of the creditors.

Like I said above, the procedure is commenced by a judicial declaration of the insolvency and this early phase is intended to see whether the undertaking can be rescued. This phase does not cause significant effects, because the sole trader keeps in possession his firm and the organs of a business association remain in their function; therefore the undertaking remains in activity. The declaration of insolvency causes only a shrinkage of their powers as regard to the administration of the undertaking and the assets, because the extraordinary administration acts (for example settlements, selling of non movable assets, real or personal securities, deeds of gift etc.) and the payments in favour of previous creditors must be authorized by the appointed judge.

These effects are in compliance with the idea that an undertaking can be submitted to an judicial or external control only if there is an insolvency declaration, which makes public the ailing situation of the undertaking. The reason for that is the respect for free trade, which impedes any external interventions to rescue an undertaking if a declaration of insolvency is not present. In other words, an alert system does not exist in Italian bankruptcy law, like for example in France, because our system is in favour of resolving

the conflict which arises from the insolvency and not to prevent the insolvency.

Returning to an evaluation of the effects, the Court, during or after its declaration of insolvency, may replace the trader with the commissary. In this case the trader loses his powers over the undertaking and the assets management which, due to precaution, are committed to the commissary; and in case of the business association the Court states the forms and the contents of the commissary's powers with regard to the business association organs' powers which remain in operation. Any credit which arises from the continuation of commercial activity, by the trader or by the commissary, must be paid by preference with respect to the former creditors of the undertaking, and that in order to favour the loan of the undertaking during the period within which the procedure is in force.

Therefore there is a connection between the continuation of the undertaking, whether by the trader or by the commissary, and the preferential payment of the creditors which arises from this continuation, because this privileged treatment is the compensation for the loan of the ailing undertaking under the procedure for allowing its recovery. In substance, while the continuation is an effect of the structure of the procedure, the preferential payment in favour of later creditors is an effect of the function of the procedure, and these tow effects are connected.

Moreover, the most important feature of the procedure is the partial statutory moratorium which begins to descend with presentation of the petition for this procedure and becomes definitive with the insolvency decision. In this legal situation the former creditors can not paid by the trader, save the payments authorized by the appointed judge. This statute causes significant effects with regard to the judicial defending means of the creditors' right, because during the procedure no individual execution or other legal process against to the trader for payment may be commenced or continued.

These effects have tow reasons. First of all the ban for individual execution has the purpose to preserve the assets and the firm of the trader in order to allow the recovery of the undertaking. Without this ban any creditor might put in execution his right against the assets of the trader and the recovery attempt would be impeded. Later this procedure is an collective procedure, within which the creditors, accounted in the passive schedule, must be satisfied by the procedure according to the " par condicio creditorum" principle. The recovery procedure is not held to the "prior in tempore potior

in jure" principle, because all the creditors are satisfied proportionally to their right and with the same procedural method.

So also these effects descend from the structure and the function of the procedure.

It is important to say that these effects exist also in the phase within which the recovery of undertaking is attempted by the extraordinary commissioner. But there is a sole difference in comparison with the first observing phase, because when the extraordinary commissioner is appointed by the Ministry of Industry the trader loses immediately the management of the undertaking and the assets, and is replaced by the commissary. Thus, in the recovery phase there is no possibility that the trader can keep possession of the undertaking.

If the undertaking, which is submitted to the procedure, is an unincorporated business association, any partners of this association will also be involved in the procedure, and therefore the partners' assets are also used in the recovery of the undertaking.

In regard to the pending contracts the law provides for their continuation by virtue of the fact that the undertaking is kept in operation. For example a supply contract must continue with the procedure, otherwise the function of the procedure would be impeded. Nonetheless the law ascribes to the commissioner a dissolution power of contracts, which he will exert when the continuation of a contract is not profitable for the procedure. Therefore the main principle is the continuation of the contract, save the discretional decision of the commissioner to dissolve the contract when there is a prevailing reason which concerns the function of the procedure.

The credit of the counterpart which arises from the decision of the commissary to dissolve a pending contract or to take over it, must be accounted for and satisfied within the procedure, and that to guarantee a whole disclosure of the debts affecting the undertaking. This aspect is most important because the commissioner before making his decision, must evaluate the costs and the benefits for the procedure which can derive from the execution of a contract. Indeed if the commissioner decides to continue with a contract, the consequent counterpart's credit must be paid prior to others creditors of the undertaking. This privileged treatment could reduce the financial resources

used to rescue the undertaking and therefore jeopardize the function of the procedure.

In light of what I have just said, it's possible to understand that the discipline of the pending contracts is a central point in the economy of the procedure. According to the commercial law the trader's contracts are elements through which the undertaking is carried out, because they display the trader's strategic decision. Their role increases when the undertaking is ailing and it is submitted to a recovery procedure; therefore the commissioner must take into consideration this aspect in the perspective to realize the function of the procedure. In conclusion to this point, I can say that the commissioner's decision in regard to pending contracts must assess the strategic relevance of a contract, the relationship between costs and benefits and the recovery function of the procedure.

A last kind of the effects concerns the operations of the trader in damage of the creditors. In general these operations decrease the estate of the trader and jeopardize the satisfaction of the creditors. The commissioner is empowered to avoid these operations when certain conditions recur. These conditions are not provided by the law on the recovery procedure for large undertaking, but by the bankruptcy law enacted in 1942. Indeed the law on recovery procedure refers back to the former law in regard to the discipline of the avoiding powers.

But the law on recovery procedure provides for a specific condition which concerns the structure and the function of the procedure.

According to Art. 49 the commissioner can exercise the avoiding power against the operations which damage the trader's estate only if the Ministry of Industry has authorized a transfer plan and not an reorganization plan. Like we saw above, the recovery of undertaking can be effected alternatively by a reorganization plan, which gives to the undertaking a new financial and economic arrangement, or by a transfer plan, which provides for the selling of the productive plant, in whole or in part.

Between these plans and their function there are deep differences.

When a reorganization plan is authorized the productive plant is destined to be kept by the trader and after its recovery the trader will pay the creditors with the financial resources which arise from the trader activity. Therefore this plan allows to keep the undertaking in operation with the former trader or management and to continue its activity on the market. In this

case the creditors are not paid from the commissioner within the procedure but from the trader once the undertaking is recovered.

On the contrary, when the transfer plan is effected, the productive plant, in whole or in part, passes to a new trader and the creditors are paid from the commissioner inside the procedure with any money deriving from the transfer. In this alternative case the procedure has a more clear payment function than the reorganization plan.

These differences explain the reason for which the avoiding powers can be only used when a transfer plan has been authorized. In fact the necessity to take back the assets or the money, which are gone out the undertaking with the trader's operations, exist only in this last case and not when a reorganization plan is in operation.

Moreover if the avoiding powers were used when a reorganization plan is in operation, these powers would become an unfair financial support of the undertaking submitted to the procedure, with an evident damage for the competition. In fact another undertaking, which is in the same market, can not avoid its operation in order to recovery itself and to remain in the market.

In short, the avoiding powers cannot be used to recovery the undertaking, but to take back only the assets or the money which must used to pay the creditors. In substance the avoiding powers belongs the judicial means to defend the creditors and not to recover an undertaking, because they are related to the gathering of the estate.

To step into the examination of the contours of the avoiding powers it's fruitful to consider a first distinction between free and onerous acts. In regard to the free acts, the law provides that they are not efficacy. Therefore in these cases the commissioner can request the return of the performance and if the counterpart denies that, the commissioner can take legal action against him. But for this regime it's necessary that the acts have been effected tow years before the insolvency declaration.

The same discipline is provided for the payments effected by the trader before the expiry date and during tow years previous to insolvency declaration. The reason of this discipline is that these acts are not in line with the essence of the undertaking, because it's not ordinary that a trader effected payments in advance or deed of gift. In case of insolvency, these acts causes a damage for the trader's estate and therefore insolvency law hits these acts denying them the efficacy.

The discipline of the onerous acts is more complex than that explained above. In this field it's important to distinguish briefly between tow different kind of acts: normal and abnormal acts.

The abnormal acts are all those characterized by an not usual guarantee, or not usual way of payment, for example: by assignment of credits or by voluntary set off of debts, or by a considerable disproportion between the contractual performances of the parties. These acts may be annulled by the commissioner if the trader are been effected them during tow years previous to insolvency declaration.

Moreover the law provides that the normal acts may be also annulled by the commissioner. A frequent case is the payments in favour of the banks through deposits on current account. The commissioner may take legal action against the recipient subjects if there are tow conditions: the accomplishment of these acts during one year previous to the insolvency declaration and the proof that the counterpart knew the insolvency of the trader.

I must specify that if these acts are accomplished within a commercial group the relevant period is enlarged to five years for the abnormal acts and to three years for the normal acts. The provision for a reinforced avoiding power with regard to the commercial group depends from the danger of decreasing the estate of the firms which compose the group, with a consequent damage for the creditors.

7. The conclusion of the procedure

The strong relationship between the plans and the function of the procedure explains the closing cases of the procedure. In regard to it, the law distinguishes between the changing of the recovery procedure into bankruptcy procedure and the conclusion of the procedure in the strict sense.

The first possibility is that the Court can order to change the recovery procedure into the bankruptcy procedure when the recovery attempt can not be continued usefully. I can say that this is a changing condition in general but the law provides also for tow specific changing cases when the plans cannot achieve their target.

In fact if the trader has not recovered the capability to pay his creditors regularly at the end of the time for the reorganization plan or if the productive

plant has not been transferred at the end of the time for the transfer plan, the procedure must be changed into bankruptcy procedure by the Court.

In short, during the recovery procedure the bankruptcy procedure is a possibility connected with the inability of the plans to achieve their goals.

On the contrary the closing cases, in strict sense, of the procedure depend from the structure and in part from the function of it. The Art. 74 of the law no. 270 provides for the following cases: if the creditors have not filed for the examination of their credit within the procedure; if the trader recovers his capability to pay the creditors before expiry date of the plan; if the Court approves an agreement between the creditors and debtor; if all the creditors are paid during the procedure or any money derived from the liquidation of the assets it is distributed among the creditors completely.

8. Final reflection

To conclude this lecture I would like to elaborate a neologism and say that the bankruptcy law is becoming a *macro-law,* because it's not intended only to resolve the limited conflict between insolvent debtors and creditors, but it involves a wide kind of interests and touches other bodies of law, for example labour law, environmental law and competition law.

In short, the changing of the function of the bankruptcy law and the idea that the bankruptcy law must be intended to keep firms in activity have enlarged its interaction to other bodies of law. In regard of this the Italian bankruptcy law system is very relevant.

As jurist we know that the challenge is that to analyse and to understand this change in order to dominate it on the democrat strength of the law.