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The Process of refounding European insolvency frameworks

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Ulrik Uber Institute for Private International Law

Groningen, The Newtherlands

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university of groningen

The Process of refounding European insolvency frameworks

PhD thesis

to obtain the degree of PhD at the
University of Groningen
on the authority of the
Rector Magnificus Prof. C. Wijmenga
and in accordance with
the decision by the College of Deans.

This thesis will be defended in public on

Monday 18 November 2019 at 11.00 hours

by

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born on 12 May 1983
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To my Father

Roberto Pincione

ACKNOWLEDGMENTS

Writing this book was a great adventure. Much has happened during the time I worked on it and much has changed. When I started I was not a husband, I was not a father, I was not the person I am now in many important aspects. This experience has taught me more than I could have ever imagined.

Some things though, luckily, stayed the same. I remained over the years a very lucky person surrounded by absolutely wonderful people to whom I owe so much. Although I tried, I found it impossible to write in just a few pages what each and every one of them means to me; I just cannot find an effective and meaningful way to thank them all for the positive impact they have had on me every day.

I have therefore decided to limit this section to a few remarks deeply connected to the PhD program and to writing the book. I will make all other acknowledgements soon in person.

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advice. He always replied to my e-mails and donated his time when I asked for support for my PhD. He gave me many very useful suggestions. He went way beyond what any person asking for help in am important challenge in life could expect to receive. I truly hope I managed to show him my appreciation over the years and I do feel deeply sorry for the time I took from him. When I think of what he has done for me and of the impact it had in my life, I hope I will be given a chance to return the favor, helping somebody else the same way he did with me, and that, once faced with this new challenge, I will be able to do it as well as he did. Once again, I thank you so much for your kind help and support!

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thank him enough for his patience and for his help in this short paragraph. Dude, as you know you are part of the family. Thank you so much for everything.

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Milano, October 2019

Federico Pincione

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INTRODUCTION

Our perception of bankruptcy has changed greatly in the past few years. The field of insolvency laws went from being a gloomy and depressing subject[1] to becoming a source of hope for a wide range of indebted business and non-business debtors. Modern views in Europe went as far as to include it among the key elements in supporting the Union's strategies to build a more solid economy that could compete successfully within the globalized market at the local and cross-border level.

As affirmed in a recent and relevant Communication of the European Commission:

> "Insolvency rules cover a wide range of measures from early intervention before a company gets into serious difficulties, timely restructuring to ensure that viable business parts are preserved, liquidation of assets where companies cannot be otherwise saved and finally giving a second chance to honest entrepreneurs via discharge of debt. A well-functioning insolvency framework covering all these measures is an essential part of a good business environment as it supports trade and investment, helps create and preserve jobs, and helps economies absorb more easily economic shocks that cause high levels of nonperforming loans and unemployment. These are all key priorities of the European Commission. Insolvency matters have a strong Union dimension. An increasingly interconnected single market with an ever stronger digital dimension means that very few companies are purely national when aspects such as their client base, supply chain, scope of activities, investor and capital base (to mention a few) are considered. Importantly, insolvency matters are also a deterrent for cross-border expansion and investments. Many investors mention uncertainty over insolvency rules or the risk of lengthy or complex insolvency procedures in another country as a main reason for not investing or not entering into a business relationship outside their own country. A higher degree of harmonisation in insolvency law is thus essential for a well-functioning single market and for a true Capital Markets Union. This is why the issue has long attracted considerable interest at EU level. Increased convergence of insolvency and restructuring procedures would facilitate greater legal certainty for cross-border investors and encourage the timely restructuring of viable companies in financial distress. Inefficient and divergent insolvency laws make it harder for investors to assess credit risk, particularly where they consider making cross-border investments. More cross-border risk-sharing, stronger and more liquid capital markets and diversified sources of funding for EU businesses will deepen financial integration, lower costs of obtaining credit and increase the EU's competitiveness."[2]

In this work, we will analyze the process developed to change the structure of modern European bankruptcy laws. We will define it as "the process of refounding European insolvency frameworks". We will refer to it as a "refoundation" because the changes that have been sought are radical and have led to deep modifications of the "natural" evolutionary path followed by local European systems for centuries. We will discuss the origins of this process, its goals, and the results achieved up to now, and we will examine several barriers that have to be overcome while proposing possible improvements for the future.

Our path will begin with the analysis of relevant official documents released within the Union in the past twenty years, with a particular focus on those published after the year 2000, the time in which an

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[1] As Professor Charles Warren used to define it. See Warren Charles, "*Bankruptcy in United States history*", William S. Hein & Co., Inc, Buffalo, New York, ISBN 0-89941-907-0, (1994).

[2] **(2016) COM 723 Final**, "*Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU*", at 2.

ambitious goal was set in the European agenda: **for the European community to become, by 2010, the most competitive and dynamic knowledge-based society in the world**.

Part of the steps taken toward reaching such demanding target revolved around the improvement of European insolvency systems both at a local and cross-border level. Yet unfortunately, as we will see, things did not go as expected despite the energies spent on this project. Several factors, in fact, have slowed down European progress, causing the system to stall; we will define this fact as the impasse in the process of refoundation.

Some, such as the global financial crisis, had systemic effects on all European plans and strategies, which were ultimately delayed or damaged. Others, which will be of greater interest to us, had a specific impact on the field of insolvency laws preventing the accomplishment of the great improvements that were scheduled. In this study we will decrypt these elements so that progress can be unlocked in the near future.

In order to do so, we will attempt to see things from a different angle.

Upon implementing the process of refounding insolvency regulations, several studies were commissioned by the Union to analyze and organize the great amount of information available on European local frameworks. Comparisons were also often made with foreign frameworks, mainly the American one[3]. Such an approach is relevant and interesting but it also faces inevitable barriers: comparing tens of complex and different models while taking them out of the social context they are enacted within necessarily involves a certain degree of approximation.

In our voyage, we will use a complementary approach. Instead of comparing data from all of the contemporary European insolvency systems, we will work on a smaller sample of interconnected, modern and ancient, local and cross-border models. We will also discuss modern best practices developed by relevant international organizations. The data that we will collect through the different scenarios will support our conclusions.

Summarizing this concept with an analogy, we could say that, if the ultimate goal of our research was to study a forest and its flora and fauna, the standard approach often used in European documents would be to do it by flying over it in a plane. This would allow us to gain relevant information by mapping it and filming it. We intend, instead, to have a walk through the woods.

In the first case it would be possible to perceive the "big picture", but it would be rather difficult to give value to important single elements. In the second case it would be possible to examine certain areas in greater depth, but others would be excluded. We have selected a path which is meaningful in explaining the process of refoundation.

In order to make our analysis complete, we will rely on important European and international studies which will provide a much-needed overview. It is worth mentioning, in fact, that the approach that we intend to follow does not aim to be better than any other, but rather complementary, so that researchers can build on each other's work and have greater success in untangling the difficulties that are holding back Europe's full potential today.

The organization of the book will be consistent with our approach. Each chapter will select a relevant scenario or topic and will analyze it in a manner which is instrumental to our goals.

In Chapter I, we will learn about the "state of the Union" (the European one) and of the strategies for its development (with a specific focus on the growth of its market) in the new millennium. In this scenario, we will learn of the origins of the process of refounding European insolvency frameworks and of the reasons for its deployment. Our discussion will be based on several official European documents and studies released from the nineties until roughly 2016 (although most of the analysis will focus on the first fifteen years of the new millennium). By making extensive use of official documents, we will try to obtain first-hand information on how strategies (systemic ones and those directly focusing on reforming the field of bankruptcy laws) have been developed and on their results. We will see how, and why, goals were set and the difficulties that were faced. We will hit the core of the impasse faced at a systemic level in reforming bankruptcy laws. In particular, in this chapter, we will learn of the two great barriers that seem

[3] See as an example of a recent and relevant study: **McCormack Gerard, Keay Andrew, Brown Sarah, Dahlgreen Judith**, "*University of Leeds - Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States' relevant provisions and practices*", European Commission, Directorate-General for Justice and Consumers Tender No. Just/2014/JCOO/PR/CIVI/0075.

to have prevented the successful development of the process of refoundation: a) the “stigma of failure”, and b) the lack of uniformity among the local bankruptcy laws of the Member States.

Chapters II and III will be connected, with both discussing the elements of effectiveness and efficiency in modern bankruptcy through an analysis of best practices and models proposed by influential international organizations. In Chapter II, we will discuss these two elements within local frameworks structured to address the needs of both business and non-business debtors. In Chapter III, we will analyze the same elements within cross-border systems; improving international frameworks is, in fact, a key task in the modern insolvency scenario.

In Chapter IV, we will go back to the roots of European bankruptcy. Our analysis will allow us to shed some light on the origins of the two most relevant barriers burdening the process of refounding European insolvency systems: the lack of uniformity among local frameworks and the presence of stigma. We will discuss these topics from an historical and comparative point of view through an analysis of several Italian and English medieval laws.

In Chapter V, we will discuss the evolution of medieval European systems in a new scenario, the American one. English insolvency statutes were, in fact, the “bricks” which constituted the foundation of Colonial systems and which impacted early state statutes. We will study the development of American laws from the Colonial period until the modern Bankruptcy Code, which we will study in greater depth. Understanding the modern American insolvency framework is important to plan modifications within European systems; the Code is, in fact, often used as a source of inspiration for (or directly transplanted into) European local frameworks.

In Chapter VI, we will go back to Europe and discuss the evolution of more modern Italian statutes. This chapter could be considered a case study. Our goal will not be to focus on the rules in detail, but to observe the process followed in their evolution and modification, placing particular emphasis on changes which occurred from the beginning of the new millennium. The local system in Italy, as in several other Member States, suffered greatly from the impact of competition within the globalized market. It struggled in following the path set by European actions and also in successfully deploying the process of refoundation, which demanded several modifications to the traditional, stigmatizing matrix of Italian laws by transplanting discordant American tools, approaches, and principles. As we will see, the resulting statutes were a Frankenstein-esque mix of reforms enacted to reshape the existing draft. Such reforms ultimately lacked organization and coordination and caused lawmakers to have to rewrite sections several times, or even, in some instances, to have to back-track and re-enact rules that had been repealed few years before.

In Chapter VII we will merge the relevant information collected in the different parts of our analysis. We will elaborate on the elements that have caused the impasse within the process of refoundation by discussing those specific factors that have delayed the achievement of the preset targets in the field of bankruptcy laws. We will also examine ways to make improvements and move forward.

Despite the relevant weaknesses in the process of refoundation, our final conclusions will be positive. Much, in fact, has been accomplished in the past few years in the field of insolvency law both at a local and cross-border level. Through the joint efforts of the Member States, much more can be accomplished in the future.

The larger purpose of this research is to offer a different, hopefully useful, point of view on relevant issues that are stressing the structure and challenging the solidity of our Union. Understanding how to improve our legal framework, especially in an area that has been placed under much pressure by the recent changes in our economies and by the global market crisis, is a key step in ensuring a better future for our community.

CHAPTER I.
EUROPEAN STRATEGIES FOR GROWTH IN THE NEW MILLENNIUM

1. Introduction: planning Europe's future in the new Millennium

The European Union approached the new millennium with great hopes.

The steps taken in previous years to introduce on-time the new, common, currency[4] and the latest enlargements, seemed to have been remunerative. National and international institutions thought very positively of the future[5]:

> "Over the last decade, the European Union has achieved a great deal: the internal market, economic and monetary union, the launch of the euro on time. As a result, the macroeconomic outlook is now positive: growth for the Union is forecasted at 3% for 2000 and 2001 and net job creation is expected to be above 1% - meaning 1.5 million new jobs each year. European inflation is at historically low levels, public sector deficits have been reduced remarkably and the stock of government debt as a percentage of GDP is on a downward path."[6]

> "The single market has already had a positive impact on growth. The free movement of, goods, services, and people has opened up a market of 370 million consumers for business, and the mutual recognition of qualifications has made it easier to create a business in another Member State."[7]

> "The introduction of the euro in physical form raised hopes for the creation of a truly dynamic scenario moving towards full coordination and integration."[8]

This was, nevertheless, a time of great change. Much had still to be done to achieve long-term growth within an increasingly globalized market, and the competition among major economies was fierce:

> "But as the macroeconomic policy framework is beginning to yield results the Union is, like every other region, facing a paradigm shift driven by globalisation and the new knowledge based economy. This has an impact on every facet of life and requires a radical transformation of Europe's economy and society. The challenges are enormous; from changing the skills needed for work through education and training, to introducing more dynamism and entrepreneurship to the European economy, to ensuring that the new knowledge based society is inclusive for all citizens.

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[4] The euro appeared in financial markets in January 1999 and started circulating in physical form January 2002.

[5] For an overview of the evolution of the European economy since 1945 and for a discussion of its interaction with the one of the United States of America see: **Eichgreen Barry**, "*The European Economy Since 1945*", Princeton University Press, Princeton New Jersey, USA, ISBN 9780691138480 (2007).

[6] **(2000) European Commission**, press release, IP/00/191, "*An agenda of economic and social renewal for Europe*" – the Commission's contribution to the Lisbon Special Council, http://europa.eu/rapid/press-release_IP-00-191_en.htm; at 1.

[7] **(1998) COM 222 Final**, European Commission, "*Fostering entrepreneurship in Europe: priorities for the future – Communication from the Commission to the Council*", at 2.

[8] **(2001) COM 605 Final**, "Communication from the Commission to the Council and the European Parliament on the implementation of the Risk Capital Action Plan (RCAP)", at 8.

> The Commission believes that it is necessary to face these challenges with optimism. It is proposing to take advantage of the emerging knowledge economy and society in order to achieve sustained economic growth, full employment and social cohesion. This requires a positive vision for the future and a series of policies to deliver it."[9]

Europe as a Union, and the single Member States individually, still had a long way to go to match the performance of other major players, in particular the United States, which was the main reference point[10]:

> "With the arrival of the euro, coupled with a more favorable economic climate and supply side liberalization, risk capital markets[11] are beginning to develop in Europe, albeit at different rates. A growing number of business angels support the creation of new businesses; increasing amounts of venture capital are beginning to be invested in fast growing companies; and new stock markets are offering high growth companies the possibility to go public. However, the amount and allocation of risk capital still remain sub-optimal, as a result of the persistence of enduring constraints and barriers throughout the financing chain, from seed capital to IPO.
> Whilst European Venture capital has grown rapidly over the past five years, it remains significantly smaller than in the US and insufficiently oriented towards young and innovative companies. In 1998, for the second year in a row, € 20 billion was raised for private equity investment in Europe (compared with € 3 to € 8 billion p.a. between 1988 and 1996) and about 14.5 billion was invested. But less than half of this € 14.5 billion, only € 7 billion, was invested in venture capital in Europe compared to € 12 billion in the US. And only € 1.6 billion was invested in early stage compared to € 4.5 billion in the US in 1998. Investment in high-tech had almost doubled in Europe between 1997 and 1998 (from € 2.3 billion in 1997 to € 4 billion in 1998). But, in the US over 80% of the venture

[9] **(2000) European Commission**, press release, IP/00/191, "*An agenda of economic and social renewal for Europe*" – the Commission's contribution to the Lisbon Special Council, http://europa.eu/rapid/press-release_IP-00-191_en.htm; at 1.

[10] In this chapter we will discuss several European official documents and studies. The American framework or data on the performance of the American system are often used as the main comparator and often used as a reference model to evaluate performance.

[11] "A capital market is a financial market in which long-term debt or equity-backed securities are bought and sold. Capital markets are defined as markets in which money is provided for periods longer than a year. Capital markets channel the wealth of savers to those who can put it to long-term productive use, such as companies/ governments making long-term investments. Financial regulators, such as the UK's Bank of England (BoE) or the U.S. Securities and Exchange Commission (SEC), oversee the capital markets in their jurisdictions to protect investors against fraud, among other duties.
Modern capital markets are almost invariably hosted on computer-based electronic trading systems; most can be accessed only by entities within the financial sector or the treasury departments of governments and corporations, but some can be accessed directly by the public. There are many thousands of such systems, most serving only small parts of the overall capital markets. Entities hosting the systems include stock exchanges, investment banks, and government departments. Physically the systems are hosted all over the world, though they tend to be concentrated in financial centres like London, New York, and Hong Kong.
A capital market can be either a primary market or a secondary market. In primary markets, new stock or bond issues are sold to investors, often via a mechanism known as underwriting. The main entities seeking to raise long-term funds on the primary capital markets are governments (which may be municipal, local or national) and business enterprises (companies). Governments issue only bonds, whereas companies often issue either equity or bonds. The main entities purchasing the bonds or stock include pension funds, hedge funds, sovereign wealth funds, and less commonly wealthy individuals and investment banks trading on their own behalf. In the secondary markets, existing securities are sold and bought among investors or traders, usually on an exchange, over-the-counter, or elsewhere. The existence of secondary markets increases the willingness of investors in primary markets, as they know they are likely to be able to swiftly cash out their investments if the need arises.
A second important division falls between the stock markets (for equity securities, also known as shares, where investors acquire ownership of companies) and the bond markets (where investors become creditors)."
See: http://ec.europa.eu/finance/capital-markets-union/index_en.htm

capital investments are in Information Technology (IT) and biotechnology and healthcare, while in Europe it is less than 28% of private equity investment.
European stock markets dedicated to high growth companies, created some 3 years ago, have grown strongly in 1998 and in the first half of 1999 have shown some very positive developments. There are now over 650 companies quoted on the main European markets for high growth companies: Euro.NM; EASDAQ and AIM. But these markets remain dwarfs compared to the American Nasdaq[12]: they quote no less than 8 times fewer companies; their total market capitalization is a staggering 33 times lower than Nasdaq's and they remain extremely fragmented despite the expansion and tightening of the Euro.NM network."[13]

In 2001 the Commission of the European Communities defined the performance of European Risk Capital Markets as spectacular[14] even in the field of start-ups[15], which had traditionally been a weak link in the financing cycle[16]:

"The aggregate figures for the EU reflect a pattern of substantial growth in the volume of venture capital investment in 2000 across the Member States. In Belgium there was also a substantial growth in seed and start-up investments but not in the total due to exceptionally high growth of the previous year. Funds in the single biggest national market (the UK) more than doubled their venture capital investments to over €6 billion 4 and, strikingly, there was a seven-fold increase in start-up investments and a substantial increase in seed-capital, thus reducing relatively the traditional focus on buy-out finance. German funds consolidated the growth of venture capital to €3.9 billion, an increase of nearly 50%, with a doubling of seed and a substantial increase in start-up investments. In France too there was nearly a doubling of venture capital investments (up to €3.3 billion), including a similar increase in start-up investments. The other major contributors by volume were the Netherlands (venture capital investment of over €1.5 billion), representing 0.39% of GDP which is almost on a par with the share the UK, and Italy with €1.6 billion (nearly a tripling over 1999), including a four-fold increase in start-ups, although the share of venture capital in GDP remains modest at 0.14%. The Finnish and Swedish markets, which have been developing significantly over the past few years, continued to grow, although the most striking growth in Sweden in 2000 came in the buy-out market (75% of the volume of new investments). In the remaining Member States both volumes of venture capital and shares in GDP, though growing, remain low."[17]

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[12] "The US NASDAQ (National Association of Securities Dealers Automatic Quotation) electronic stock market (the world's second largest capital market in terms of dollar volume of equity trading) provides upwards of 400 suitable smaller companies each year with ready access to equity capital through a public offering of their shares. In Europe, only 10 to 20% of this number tap the secondary markets and many choose a NASDAQ listing, instead with a corresponding reorientation of their strategy towards the US markets. The number of companies newly listed on US stock markets represents more than 200% of the number in the EU." See **(1995) COM 2087 Final**, "*Small and medium-sized enterprises a dynamic source of employment, growth and competitiveness in the European Union – Report presented by the European Commission for the Madrid European Council*", at 7.

[13] **(1999) COM 493 Fina**l, "*Communication from the Commission to the Council and the European Parliament – Risk Capital: Implementation of the Action Plan Proposals for moving forward*", at 4.

[14] "The total volume of venture capital investments in Europe, covering seed, start up, expansion and replacement phases of company development, grew spectacularly from about € 10 billion (0,14 of GDP) in 1999 to over € 19.6 billion (0.23 of GDP) in 2000, continuing the trend of the last few years". See **(2001) COM 605 Final**, "*Communication from the Commission to the Council and the European Parliament on the implementation of the Risk Capital Action Plan (RCAP)*", at 3-4.

[15] "Growth in total seed and start-up investment was even more striking, up by nearly 115% at € 6.4 billion, a figure equivalent to the total volume of venture capital investments only two years earlier. Start-up investments, moreover, more than doubled in volume, representing 29% of the total venture capital invested and 38% of the total number of investments." See *Id.* at 4.

[16] See *Id.,* at 2.

[17] See *Id.,* at 4.

However, the gap with the U.S. remained wide open:

> "US risk capital investments in 2001 were "**only**" three times that of the EU. This breaks the trend of previous years (in 2000 it was four times bigger). But it does not mean further progress in closing the gap with the US will be automatic."[18]

In order to make progress and catch up, Europe needed to find an effective way to unlock its full potential. With the beginning of the new millennium, a challenging ten-year agenda was set to support European efforts and set a common strategy.

In the next sections of this chapter, we will analyze the first ten-year plans of the millennium and several initiatives that were promoted to support them. Our focus will be placed, of course, on insolvency-related actions, which will be discussed in an ample context. It is our goal to understand the:

- origins of the process of refounding European insolvency systems;
- goals such an ambitious and complex process aimed to attain;
- reasons that delayed the achievement of several preset goals; and
- causes of the impasse.

We would be unable to gain all the necessary data on such relevant points if we did not include in our discussion relevant economic and social factors.

We will be guided in our analysis by official documents, which we will discuss in chronological order of publication for as much as it will be possible and useful. This process will allow us to obtain relevant information on how strategies developed and on the reasons that led to their modification over time.

Our approach will lead to several repetitions or *déjà vu* moments which, at times, will be so numerous as to cause confusion. Topics will overlap at times; although actions will be presented as "new", they will repeat themselves in a fairly similar fashion over the decades. While walking our path through several documents in this chapter we will not try to emphasize this weakness, but we will not try to cure it either.

Such confusion is an interesting aspect of our research. It allows us to grasp the difficulties faced by the Union and by Member States within the past two decades. Understanding more about it will allow us to have a better perception of what went wrong and of what has prevented the EU from achieving its goals.

Was it just an extraordinary economic crisis? Or was there (is there) much more to halt our common growth and the process of integrating our insolvency frameworks?

1.1 The "Lisbon strategy" and the goal to become the most competitive and dynamic knowledge-based economy of the world by 2010

At the European Council held on the 19th and 20th of June, 2000 in Santa Maria da Feira, Portugal[19], a demanding[20] goal was set for the future: **for the European community to become, by 2010, the most competitive and dynamic knowledge-based[21] society in the world**[22 23].

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[18] See *Id.,* at 4.

[19] See http://www.europarl.europa.eu/summits/fei2_en.htm.

[20] See **(2001) COM 605 Final**, "*Communication from the Commission to the Council and the European Parliament on the implementation of the Risk Capital Action Plan (RCAP)",* at 8.

[21] See **Report from the high level group chaired by Wim Kok**, "*Facing the challenge – The Lisbon strategy for growth and employment",* Office for Official Publications of the European Communities, (2004), at 19: "The Lisbon European Council rightly recognized that Europe's future economic development would depend on its ability to create and grow high value, innovative and research-based sectors capable of competing with the best in the world.

The evidence is overwhelming that the higher research and development expenditure, the higher subsequent productivity growth. One of the preconditions for any increase in European productivity growth is to raise R & D spending. Studies demonstrate that up to 40% of labour productivity growth is generated by R & D spending and that there are powerful spillover effects into other areas of the economy, depending on the way in which the money is spent. One of the most disappointing aspects of the Lisbon strategy to date is that the importance of R & D remains so little understood and that so little progress has been made.

However, the knowledge society is a larger concept than just an increased commitment to R & D. It covers every aspect of the contemporary economy where knowledge is at the heart of value added — from high-tech manufacturing and ICTs through knowledge intensive services to the overtly creative industries such as the media and

A ten-year[24] strategy based on relevant economic and social pillars was designed to reach the target[25]. Much had to be done, though, to coordinate the actions of the single Member States at a local level and make them fruitful for the whole Community. Despite the optimism that had accompanied the implementation of the "Lisbon Agenda", at the time the European scenario was still greatly fragmented and fragile compared to the American one[26].

The lack of cohesion and uniformity of action within such a young (and growing) coalition caused it to lag behind its main competitor of the time:

> "In March 2000 the then 15 EU leaders agreed at the Lisbon Spring Council that the EU should commit to raising the rate of growth and employment to underpin social cohesion and environmental sustainability. The US economy, building on the emergence of the so-called 'new' knowledge economy and its leadership in information and communication technologies (ICTs), had begun to outperform all but the very best of the individual European economies. Europe, if it wished to protect its particular social model and continue to offer its citizens opportunity, jobs and quality of life, had to act with determination — particularly in the context of the mounting economic challenge from Asia and the slowdown of European population growth. The EU set itself 'a strategic goal for the next decade: to become the most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment'.
> Enlargement has made inequality and the problems of EU cohesion more pronounced. The EU population has increased by 20% while the addition to European GDP is only 5%, resulting in a drop of output per head of 12.5% in the EU-25. Moreover, the new Member States are characterised by strong regional disparities with wealth concentrated in a small number of regions. The population living in regions with output per head of less than 75% of the EU has increased from 73 million to 123 million. Equally, as noted earlier, the EU-25 will find some of the Lisbon targets even more challenging than the EU-15. For example, the EU-25 average employment rate has dropped as a consequence of enlargement by almost 1.5 percentage points. The long-term unemployment rate for the EU-25 is 4% compared with 3.3% for the EU-15. Some of the environmental targets will also be more difficult to achieve."[27]

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architecture. Up to 30% of the working population are estimated in future to be working directly in the production and diffusion of knowledge in the manufacturing, service, financial and creative industries alike. A large proportion of the rest of the workforce will need to be no less agile and knowledge based if it is to exploit the new trends. Europe can thus build on its generally strong commitment to create a knowledge society to win potential world leadership. The possibilities for wider economic structures to create the network economy and society and a fundamental re-engineering of business processes are being opened up by ICTs. They permit every step in value generation to become smarter. Value is being created less in the simple transformation of inputs into outputs but more in fundamentally enlisting the new capacity and competences created by ICTs to meet individualised and complex customer needs — whether business-to-business or business-to consumer relationships."

[22] **(2002) COM 563 Final**, "*Communication from the Commission to the Council and the European Parliament on implementation of the Risk Capital Action Plan (RCAP)*", at 3.

[23] **(2002) COM 68 Final**, "*Report from the Commission to the Council and the European Parliament – Report on the implementation of the European Charter for Small Enterprises*", at 4.

[24] "The Lisbon Strategy then adopted the Open Method Coordination to provide a common framework for coordinating actions to be taken at the Member States level. A ten year period (2000-2010) was set to reach the main target, with yearly monitoring to be carried out by the Spring European Council."
See: https://portal.cor.europa.eu/europe2020/Profiles/Pages/TheLisbonStrategyinshort.aspx

[25] *Id.*

[26] U.S. investments in the venture capital market were approximately twice the ones of Europe in 1998; the triple in 1999 and the quadruple in 2000 evidencing a gap that, despite EU growth, kept widening itself. See **(2001) COM 605 Final,** "*Communication from the Commission to the Council and the European Parliament on implementation of the Risk Capital Action Plan (RCAP)*", at 20.

[27] **Report from the high level group chaired by Wim Kok**, "*Facing the challenge – The Lisbon strategy for growth and employment*", Office for Official Publications of the European Communities (2004), at 14.

Several relevant factors negatively affected the overall performance of the European Community. Many were not new; they had already been identified in the years immediately preceding the implementation of the Lisbon strategy. The analysis developed by the European Risk Capital Action Plan[28] in 1998, for example, evidenced six main barriers that heavily limited European potential:

1. "Capital markets in Member States are still extremely fragmented, reducing market capitalisation and liquidity;
2. Institutional and regulatory barriers persist owing to the lack of a satisfactory regulatory framework at either European or national level. This is especially the case as regards the regulation of venture capital funds, institutional investors (insurance companies, pension funds), investment services, cross-border issues/listing and accounting rules;
3. The national tax systems of the Member States seem to penalise risk-capital investment. Firstly, revenue from direct participation in companies (dividends) tends to be taxed at higher rates than income resulting from capital invested free of risk in bonds and accounts deposits (interest). Secondly, it is important that taxation of capital gains should not be a brake either on investment or on the use of stock options as part of remuneration packages. Thirdly, there is a general lack of clarity as regards the tax regimes applicable to venture capital funds;
4. In the high-technology sector, there is an acute shortage both of start-up SMEs and of the investment opportunities that result from them. These deficiencies are accentuated by the rarity of networks or geographic concentrations of high-technology SMEs and by a legal and regulatory environment (intellectual property rules, administrative requirements for starting a company) scarcely conducive to innovation and business start-ups;
5. There are insufficient human resources (entrepreneurs and qualified experts) available for venture capital investment projects;
6. "Cultural" factors, such as the attitude of investors to risk and the absence of an enterprise culture in schools and universities, hamper the formation of a new generation of European entrepreneurs."

With the setting of the new, ambitious targets, it became also necessary to bring major improvements in all such areas. In particular: a) increasing the levels of uniformity among markets and legal frameworks; b) increasing the levels of entrepreneurialism; c) supporting the growth small and medium enterprises (SMEs).

Bearing this in mind, the Community decided to take action and focus on its best assets, placing a bet on SMEs. As a fertile breeding ground for business ideas and a main driver for innovation, employment, and social and local integration, SMEs seemed to present Europe with a unique opportunity: a chance to make simultaneous and uniform improvements in most, if not all, of the critical areas that had been considered weak in the previous years throughout the entire territory of the Union, hence overcoming the differences existing among Member States and single areas, territories, regions, cultures, and societies.

The broad spectrum of beneficial effects that could derive from increasing the number and levels of competitiveness of SMEs within the European market acted as a great incentive to start more relevant actions in this area. Europe faced renewed difficulties not just in coordinating efforts with regard to barriers, but also in the general process of integration of new Members[29]. The latest enlargements had a relevant impact on the balances that had been slowly consolidating over the previous decades within the Union, with potentially negative effects on the new strategies:

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[28] **(1998) COM 552 Final**, "*Risk capital: a key to job creation in the European Union*" [SEC(1998) 552 final - Not published in the Official Journal].

[29] The growth in numbers of SMEs had a positive impact in regions that were lagging behind in terms of development. See **(2002) COM 68 Final**, "*Report from the Commission to the Council and the European Parliament – Report on the implementation of the European Charter for Small Enterprises*", at 5.

“With a combined population of 106 million and an area of 1.1 million square km, the CE-10 represent 29% of the population and 33% of the area of EU-15. It should be pointed out here that as far as other economic indicators are concerned, it is necessary to treat them with prudence in particular because of the unreliability of basic statistics as well as the size of the black economy. Bearing this in mind, it is estimated that their combined GDP represents less than 4% of the GDP of EU-15. In effect, they have an economic weight at present approximately equivalent to that of the Netherlands, although their population is seven times more numerous. Although their trade with the Union is increasing, it still represents less than 4% of the Union's trade with the rest of the world. The economies of the CE-10 are engaged in a rapid process of reform and are showing good signs of recovery after a significant contraction in recent years. But they are still very different in economic structure from most members of the Union. For example, agriculture’s share of the workforce and output is high (7.8% of GDP and 26.7% of employment in CE-10 compared with 2.5% and 5.7% in EU-15) and the service sector is generally underdeveloped. Compared with EU -15 the CE-10 have much lower levels of economic development, as measured by their GDP in terms of purchasing power standards:
- their average GDP per head is only about 30% of the EU average;
- although the GDP per head of Slovenia is 50% of the EU average and that of the Czech Republic is more than 40% of those of Romania and Lithuania are less than 20%.
The extension of the Internal Market to 100 million more consumers can bring a new boost and dynamism to the European economy, and important gains will be made by the existing Member States as a result of the increased trade and economic activity induced by growth in the economies of the CE-10. The main vehicles of integration in the region will continue to be trade and investment. The framework created by the Europe agreements, which provide access to markets for goods, services and capital has encouraged a strong increase in trade and investment and will continue to do so in the coming years. Estimates of the potential trade effects suggest that, with continuing integration, trade between the CE-1 0 and EU-15 could increase in the long run by as much as three to five times compared with 1989. Already an important expansion of trade has taken place, with a doubling of EU in1ports and a tripling of EU exports since 1989. If the CE-10 successfully maintain the process of growth and convergence, significant trade imbalances with EU-15 should not occur. Regional economic cooperation between the CE-10 can also play an important role in developing trade between them and encouraging inward investment. Good management of the accession process, both before and after enlargement, can ensure that the economic gains are obtained much more rapidly than if the CE-10 were to remain outside the Union. Moreover, experience with previous enlargements shows that the convergence process is generally faster once accession has taken place. However, the size of the present differences is such that, even in an optimistic scenario of growth, transition and integration, large gaps will remain at the time of accession and for a considerable period thereafter.
With the same reserve as mentioned in § 18, it is estimated that the average GDP per head of the CE-10 is now about 30% of the EU average. For it to reach even 50& of the EU average (the same relative level as Portugal had at the time of its accession) by the year 2001 would require them to sustain a growth differential with the Union of about 11% in the coming years, which is evidently unrealistic. Most assumptions concerning growth in the region and elsewhere in the world do not generate annual growth rates of more than 5% in the medium term for CE-10. A more probable scenario is that by 2000 some of them will have succeeded in sustaining accelerated growth and in approaching the level of the less favoured countries of EU-15, while others will still be struggling with reform and stabilization; even by 2005, many of them will still not have GDP per head much above 40% of the then EU average. However, the economic problems of adjustment for the Union should not be exaggerated. Integration into the Union of the central and eastern European countries should not pose insuperable problems, given their economic weight, although specific aspects and sectors will need to be examined. It should be recalled, in this context, that previous accession arrangements did not result in displacement of jobs and inflow of labour in neighboring Member States, as was feared at the time. On the contrary, migratory outflows from these countries diminished as a result of better prospects for employment and economic growth at home. The main economic challenge

> is for the central and eastern European countries themselves, for they have to introduce the regulatory and administrative framework, manage the restructuring and reorientation of their economies and ensure stable macroeconomic development over a sustained period."[30]

The bet on SMEs became, therefore, a lynchpin in the process for the achievement of the da Feira goals.

As we will see, though, promoting healthy and productive SMEs was easier said than done. In the following years several specific barriers contributed to delaying results. Obstacles that would soon grow to become European headaches included the[31]:

- great number and unique characteristics of small and medium enterprises, which made it difficult to take generalized measures in their support;
- lack of uniformity among and the complexity of European legal frameworks, which challenged the development of such entities and caused them to struggle to obtain qualified advisors;
- presence of several administrative burdens and of high administrative costs, which were particularly burdensome for lower-income businesses.

The Union, nevertheless, gave this process best shot; new policies and initiatives were developed to improve the European scenario and keep up with the targets set for 2010.

In the next section we will discuss the so-called "Charter for Small Enterprises", a key document published with the specific goal of structuring a path to support SMEs through the ten-year plan.

1.1.1 The vital importance of SMEs in the European economy and the "Charter for Small Enterprises"

Small businesses in Europe are often defined as those employing fifty or less people[32]. Parameters became more detailed over time in an attempt to improve the efficacy of new policies. The key role of small- and medium-size enterprises within the European market, in any case, remain unhindered to this day, regardless of changes in the definitions and benchmarks applied to identify them. A study made on the recovery of SMEs after the crisis of 2010, for example, divided SMEs into three classes, a trend that was followed also in later years:

> "Three classes of SME can be identified: micro enterprises, small- and medium scale enterprises are distinguished. Micro enterprises are enterprises that employ up to 9 people. Small enterprises employ between 10 and 49 people. Medium enterprises employ between 50 and 249 people. Large enterprises are thus defined as having 250 or more employees."[33]

The "added value" provided by SMEs within the EU's framework was proven several times to be far greater than the one provided by SMEs in competing markets such as the American and Japanese ones. Many studies and communications published in the past 20 years include statistics to emphasize this relevant point; the following extracts taken from official documents released over the past two decades provide some relevant examples:

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[30] **(1995) CSE 605**,"*Commission of the European Communities – Interim report from the Commission to the European Council on the effects on the policies of the European Union of enlargement to the associated countries of central and eastern Europe*", at 6-8.

[31] See the discussion in the next section (1.1.1.) and the documents which are listed as reference such as: **(2002) COM 68 Final**, "*Report from the Commission to the Council and the European Parliament – Report on the implementation of the European Charter for Small Enterprises*", at 5.

[32] **(2002) COM 68 Final**, "*Report from the Commission to the Council and the European Parliament – Report on the implementation of the European Charter for Small Enterprises*", at 4.

[33] de **Kok Jan; Vroonhof Paul; Verhoven Wim; Timmermand Niek; Kwaak Ton; Snijders Jacqueline; Westhof Florieke,** "*Do SMEs create more and better jobs*", EIM Business & Policy Research, Zoetermeer, The Netherlands (2011), at 5.

1996	“There is now widespread recognition that small and medium-sized enterprises (SMEs) are the key sector for generating employment opportunities and growth within the European Union. To help unlock SMEs' full potential to meet these objectives the Commission recently presented a report to the Madrid European Council calling for a more ambitious policy in favour of SMEs. The conclusions of this Council endorsed this approach, inviting the Commission to put the objectives of the Madrid SME Policy Paper into practice as swiftly as possible. Accordingly, the Commission announced that a four year programme (1997-2000) would be launched as part of the **European Confidence Pact on Employment** Clearly, a stronger and more direct focus on SME policy is necessary both at Member State and European Union level to safeguard existing jobs and to create new employment opportunities. **Empirical evidence shows that targeted** help to **SMEs is a cost-effective way to support job creation.** SMEs are the key sector for generating employment opportunities and growth. **SMEs account for 99.8% of all companies, 66% of total employment and 65% of business turnover in the European Union.** The employment growth rate of SMEs is greater than that of large enterprises. While SMEs are potentially a dynamic source of employment grow1th and wealth creation, it must also be recognised that they are inherently weaker and more vulnerable to failure, particularly in the early years. On average 50% of SMEs in the EU fail within the first five years of start-up. The relative weakness and vulnerability of SMEs arises primarily from five sources: • the increasingly complex legal, fiscal and administrative environment; • difficulties in accessing research programmes and exploiting research results; • structural weakness of their management capacity and ill-adapted training programmes; • difficulties in obtaining finance at reasonable cost; • barriers to accessing product and services markets.”[34]
2002	“there are no less than 20 million such (50 employees or less) businesses in the EU, providing employment to 65 million people. They account for 99% of all businesses and provide 53% of jobs. The proportion of jobs to be found in small business is significantly greater in the EU than in either the US or in Japan, both of which find a much higher share of jobs in large companies. […] Small businesses may be very small indeed. In Europe, 1.2 million of them provide jobs to between eleven and fifty people , with an average of twenty; no less than 19 million of them have ten or less jobs, with an average of two occupied people per business.”[35]
2004	"In Europe small business play a much more important role than in other parts of the world In Japan, for example, SMEs provide 33% of total private employment, the average Japanese company employing 10 people. In the United States, SMEs provide 46% of total private employment, the average American company employing 19 people. SMEs in Europe-19 (EEA plus Switzerland) provide 66% of total private employment, corresponding to over 80 million jobs. Figures concern non-primary private enterprises. Observatory of European SMEs 2002 / No 2, “SMEs in Europe, including a first glance at the candidate countries.”[36]
2005	“Small businesses play a central role in the European economy. Some 25 million small businesses, constituting 99% of all businesses, employ almost 95 million people, providing 55% of total jobs in

[34] **(1996) COM 98 Final**, “*Commission of the European Communities – Maximising European SMEs full potential for employment, growth and competitiveness – proposal for a Council Decision on a Third Multiannual Programme for Small and Medium-sized Enterprises (SMEs) in the European Union (1997 – 2000)*”, at 1.

[35] **(2002) COM 68 Final**, “*Report from the Commission to the Council and the European Parliament – Report on the implementation of the European Charter for Small Enterprises*”, at 4.

[36] **(2004) COM 64 Final**, “*Commission of the European Communities – Report from the Commission to the Council and the European Parliament on the implementation of the European Charter for Small Enterprises*”, at 3.

	the private sector. Small businesses are thus crucial for growth and employment all over Europe."[37] [38]
2010	"Small and medium-sized enterprises (SMEs) play a key role in shaping Europe's economy, accounting for 99% of enterprises, of which 92% are micro-enterprises. They provide more than two thirds of private sector employment and play a key role in economic growth. They have a crucial importance to the European economy as employers and sources of innovation."[39]
2011	"Throughout the downturn, however, SMEs retained their position as the backbone of the European economy. In 2010, there were almost 20.8 million SMEs in the EU of which the lion´s share – 19.2 million (or 92.1 percent of all EU business) – were micro-firms with less than ten employees. As in previous years, the share of large businesses, i.e. non-SMEs, remains marginal in terms of the number of enterprises (43,000 or 0.2 percent of the total). Altogether these SMEs provided more than two-thirds (87.5 million) of all employment opportunities in the private sector in EU-27. Also, 58.4 percent of the total Gross-value Added (GVA) produced by private businesses in the EU in 2010 was accounted for by SMEs."[40] "Comparing the EU with major partner countries such as the United States and Japan, reveals some interesting differences: SMEs in the United States have shown a negative growth in numbers during 2007-2009. During the recession of 2009 the United States had a stronger drop in SME employment (-6.0 percent) than the EU (-2.7 percent). In Japan the downward trend in SME development in terms of numbers, employment and value added already occurred much earlier than the recession in Europe."[41]
2013	"The 20 million European SMEs play an important role in the European economy. These are mostly micro-enterprises and in 2012 employed approximately 86.8 million people. This represents 66.5% of all European jobs for that year. Micro-enterprises provide just under a third of that total employment figure. The SME sector as a whole delivered 57.6% of the gross value added generated by the private, non-financial economy in Europe during 2012."[42]

The bet on SMEs was, therefore, a direct consequence of the value of small and medium enterprises within the European scenario. Actions and policies in the new millennium had to be specifically designed in order to support their growth in number and to increase in their positive impact within the European economy. This process, though, proved to be a real challenge.

One of the main difficulties met by European institutions was understanding the needs of such a vast, heterogeneous reality. Implementing an effective dialogue, in fact, was *per se* a challenge given the nature of the interlocutors:

> "The main difficulty in "thinking" in favor of this immense volume of business was the challenge in the implementation of common policies due to lack of communication, or data collecting at national level."[43]

[37] **(2005) COM 30 Final**, "*Communication from the Commission to the Council and the European Parliament – Report on the implementation of the European Charter for Small Enterprises*", at 3.
[38] *Id.*
[39] **(2011) COM 803 Final**, "*European Commission – Report from the Commission to the Council and the European Parliament – Minimizing regulatory burdens for SMEs – Adapting EU regulation to the needs of micro-enterprises*", at 2.
[40] **de Kok Jan; Vroonhof Paul; Verhoven Wim; Timmermand Niek; Kwaak Ton; Snijders Jacqueline; Westhof Florieke**, "*Do SMEs create more and better jobs*", EIM Business & Policy Research, Zoetermeer, The Netherlands (2011), at 3.
[41] *Id.*
[42] **Gagliardi Dimitri; Muller Patrice; Glossop Edward; Caliandro Cecilia; Fritsch Michael; Gabriela Brtkova; Bohn Nuray Unlu; Klitou Demetrious; Avigdor Gavriel; Marzocchi Chiara; Romlogan Ronnie**, "*European Commission - A recovery on the horizon – Annual report on European SMEs – Final report*", (2012/2013), at 9.
[43] **(2002) COM 68 Final**, "*Report from the Commission to the Council and the European Parliament – Report on the implementation of the European Charter for Small Enterprises*", at 5.

The challenges met in structuring effective and synchronized strategies brought to the adoption, by the "General Affairs" Council in Lisbon, of the European Charter for Small Enterprises[44] on 13 June 2000[45]. The "Charter" attempted to bring results from the bottom-up, recommending local authorities to take action to improve the environment for the growth of small and medium enterprises, which were described as "the driving force for innovation and job creation in Europe". The focus was placed on ten specific areas which were deemed the keys to removing barriers that limited the European Union in expressing its full potential:

> "In order to stimulate entrepreneurship and improve the business environment for small enterprises, the Heads of State or Government and the European Commission have decided to work on ten routes of action, i.e.:
>
> - **Education and training for entrepreneurship**
>   Business principles will have to be taught from an early age if an 'entrepreneurial spirit' is to be encouraged; this applies particularly to secondary and university levels, in encouraging entrepreneurial initiatives by young people and developing training programmes for small enterprises.
> - **Cheaper and faster start-up**
>   Company start-ups will become cheaper and faster, particularly through the use of online registration.
> - **Better legislation and regulation**
>   There will be a reduction in the negative impact of national bankruptcy laws and new regulations on small enterprises. It will be made easier for small enterprises to use administrative documents and they will not have to enforce certain regulative obligations.
> - **Availability of skills**
>   Training institutions will impart skills adapted to the needs of small enterprises and provide lifelong training and consultancy services.
> - **Improving online access**
>   Public administrations will be urged to develop online services for their dealings with enterprises.
> - **Getting more out of the single market**
>   The Member States and the European Commission will complete the single market so that enterprises can derive the maximum benefit from it. At the same time, national and Community competition rules will have to be strictly applied.
> - **Taxation and financial matters**
>   Tax systems will need to make life easier for enterprises. Access to finance (risk capital, structural funds) will also need to be improved.
> - **Strengthening the technological capacity of small enterprises**
>   Efforts will be made to promote new technologies, implement the Community patent and facilitate access to research programmes which are more focused on commercial applications. Inter-firm cooperation and cooperation with higher education institutions and research centres will be encouraged.
> - **Successful e-business models and top-class small business support**
>   Enterprises will be encouraged to adopt best practices. Business support services will be developed.

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[44] See http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=LEGISSUM:n26002&from=EN

[45] "The European Council welcomes the recently adopted European Charter for Small Enterprises *(see Annex III)*, and underlines the importance of small firms and entrepreneurs for growth, competitiveness and employment in the Union. It requests its full implementation as part of the comprehensive framework for enterprise policy under preparation. This comprehensive framework is advancing on the basis of the Commission's proposed Work Programme for Enterprise Policy 2000-2005, the proposals for benchmarking enterprise policy as well as the proposed Multiannual Programme for Enterprise and Entrepreneurship 2001-2005. First results of these exercises must be achieved by the end of 2000."
See http://www.europarl.europa.eu/summits/fei1_en.htm

- **Develop stronger, more effective representation of SMEs' interests at Union and national level**
  Solutions aimed at representing small enterprises within the Member States and the European Union will be reviewed. National and Community policies will be better coordinated and evaluations will be carried out with a view to improving the performance of small enterprises. An annual report on the implementation of the Charter will appear in the spring of each year."[46]

All ten areas would remain a topic of fervent debate in the following years. The first and the third are of particular relevance to our study and will be discussed in greater depth in the next pages.

1.1.2 Supporting SMEs by increasing levels of entrepreneurship

The key role of entrepreneurship in creating a better future for the Union had already been recognized by European institutions years before the development of the Lisbon strategy:

> "The need for comprehensive action fostering entrepreneurship is increasingly being recognized by political and economic actors as one of the keys to unlocking greater employment growth and competitiveness in Europe."[47]

In 1998 the Commission defined entrepreneurship as:

> "A dynamic process by which individuals constantly identify economic opportunities and act upon them by developing, producing and selling goods and services. Such process required qualities such as self-reliance, a capacity for risk-taking and a sense of personal commitment."[48]

At that time the focus was placed on the act of exploiting creativity and innovation so as to improve competitiveness, hence boosting productivity and increasing the levels of effectiveness and efficiency in a sector of the market. As such, entrepreneurship constituted a process of continuous growth within a group of people identified as entrepreneurs: individuals that chose to challenge themselves through such a way of life. Their successes would not benefit themselves alone, but constituted a great advancement for society at large[49]:

> "Entrepreneurship is a key competence of life, helping people think creatively, assess and take risk, and innovate: entrepreneurship is the ability to turn ideas into action."[50]

Turning ideas into action meant the creation of more and more start-ups, which would, hopefully, lead to a more vital and competitive market and to decreased unemployment rates.

Understanding, studying, and teaching entrepreneurship was confirmed therefore as both a necessity and a priority for the Community:

> "Europe will nurture entrepreneurial spirit and new skills from an earlier age. General knowledge about business and entrepreneurship needs to be taught at school levels. Specific business related modules should be made an essential ingredient of education schemes at secondary level and at colleges and universities"[51]

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[46] Charter's summary at:
http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=LEGISSUM:n26002&from=EN

[47] **(1998) COM 222 Final**, European Commission, "Fostering entrepreneurship in Europe: priorities for the future – Communication from the Commission to the Council", at 1.

[48] *Id.*

[49] *Id.,* at 5-6.

[50] **European Commission Enterprise and Industry**, "*European Small Businesses Portal – Thinking Big for Small Businesses –What the EU does for SMEs*", (2011), at 15.

[51] At http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=LEGISSUM:n26002&from=EN

> "Attention to the requirement for more positive attitudes to calculated and well based business risk and tolerance of business failure by society generally, but more specifically the banking and public sectors and calls on Member States to ensure that a more entrepreneurial culture is created throughout the EU and that greater value is attached to whatever previous business experience an entrepreneur possesses; improving SMEs access to markets."[52]

Several Member States were quick in taking early steps in this process, through education especially, towards raising awareness and encouraging the growth of general entrepreneurial skills within their local systems:

> "Most countries shave stepped up efforts to improve entrepreneurship-related education at university level. […] In a number of countries, notably Finland and Sweden, entrepreneurship is now a part of the secondary school curriculum. Pilot projects to teach students how to set up and run a business have also been introduced, with some interesting examples in Germany, Ireland, Austria, Sweden and the UK. Projects to nurture general entrepreneurial skills, such as creativity and independence have been developed in Italy, the Netherlands, and Austria, among others while prizes for entrepreneurship are available in Belgium, Denmark and Ireland."[53]

But the big picture remained, over all, fragmented and lacked the levels of uniformity necessary to achieve the benefits that were sought:

> **"Education for entrepreneurship – Fostering entrepreneurial mindsets at school**
> Developments show a dynamic picture for entrepreneurship education. However, a coherent framework is still missing in many cases. As entrepreneurship education has a horizontal dimension, a necessary first step is establishing formal links between different sectors of the public administration, notably Ministries of Economy and Education, with the aim of setting up a global strategy. Such cooperation already exists in several countries, including **France, the Netherlands, Finland and Norway**. Recent steps in this direction have also been taken by some of the new Member States, in particular **Lithuania**. The next step is the development of entrepreneurial skills and attitudes explicitly recognized as one objective in the national curriculum of comprehensive and vocational secondary schools. In this context, entrepreneurship should be understood in its broader meaning: not only as a means for creating new businesses, but also as a general mindset. So far, countries such as the **Czech Republic, Spain, Ireland, Poland, Finland and Norway** where entrepreneurship is already explicitly recognised by the curriculum for comprehensive secondary education are a minority. More positive examples can be found in vocational and technical schools.
> Where schools have a large degree of autonomy, it is advisable to support the take-up of measures to promote entrepreneurship education. While there are some good examples, active promotion measures have so far been taken on a limited basis. Insufficient provision of specific training to teachers remains a problem. Interesting developments can be highlighted in the **Netherlands,** where the government supports pilot projects in schools and disseminates good practice, and in the **United Kingdom**, with its "Enterprise Education Pathfinders".
> Programmes based on students running mini-companies or virtual firms should be recognized and supported by the educational authorities, and also be better embedded

[52] **Official journal of the European union", C 229/08**, "*Opinion of the Committee of the Regions on the Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions - Implementing the Community Lisbon Programme - Modern SME Policy for growth and employment"*, (2006), at 54.
[53] **(2002) COM 68 Final**, "*Report from the Commission to the Council and the European Parliament – Report on the implementation of the European Charter for Small Enterprises*", at 9.

into the curricula – as in **Ireland** – since they provide well tested methodologies that can be adapted to the local context. Some 600 000 students in Europe every year participate in student companies. At all levels of education, non-governmental organisations are promoting programmes based on these methodologies, in many cases under the umbrella of networks such as *Junior Achievement-Young Enterprise*, *EUROPEN (Practice Firms)* and *JADE*. An interesting example can be found in **Austria**, with systematic application of practice firms in vocational secondary education. In some countries, awareness of the importance of entrepreneurship learning in secondary education still needs to be increased. Further policy developments are particularly needed in **Cyprus**, **Hungary and Slovakia**. In **Portugal**, there are no public initiatives to strengthen entrepreneurship in secondary schools. More effort should also be made by **Greece**, where government initiatives in this area are currently limited to technical secondary education. **Better regulation – Making compliance easier for small businesses**.

In the last year, several countries have launched extensive programmes to improve the regulatory environment for businesses and in nearly all Member States impact assessments are high on the political agenda. In a significant number of Member States, impact assessments are already part and parcel of the preparation of new legislation. In practice, however, there are difficulties in ensuring that the results are actually used to improve the proposals, thus avoiding that the assessment becomes a mere formality.

The over-proportional negative effects on small businesses are hardly ever assessed. Only seven countries carry out tests on impact on small enterprises. Exempting small enterprises from certain regulatory obligations, as proposed by the Charter, can also be useful in alleviating the burden on small enterprises. However, only a few countries allow such exemptions. The **Netherlands and the United Kingdom** are among the leaders in the use of regulatory impact assessment. Good progress has also been made in **Poland**. All Member States are recommended to use impact assessments as a standard tool to improve regulatory quality and remove administrative burdens.

Increased cooperation between government departments is encouraged. Impact assessment work and monitoring could be successfully coordinated through a horizontal unit within the government and this is already the case for many Member States. The introduction of government procedures, e.g. in **Estonia and Latvia**, has helped stakeholder consultation in the early stages of drafting legislative proposals and carrying out impact assessments, and is recommendable. Whereas good progress has been made in the use of impact assessment in many countries, **France, Portugal, Slovenia and Slovakia** need to step up their efforts in this area. In some countries, e.g. **Poland**, the period for consultation of stakeholders is too short to arrive at a well-researched opinion on the impact on businesses."[54]

The process to incentivize entrepreneurship had to be helped, though, through other concomitant actions. The energies spent in promoting self-employment and in developing the "entrepreneurial spirit" of European citizens alone could not guarantee the success of the initiative. The European economy could not benefit from the opening of a number of "weak" micro-enterprises without also providing efficient and effective safety nets to protect them from the risks of failure and, therefore, from bankruptcy and its potential consequences.

At the time, though, European insolvency systems were not tailored to effectively support the strategies for the growth of the European market and such a grand project of enlargement of the entrepreneurial base. Despite years of mediation on this topic, the Union still had not enacted a cross-border insolvency framework that could boost European trade[55]. Moreover, local frameworks differed greatly among each other; low uniformity levels meant that European frameworks lacked in transparency and predictability[56], making it difficult for investors to maximize their opportunities.

[54] **(2005) COM 30 Final**, "*Communication from the Commission to the Council and the European Parliament – Report on the implementation of the European Charter for Small Enterprises*", at 5-7.

[55] See Chapter III.

[56] See Chapter II.

Another relevant factor that made the insolvency scenario of the time inadequate was the presence of the so-called "stigma of failure": aa generalized approach shared by the bankruptcy frameworks of Member States which tended to see debtors as quasi-criminals and second-class citizens, causing harsh civil disqualifications, fines, and criminal punishments to be imposed upon those that failed. As such, stigma constituted a powerful deterrent toward entrepreneurship.

For all the above-mentioned reasons, Europe was unprepared to actively and effectively support the strategies embodied in the ten-year plan. In the field of insolvency laws especially, the Union needed to swiftly structure an organized process of "refoundation" of the whole insolvency scenario at the local and cross-border level. The new system, which had to radically alter the status quo, had to become a pillar on which to build the path toward achieving the da Feira goals.

1.1.3 The process of refoundation of European insolvency frameworks and its role in supporting European growth and the attainment of the da Feira goals

At the time the da Feira goals were set, the panorama offered by European insolvency frameworks lacked uniformity. Local frameworks, in fact, presented great disparities in substantive rules and approaches. Moreover (and ironically, as we will have a chance to discuss throughout the book), those relevant elements that could constitute some sort of traditional common ground or uniform back bone among frameworks were inadequate or "harmful"[57], and had to be modified or eradicated since they caused the stigmatization of debtors.

Traditionally, in fact, European insolvency frameworks contributed to spread within societies a negative perception of failure and of bankrupts. They often imposed on debtors harsh civil and criminal punishments, turning them into second-class citizens. Moreover, bankrupts were often disqualified from commencing new businesses or from holding managerial positions for years (in the past, for life[58]). As such, they were evicted from the market due to their mistakes without having a change to redeem themselves.

All such factors contributed to inculcating in citizens fear of the potential consequences of self-employment and of personal initiatives. The stigma was, therefore, in antithesis with the new European strategies set to increase the number of entrepreneurs and to create more productive and competitive SMEs. Urgent measures had to be adopted.

The Union was well aware of the status quo.

In implementing the ten-year "battle plan" for the beginning of the new millennium, Europe had clear ideas on the changes that had to be made in the field of bankruptcy law to improve the general business environment and support the development of the common market:

> "Businesses create prosperity, jobs and growth in the European Union. The interest of the European Commission in bankruptcy and second chance policy is to prevent businesses from bankruptcy and in the case this is unavoidable to give honest failed entrepreneurs quickly a second chance in business. Therefore the Commission has since 2000 focused on policies that support the rescuing of viable firms that face financial difficulties and the creation of a second chance."[59]

Change had to be obtained swiftly, though, since the current scenario could slow down and severely weaken the whole strategy. The path to walk, though, was steep and curvy. In establishing a "Competitiveness and Innovation Framework Program", the Council and European Parliament observed:

> "The market for knowledge transfer and absorption is frequently opaque, and both lack of information and failure to make connections create market barriers. Businesses also find it difficult to incorporate technologies which are not part of their traditional field of activity

[57] To the strategies that the Union attempted to implement.

[58] See Chapter IV for a discussion of medieval approaches to bankruptcy and Chapter VI as an example of how rules on disqualification have evolved in Italy over the past decades.

[59] **Wymenga Paul; Gloser Jacob; Bezegova Edita; Besseling Corine**, "*Bankruptcy and second chance for honest bankrupt entrepreneurs – Final report*", ECORYS, (2014), at 7.

> and to gain access to new types of skills. Financial risks can be high for innovation and tax may not be neutral between success and failure. Skills needed to exploit opportunities may be in short supply. Institutional or regulatory obstacles can delay or undermine the emergence of new markets and access to them. **Bankruptcy laws may create strong disincentives to assume entrepreneurial risk because of fear of failure**. In addition, economic circumstances can determine whether innovation takes place or not. The development of a business environment conducive to entrepreneurship, competitiveness and innovation should include the improvement of enterprise and innovation- related economic and administrative reform, in particular for increased competitiveness, reduction of administrative burdens for SMEs and a better regulatory environment for entrepreneurship, business and business transfer, growth and innovation."[60]

Bankruptcy laws were, to a certain extent, the twin side of the entrepreneurship coin. Growth in the numbers of entrepreneurs and active businesses almost invariably would lead to an increase of winding-downs and bankruptcies. A certain number of "casualties" is natural in business and a product of competition. Yet, to meet the needs of the new master plan, the number of such casualties had to be reasonable (not to say limited) and the effects of failure had to be mitigated in order to ensure that they would not have disruptive effects on the general master plan.

Hence, excessively afflictive systems had to be rethought. A new formula had to be conceived to ensure greater levels of uniformity. Such "uniformity" moreover, had to be shaped in a way to incentivize potential entrepreneurs so that they would not be unnecessarily afrai" or barred from exploring their potential.

1.1.4 The status quo in the beginning of the new millenniumm. The identification of two great barriers: the stigma of failure and the lack of uniformity among local regulations

As mentioned in the previous section, two main barriers characterized the European insolvency scenario at the beginning of the new millennium:

- The presence of several, extremely relevant, discrepancies among insolvency frameworks – which caused a lack of transparency and predictability in the European system, hence decreasing investments and weakening cross-border businesses activities; and
- The so-called "stigma of failure": a set of approaches and policies which made of bankruptcy a "gloomy and depressing subject"[61]. Fear of failure prevented individuals from trying and headed, therefore, in the opposite direction compared to the one forecast by the Community in setting the da Feira goals.

> "Excessively severe legal consequences of bankruptcy and complex bankruptcy procedures can obstruct entrepreneurship. Time and money-consuming bankruptcy procedures need therefore, to be revised or give ground to new laws aimed at quick, low cost, accessible, streamlined and predictable procedures. Often failed entrepreneurs are more successful at the next attempt and enabling honest bankrupts to try again would contribute positively to economic growth. Making a fresh start should, therefore, be made easier for non-fraudulent entrepreneurs."[62]

Before the Lisbon Council, Member States had already undergone several independent attempts to bring improvements and modifications to their national laws:

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[60] **Official Journal of the European Union, L 310/15,** "*Decision n. 1639/2006/EC of the European Parliament and of the Council; 24 October 2006; establishing a Competitiveness and innovation Framework Programme (2007 to 2013)*", (2006), at 5.

[61] **Warren Charles**, "*Bankruptcy in United States history*", William S. Hein & Co., Inc, Buffalo, New York, ISBN 0-89941-907-0, (1994), at 3.

[62] **(2005) COM 30 Final**, "*Communication from the Commission to the Council and the European Parliament – Report on the implementation of the European Charter for Small Enterprises*", at 6.

> "Reform of the legislation on insolvency and bankruptcy.
> This issue is clearly considered as crucial by many Member States, but few have been able to implement a comprehensive reform giving entrepreneurs a real "second chance". At the beginning of July 1999, the UK government announced its intention to work on a relaxation of bankruptcy laws to remove the stigma of failure from those whose businesses fails through no fault of their own. One consideration is whether to allow such bankrupt entrepreneurs to keep some minimum assets (in the range of € 15.000) and to be discharged after a short period (six months rather than the present three years). In Germany, under the new insolvency law it is now possible to obtain discharge of the remaining debt, after seven years. Provided ways are found to avoid protecting "culpable" bankrupts while giving a second chance to those entrepreneurs who were genuinely unfortunate, a relaxation of bankruptcy laws removing the stigma of failure would be a crucial reform to promote entrepreneurship."[63]

With the setting of the da Feira goals and the new enlargements, the Union needed, though, to guide this process giving it a precise and indelible imprint. It had to provide a map of the structure of the new "insolvency formula", which had to be adopted and shared to achieve the goal of effectively supporting the Community's strategies for growth.

A complex process to study relevant aspects of European and international insolvency regulations began. Seminars were held and international best practices were studied. We will mention and briefly discuss some of them.

In 2001, a relevant seminar on Business Failure took place in Noorwijk, the Netherlands[64]. It counted around 130 participants including lawyers, accountants, entrepreneurs, international organizations, business support organizations, and ministries and universities from EU countries, the US, Canada, and New Zealand. The summit pointed out the importance of prevention.

The discussion focused on relevant elements and placed particular emphasis on the stigma attached to business failure which, in many parts of Europe, operated as:

- A powerful deterrent towards commencing a business project in the first place;
- A barrier towards restarting after failing; and
- A barrier which made it so that entrepreneurs were reluctant to take early action, or to liquidate their business in a timely manner even if it was causing great losses.

> "The stigma of business failure is one reason why many SMEs in financial trouble conceal their problems until it is too late."[65]

SMEs (which, following the new strategies, had to be handled with great care) suffered greatly from the difficulties encountered in the markets they had invested in. Self-employed entrepreneurs and the small-business owners often did not have access to the necessary resources or knowledge in the form of expert consultants to prevent a minor crisis from developing into insolvency.

The conclusions of the seminar affirmed that, in a market in which statistics showed that more than 50% of enterprises did not survive the first five years, bankrupts should be encouraged to restart and the negative effects of stigma should be removed as soon as possible[66]:

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[63] **(1999) COM 493 Final**, "*Communication from the Commission to the Council and the European Parliament – Risk Capital: Implementation of the Action Plan Proposals for moving forward*", at 5.

[64] **European Commission**, "*The Seminar on Business Failure, 10 and 11 May*", Noordwijk, (2001), the Netherlands.

[65] **(2007) COM 584 Final**, "*European Commission – Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions – Overcoming the stigma of business failure – for a second chance policy – Implementing the Lisbon partnership for growth and jobs*", at 8.

[66] **European Commission**, "*The Seminar on Business Failure, 10 and 11 May, Noordwijk*", the Netherlands: "The Dutch Minister called for attention for business failure. She stated that economically the US outperforms Europe and the driving force is entrepreneurship. In order to highlight the negative effects of the stigma in the Netherlands, the Minister referred to a survey, which showed that around half of the entrepreneurs would attach conditions when doing business with bankrupt entrepreneurs and fears that bankruptcy leads to less entrepreneurial behavior and more cautious business practices", at 1.

> "The Commission will strengthen its support for activities to reduce the burden of risk intrinsically linked to entrepreneurship. It would take initiatives to tackle the negative effects of business failure and examine the possibility of improving social security schemes and bankruptcy procedures."[67]

Following the Noordwijk seminar of 2001, the European Commission and experts from fourteen Member States, seven candidate countries and Norway were involved in a comparative study to collect data on the legal and social consequences of business failure.[68] A final guide, entitled "Best Project on Restructuring, Bankruptcy and a Fresh Start"[69], was prepared and published in September 2003.

The focus was placed on discussing and analyzing the following four main areas:

a) Early warning

An evaluation of the availability of mechanisms to grant early warning and the prevention of failure showed that:
- Entrepreneurs struggle to admit their financial difficulties; competent, external advice is therefore key in acting in a timely manner, hence saving vital resources; - A common definition of what constitutes "difficulties" is absolutely necessary to create a uniform framework; - A common list of warning indicators should be provided; - Training should be made available not just to new entrepreneurs but also to restarters; - Advisors should be made available to actors in the market to prevent, or limit, the risks of incurring new difficulties.

b) Legal system

An evaluation of the availability of effective frameworks supporting restructuring showed that:
- Early action increased the chances of success; entrepreneurs should have therefore be encouraged to act timely; - Managers should be appointed to support entrepreneurs in difficulties; - Low thresholds for entry should be applied in restructuring proceedings; - The costs of reorganization proceedings should be reduced to make the process more appealing; - All insolvency matters should be assigned to specialized sections of courts with specialized judges.

c) Fresh start

The study showed that frameworks should enact measures to differentiate between honest entrepreneurs that fail and dishonest ones, supporting the first group in restarting. Among such measures the following were found to hold key relevance:
- Structuring campaigns to promote the "fresh start" of honest and worthy entrepreneurs, reducing stigma; - Avoiding of the use in Latin countries of the words "*fallito, fallite, quebra*," which hold negative, stigmatizing connotations; - Providing clear parameters to differentiate between honest and dishonest debtors;

[67] **(2005) COM 551 Final**, "*Commission of the European Communities – Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions – Implementing the Community Lisbon Programme Modern SME policy for growth and employment*", at 5.

[68] European Commission, Enterprise Directorate General "Best Project on Restructuring, Bankruptcy and a Fresh Start", Final Report of the Expert Group, Directorate General for Enterprise, (2002), at 10.

[69] *Id.*

- Preventing the imposition of disqualifications for debtors based solely on their insolvency;
- Allowing early discharges to honest debtors while imposing heavy sanctions to punish frauds.

d) Social attitudes

The study showed that more in-depth research should be conducted to identify ways to change the social perception of failure and the stigma attached to it. In particular, frameworks should:
- Inform the public in all those cases in which a court decided that a bankrupt had not been dishonest; - Educate society on insolvency to better understand the meaning, impact, and consequences of business failure within the modern market.

An almost contemporaneous study sponsored by the European Commission, entitled "Bankruptcy and fresh start: stigma on failure and consequences of bankruptcy"[70], presented an extremely interesting, extensive, comparative research initiative among European and US experts and different organizations. The document focused on two main areas:

a) An in-depth assessment of the "stigma of failure";

b) A comparison between the different legal frameworks of European Countries[71] and the US, based on an analysis of the World Bank Principles.[72]

The first part, which focused on understanding the phenomenon-of the stigma of failure and the attitude towards "fresh-starters" within the different frameworks, was derived from the goals set in the European Charter of Small Enterprises endorsed at the da Feira European Council, which considered some failure to be concomitant with responsible business initiatives and risk-taking, and invited governments and societies to see the whole process, even in its negative aspects, as a "learning opportunity". Its goal was to assess the extent to which the bankruptcy framework acted as a deterrent to business survival and to the possibility of obtaining a meaningful fresh start after default.[73]

The study found that general knowledge of bankruptcy was limited. Concepts such as insolvency and bankruptcy, for example, were used as synonyms within the business environment. Moreover, it was found that society did not perceive the relevant difference between honest failures (a natural event within a market) and fraudulent ones:

> "The vast majority of the targeted organizations declared that the general public does not know whether there is a difference between fraudulent and non-fraudulent bankruptcy."[74]

Despite a general positive trend in the acceptance of the idea that mistakes can happen and that only fraudulent bankruptcy should be stigmatized, the organizations that answered the questionnaires admitted that they would they would inform perspective business partners of the risks of doing business with a company undergoing financial difficulties. Therefore, such companies would be cut out of the market and would have no way to recover.[75] Such attitude towards bankruptcy turned out to be deeply rooted within the European social context. The study deemed it to be the product of society's sole reliance on media as a source of information on business failure[76] and assessed that this process had negative consequences, since

[70] **Philippe & Partners, Deloitte & Touche Corporate Finance**, "*Bankruptcy and fresh start: stigma on failure and consequences of bankruptcy*", (2002).

[71] The countries included in the study were Austria, Belgium, Denmark, Finland, Germany, Italy, Ireland, Luxembourg and the Netherlands.

[72] The list of Principles available at the time was the one of 2001. See Chapter II.

[73] **Philippe & Partners, Deloitte & Touche Corporate Finance**, "*Bankruptcy and fresh start: Stigma on failure and consequences of bankruptcy*", (2002), at 2.

[74] *Id.,* at 157.

[75] *Id.,* at 2-3.

[76] *Id.,* at 3.

it ultimately led to: a) lack of before-hand protection of honest businesses in distress; b) ex-post difficulties for debtors in "getting back in the game"[77]:

> "It appears that in the majority of Member States, the financial community considers that the failure of a business or its bankruptcy entails stigma."[78]
>
> "Within the three targeted communities, in the vast majority of the Member States there is a strong stigma attached to the bankrupt entrepreneur. However, it is impossible to define national trends. […]
> During the interviews, the impression emerged that within the business community there is a kind of class complicity between entrepreneurs, namely within the crafters' communities: financial difficulties, and eventually honest bankruptcy, are considered as expected the normal risks of business life accidents during the business life. Therefore, there is no strong stigma vis-à-vis entrepreneurs having faced difficulties and / or honest bankrupts. This is confirmed by the answers given to question 15. A difference in approach could be identified with regard to the issue of fraudulent bankruptcy as opposed to non-fraudulent bankruptcy (see answers 4, and 7 of respective questionnaires). Both the business (within answer 25) and the financial community (within answer 35) considered the presence of stigmas in case of fraud, and further stated that these stigmas in case of fraudulent bankruptcy should not be eliminated. In this context, it is worth noting that the public in general mentions fraud among the four most common reasons for failure, whereas it does not appear in the reasons expressed by the business and financial communities."[79]

The second part of the study included an interesting step-by-step, point-by-point analysis and comparison between the different legal frameworks of Member States based on the World Bank's Principles.

The ICR Principles will be discussed in greater detail in Chapter II. For now, it is worth introducing the topic by mentioning that the system created in 2001 by the World Bank is meant to serve as a guideline to analyze the levels of effectiveness and efficiency of local insolvency systems and as a tool to guide societies in making reforms. The Principles, in fact, embody those modern practices that are deemed to work best within an international business environment, providing an effective set of modern tools to integrate existing insolvency laws.

The study applied the Principles to the European scenario in an attempt to determine the levels of their adoption within the local systems of Member States. Such comparative analysis provided interesting information not just on the levels of effectiveness and efficiency of the single frameworks under modern standards but also, and especially, on existing discrepancies. The data that was collected showed that the Principles found, indeed, an ample application within European insolvency systems which, over all, were found to be "up to date" under several relevant aspects. The national models showed, nevertheless, a great lack of uniformity within individual rules and approaches, as shown by the following summary table of comparisons made by the study:

[77] "The business community expressed a general position of awareness as to the restriction regime applicable to a bankrupt business, and of tolerance in dealing with a business in insolvency status. The attitude was however divided as to whether the members of the organizations would be willing to get involved in the management of a bankrupt person, and was strongly reluctant on the issue of selling shares to a bankrupt person. Employment of a bankrupt person in a business would often be possible, though positioned at the highest management levels would be excluded. Finally strong extra guarantees would be required when dealing with a person who failed in the past." *Id.,* at 5.

[78] *Id.*

[79] *Id.* at 323-4.

WORLD BANK'S PRINCIPLES 2001[80]	Evaluation of the level of their adoption among EU countries and the US
PRINCIPLE 1: COMPATIBLE ENFORCEMENT SYSTEMS A modern credit-based economy requires predictable, transparent and affordable enforcement of both unsecured and secured credit claims by efficient mechanisms outside of insolvency, as well as a sound insolvency system. These systems must be designed to work in harmony.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of Greece and Spain where it is only partially adopted.*
PRINCIPLE 2: ENFORCEMENT OF UNSECURED RIGHTS A regularised system of credit should be supported by mechanisms that provide efficient, transparent, reliable and predictable methods for recovering debt, including seizure and sale of immovable and movable assets and sale or collection of intangible assets such as debts owed to the debtor by third parties.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States, with the exception of Greece and the UK where it is only partially adopted.*
PRINCIPLE 3: SECURITY INTEREST LEGISLATION The legal framework should provide for the creation, recognition, and enforcement of security interests in movable and immovable (real) property, arising by agreement or operation of law. The law should provide for the following features: · Security interests in all types of assets, movable and immovable, tangible and intangible, including inventory, receivables, and proceeds; future or after-acquired property, and on a global basis; and based on both possessory and non- possessory interests; · Security interests related to any or all of a debtor's obligations to a creditor, present or future, and between all types of persons; · Methods of notice that will sufficiently publicise the existence of security interests to creditors, purchasers, and the public generally at the lowest possible cost; · Clear rules of priority governing competing claims or interests in the same assets, eliminating or reducing priorities over security interests as much as possible.	*This principle is fully or almost fully adopted in all EU Member States.* *Unfortunately, we did not get any answer from our U.S. experts on this topic.*
PRINCIPLE 4: RECORDING AND REGISTRATION OF SECURED RIGHTS There should be an efficient and cost-effective means of publicising secured interests in movable and immovable assets, with registration being the principal and strongly preferred method. Access to the registry should be inexpensive and open to all for both recording and search.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States, with the exception of Italy and The Netherlands where it is only partially adopted.*
PRINCIPLE 5: ENFORCEMENT OF SECURED RIGHTS Enforcement systems should provide efficient, inexpensive, transparent and predictable methods for enforcing a security interest in property. Enforcement procedures should provide for prompt realisation of the rights obtained in secured assets, ensuring the maximum possible recovery of asset values based on market values. Both non-judicial and judicial enforcement methods should be considered.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member* *States, with the exception of Greece, Italy and Luxembourg where it is only partially adopted.*
PRINCIPLE 6: KEY OBJECTIVES AND POLICIES Though country approaches vary, effective insolvency systems should aim to:	*This principle is fully or almost fully adopted in the U.S. and in all*

[80] Data as presented by the **Philippe & Partners, Deloitte & Touche Corporate Finance**, "*Bankruptcy and fresh start: stigma on failure and consequences of bankruptcy*", (2002).

· Integrate with a country's broader legal and commercial systems. · Maximise the value of a firm's assets by providing an option to reorganise. · Strike a careful balance between liquidation and reorganisation. · Provide for equitable treatment of similarly situated creditors, including similarly situated foreign and domestic creditors. · Provide for timely, efficient and impartial resolution of insolvencies. · Prevent the premature dismemberment of a debtor's assets by individual creditors seeking quick judgements. · Provide a transparent procedure that contains incentives for gathering and dispensing information. · Recognise existing creditor rights and respect the priority of claims with a predictable and established process. · Establish a framework for cross-border insolvencies, with recognition of foreign proceedings.	*EU Member States, with the exception of Germany and Greece where it is only partially adopted. In addition, principle 6 is not adopted in Spain.*
PRINCIPLE 7: DIRECTOR AND OFFICER LIABILITY Director and officer liability for decisions detrimental to creditors made when an enterprise is insolvent should promote responsible corporate behaviour while fostering reasonable risk taking. At a minimum, standards should address conduct based on knowledge of or reckless disregard for the adverse consequences to creditors.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States.*
PRINCIPLE 8: LIQUIDATION AND REHABILITATION An insolvency law should provide both for efficient liquidation of nonviable businesses and those where liquidation is likely to produce a greater return to creditors, and for rehabilitation of viable businesses. Where circumstances justify it, the system should allow for easy conversion of proceedings from one procedure to another.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of Germany, Greece, Italy and Spain where it is only partially adopted.*
PRINCIPLE 9: COMMENCEMENT: APPLICABILITY AND ACCESSIBILITY A. The insolvency process should apply to all enterprises or corporate entities except financial institutions and insurance corporations, which should be dealt with through a separate law or through special provisions in the insolvency law. State-owned corporations should be subject to the same insolvency law as private corporations.	*This part of principle 9 is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of Greece, Italy and Spain where it is partially adopted. It is not adopted in Belgium.*
B. Debtors should have easy access to the insolvency system upon showing proof of basic criteria (insolvency or financial difficulty). A declaration to that effect may be provided by the debtor through its board of directors or management. Creditor access should be conditioned on showing proof of insolvency by presumption where there is clear evidence that the debtor failed to pay a matured debt (perhaps of a minimum amount).	*This part of principle 9 is fully or almost fully adopted in the U.S. and in all EU Member States.*
C. The preferred test for insolvency should be the debtor's inability to pay debts as they come due—known as the liquidity test. A balance sheet test may be used as an alternative secondary test, but should not replace the liquidity test. The filing of an application to commence a proceeding should automatically prohibit the debtor's transfer, sale or disposition of assets or parts of the business without court approval, except to the extent necessary to operate the business.	*This part of principle 9 is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of Finland and The Netherlands where it is only partially adopted.*
PRINCIPLE 10: COMMENCEMENT: MORATORIUMS AND SUSPENSION OF PROCEEDINGS A. The commencement of bankruptcy should prohibit the unauthorised	*This part of principle 10 is fully or almost fully adopted in the U.S. and in all EU Member States with*

disposition of the debtor's assets and suspend actions by creditors to enforce their rights or remedies against the debtor or the debtor's assets. The injunctive relief (stay) should be as wide and all embracing as possible, extending to an interest in property used, occupied or in the possession of the debtor.	*the exception of Finland where it has not been adopted.*
B. To maximise the value of asset recoveries, a stay on enforcement actions by secured creditors should be imposed for a limited period in a liquidation proceeding to enable higher recovery of assets by sale of the entire business or its productive units, and in a rehabilitation proceeding where the collateral is needed for the rehabilitation.	*This part of principle 10 is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of Spain where it has not been adopted and the UK where it is only partially adopted*
PRINCIPLE 11: GOVERNANCE: MANAGEMENT A. In liquidation proceedings, management should be replaced by a qualified court-appointed official (administrator) with broad authority to administer the estate in the interest of creditors. Control of the estate should be surrendered immediately to the administrator except where management has been authorized to retain control over the business, in which case the law should impose the same duties on management as on the administrator. In creditor-initiated filings, where circumstances warrant, an interim administrator with reduced duties should be appointed to monitor the business to ensure that creditor interests are protected.	*This part of principle 11 is fully or almost fully adopted in all EU Member States with the exception of Ireland and Spain where it is only partially adopted. In the U.S. it is partially adopted.*
B. There are two preferred approaches in a rehabilitation proceeding: exclusive control of the proceeding by an independent administrator or supervision of management by an impartial and independent administrator or supervisor. Under the second option complete power should be shifted to the administrator if management proves incompetent or negligent or has engaged in fraud or other misbehaviour. Similarly, independent administrators or supervisors should be held to the same standard of accountability to creditors and the court and should be subject to removal for incompetence, negligence, fraud or other wrongful conduct.	*This part of principle 11 is fully or almost fully adopted in all EU Member States with the exception of Finland, Italy, The Netherlands and Spain where it is only partially adopted. In the U.S. it is not adopted.*
PRINCIPLE 12: GOVERNANCE: CREDITORS AND THE CREDITORS' COMMITTEE Creditor interests should be safeguarded by establishing a creditors committee that enables creditors to actively participate in the insolvency process and that allows the committee to monitor the process to ensure fairness and integrity. The committee should be consulted on non-routine matters in the case and have the ability to be heard on key decisions in the proceedings (such as matters involving dispositions of assets outside the normal course of business). The committee should serve as a conduit for processing and distributing relevant information to other creditors and for organising creditors to decide on critical issues. The law should provide for such things as a general creditors assembly for major decisions, to appoint the creditors committee and to determine the committee's membership, quorum and voting rules, powers and the conduct of meetings. In rehabilitation proceedings, the creditors should be entitled to select an independent administrator or supervisor of their choice, provided the person meets the qualifications for serving in this capacity in the specific case.	*This principle is fully or almost fully adopted in the U.S. and in 8 EU Member States. It is only partially adopted in France, Ireland, Italy, Sweden, The Netherlands and the UK. It is not adopted in Belgium.*
PRINCIPLE 13: ADMINISTRATION: COLLECTION, PRESERVATION, DISPOSITION OF PROPERTY The law should provide for the collection, preservation and disposition of all property belonging to the debtor, including property obtained after the commencement of the case. Immediate steps should be taken or allowed to preserve and protect the debtor's assets and business. The law should provide a	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of Denmark, Greece and Spain where it is only partially adopted.*

flexible and transparent system for disposing of assets efficiently and at maximum values. Where necessary, the law should allow for sales free and clear of security interests, charges or other encumbrances, subject to preserving the priority of interests in the proceeds from the assets disposed.	
PRINCIPLE 14: ADMINISTRATION: TREATMENT OF CONTRACTUAL OBLIGATIONS The law should allow for interference with contractual obligations that are not fully performed to the extent necessary to achieve the objectives of the insolvency process, whether to enforce, cancel or assign contracts, except where there is a compelling commercial, public or social interest in upholding the contractual rights of the counter-party to the contract (as with swap agreements).	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of France and Spain where it is only partially adopted.*
PRINCIPLE 15: ADMINISTRATION: FRAUDULENT OR PREFERENTIAL TRANSACTIONS The law should provide for the avoidance or cancellation of pre-bankruptcy fraudulent and preferential transactions completed when the enterprise was insolvent or that resulted in its insolvency. The suspect period prior to bankruptcy, during which payments are presumed to be preferential and may be set aside, should normally be short to avoid disrupting normal commercial and credit relations. The suspect period may be longer in the case of gifts or where the person receiving the transfer is closely related to the debtor or its owners.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of Greece where it is only partially adopted.*
PRINCIPLE 16: CLAIMS RESOLUTION: TREATMENT OF STAKEHOLDER RIGHTS AND PRIORITIES A. The rights and priorities of creditors established prior to insolvency under commercial laws should be upheld in an insolvency case to preserve the legitimate expectations of creditors and encourage greater predictability in commercial relationships. Deviations from this general rule should occur only where necessary to promote other compelling policies, such as the policy supporting rehabilitation or to maximise the estate's value. Rules of priority should support incentives for creditors to manage credit efficiently.	*This part of principle 16 is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of France and Greece where it is only partially adopted.*
B. The bankruptcy law should recognise the priority of secured creditors in their collateral. Where the rights of secured creditors are impaired to promote a legitimate bankruptcy policy, the interests of these creditors in their collateral should be protected to avoid a loss or deterioration in the economic value of their interest at the commencement of the case. Distributions to secured creditors from the proceeds of their collateral should be made as promptly as possible after realisation of proceeds from the sale. In cases where the stay applies to secured creditors, it should be of limited specified duration, strike a proper balance between creditor protection and insolvency objectives, and provide for the possibility of orders being made on the application of affected creditors or other persons for relief from the stay.	*This part of principle 16 is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of France and Portugal where it is only partially adopted.*
C. Following distributions to secured creditors and payment of claims related to costs and expenses of administration, proceeds available for distribution should be distributed pari passu to remaining creditors unless there are compelling reasons to justify giving preferential status to a particular debt. Public interests generally should not be given precedence over private rights. The number of priority classes should be kept to a minimum.	*This part of principle 16 is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of Belgium, Ireland, Sweden and Greece where it is only partially adopted. It is not adopted in Spain*

PRINCIPLE 17: DESIGN FEATURES OF REHABILITATION STATUTES To be commercially and economically effective, the law should establish rehabilitation procedures that permit quick and easy access to the process, provide sufficient protection for all those involved in the process, provide a structure that permits the negotiation of a commercial plan, enable a majority of creditors in favor of a plan or other course of action to bind all other creditors by the democratic exercise of voting rights (subject to appropriate minority protections and the protection of class rights) and provide for judicial or other supervision to ensure that the process is not subject to manipulation or abuse.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of France, Greece and Spain where it is only partially adopted*.
PRINCIPLE 18: ADMINISTRATION: STABILIZING AND SUSTAINING BUSINESS OPERATIONS The law should provide for a commercially sound form of priority funding for the ongoing and urgent business needs of a debtor during the rescue process, subject to appropriate safeguards.	*This principle is fully or partially adopted in the U.S. and in 8 EU Member States.* *It is partially adopted in Belgium, France, Germany, Greece, Ireland, Italy and Luxembourg. It is not adopted in Spain.*
PRINCIPLE 19: INFORMATION: ACCESS AND DISCLOSURE The law should require the provision of relevant information on the debtor. It should also provide for independent comment on and analysis of that information. Directors of a debtor corporation should be required to attend meetings of creditors. Provision should be made for the possible examination of directors and other persons with knowledge of the debtor's affairs, who may be compelled to give information to the court and administrator.	*Principle 19 is fully or almost fully adopted in the U.S. and in 9 EU Member States. It is partially adopted in Austria, Belgium, France and Greece. It is not adopted in Italy and Spain.*
PRINCIPLE 20: PLAN: FORMULATION, CONSIDERATION AND VOTING The law should not prescribe the nature of a plan except in terms of fundamental requirements and to prevent commercial abuse. The law may provide for classes of creditors for voting purposes. Voting rights should be determined by amount of debt. An appropriate majority of creditors should be required to approve a plan. Special provision should be made to limit the voting rights of insiders. The effect of a majority vote should be to bind all creditors.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of France, Greece, Austria and Ireland where it is only partially adopted.*
PRINCIPLE 21: PLAN: APPROVAL OF PLAN The law should establish clear criteria for plan approval based on fairness to similar creditors, recognition of relative priorities and majority acceptance. The law should also provide for approval over the rejection of minority creditors if the plan complies with rules of fairness and offers the opposing creditors or classes an amount equal to or greater than would be received under a liquidation proceeding. Some provision for possible adjournment of a plan decision meeting should be made, but under strict time limits. If a plan is not approved, the debtor should automatically be liquidated.	*This principle is fully or almost fully adopted in the U.S. and in 10 EU Member States. It is partially adopted in Belgium, France, Greece and the UK. It is not adopted in Spain.*
PRINCIPLE 22: PLAN: IMPLEMENTATION AND AMENDMENT The law should provide a means for monitoring effective implementation of the plan, requiring the debtor to make periodic reports to the court on the status of implementation and progress during the plan period. A plan should be capable of amendment (by vote of the creditors) if it is in the interests of the creditors. The law should provide for the possible termination of a plan and for the debtor to be liquidated.	*This principle is fully or almost fully adopted in 9 EU Member States. It is partially adopted in Belgium, Denmark, Ireland, Spain, the UK and Greece. Unfortunately, we did not get any answer from the U.S..*
PRINCIPLE 23: DISCHARGE AND BINDING EFFECTS To ensure that the rehabilitated enterprise has the best chance of succeeding,	*This principle is fully or almost fully adopted in the U.S. and in 11*

the law should provide for a discharge or alteration of debts and claims that have been discharged or otherwise altered under the plan. Where approval of the plan has been procured by fraud, the plan should be subject to challenge, reconsidered or set aside.	*EU Member States. It is partially adopted in Germany and Greece. It is not adopted in Italy and France.*
PRINCIPLE 24: INTERNATIONAL CONSIDERATIONS Insolvency proceedings may have international aspects, and insolvency laws should provide for rules of jurisdiction, recognition of foreign judgements, co-operation and assistance among courts in different Member States, and choice of law.	*This principle is fully or almost fully adopted in the U.S. and in 6 EU Member States. It is partially adopted in Austria, Belgium, and Ireland. It is not adopted in Italy, Denmark, Germany, France, Spain and Greece. The question is however no more relevant under a European perspective, because of the adoption of the Council Regulation No 1346/2000 of 29 May 2000 on insolvency proceedings, which is directly applicable in all EU Member States with the exception of Denmark.*
PRINCIPLE 25: ENABLING LEGISLATIVE FRAMEWORK Corporate workouts and restructurings should be supported by an enabling environment that encourages participants to engage in consensual arrangements designed to restore an enterprise to financial viability. An enabling environment includes laws and procedures that require disclosure of or ensure access to timely, reliable and accurate financial information on the distressed enterprise; encourage lending to, investment in or recapitalization of viable financially distressed enterprises; support a broad range of restructuring activities, such as debt write-offs, reschedulings, restructurings and debt- equity conversions; and provide favourable or neutral tax treatment for restructurings.	*This principle is fully or almost fully adopted in the U.S. and in 7 EU Member States. It is partially adopted in Denmark, Germany, Finland, Luxembourg and Portugal. It is not adopted in Italy, Austria and Spain.*
PRINCIPLE 26: INFORMAL WORKOUT PROCEDURES A country's financial sector (possibly with the informal endorsement and assistance of the central bank or finance ministry) should promote the development of a code of conduct on an informal out-of-court process for dealing with cases of corporate financial difficulty in which banks and other financial institutions have a significant exposure—especially in markets where enterprise insolvency has reached systemic levels. An informal process is far more likely to be sustained where there are adequate creditor remedy and insolvency laws. The informal process may produce a formal rescue, which should be able to quickly process a packaged plan produced by the informal process. The formal process may work better if it enables creditors and debtors to use informal techniques.	*This principle is fully or almost fully adopted in the U.S. and in 5 EU Member States only. It is partially adopted in Denmark, France, Finland, Luxembourg and Ireland. It is not adopted in Italy, Austria, Belgium, Germany and Spain.*
PRINCIPLE 27: ROLE OF COURTS Bankruptcy cases should be overseen and disposed of by an independent court or competent authority and assigned, where practical, to judges with specialized bankruptcy expertise. Significant benefits can be gained by creating specialized bankruptcy courts. The law should provide for a court or other tribunal to have a general, nonintrusive, supervisory role in the rehabilitation process. The court/tribunal or regulatory authority should be obliged to accept the decision reached by the	*This principle is fully or almost fully adopted in the U.S. and in 9 EU Member States. It is partially adopted in Austria, France, Italy, Spain and Portugal. It is not adopted in Sweden.*

creditors that a plan be approved or that the debtor be liquidated.	
PRINCIPLE 28: PERFORMANCE STANDARDS OF THE COURT, QUALIFICATION AND TRAINING OF JUDGES Standards should be adopted to measure the competence, performance and services of a bankruptcy court. These standards should serve as a basis for evaluating and improving courts. They should be enforced by adequate qualification criteria as well as training and continuing education for judges.	*This principle is fully or almost fully adopted in the U.S. and in 5 EU Member States. It is partially adopted in Belgium, France, Greece, Ireland, Italy and Sweden. It is not adopted in Denmark, Austria, Finland and Spain*
PRINCIPLE 29: COURT ORGANIZATION The court should be organised so that all interested parties—including the administrator, the debtor and all creditors—are dealt with fairly, objectively and transparently. To the extent possible, publicly available court operating rules, case practice and case management regulations should govern the court and other participants in the process. The court's internal operations should allocate responsibility and authority to maximise resource use. To the degree feasible the court should institutionalise, streamline and standardise court practices and procedures.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of France, Austria and Spain where it is only partially adopted*.
PRINCIPLE 30: TRANSPARENCY AND ACCOUNTABILITY An insolvency systems should be based on transparency and accountability. Rules should ensure ready access to court records, court hearings, debtor and financial data and other public information.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of Belgium, Denmark and Germany where it is only partially adopted. In addition, it is not adopted in Spain.*
PRINCIPLE 31: JUDICIAL DECISION MAKING AND ENFORCEMENT Judicial decision making should encourage consensual resolution among parties where possible and otherwise undertake timely adjudication of issues with a view to reinforcing predictability in the system through consistent application of the law. The court must have clear authority and effective methods of enforcing its judgments.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States with the exception of France, Germany, Belgium and Spain where it is only partially adopted.*
PRINCIPLE 32: INTEGRITY OF THE COURT Court operations and decisions should be based on firm rules and regulations to avoid corruption and undue influence. The court must be free of conflicts of interest, bias and lapses in judicial ethics, objectivity and impartiality.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States.*
PRINCIPLE 33: INTEGRITY OF PARTICIPANTS Persons involved in a bankruptcy proceeding must be subject to rules and court orders designed to prevent fraud, other illegal activity or abuse of the bankruptcy system. In addition, the bankruptcy court must be vested with appropriate powers to deal with illegal activity or abusive conduct that does not constitute criminal activity.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States.*
PRINCIPLE 34: ROLE OF REGULATORY OR SUPERVISORY BODIES The body or be independent of individual administrators and should set standards that reflect the requirements of the legislation and public expectations of bodies responsible for regulating or supervising insolvency administrators should fairness, impartiality, transparency and accountability.	*Principle 34 is fully or almost fully adopted in the U.S. and in 9 EU Member States. It is partially adopted in Austria, Finland, Germany, Ireland and Spain. It is not adopted in Belgium.*
PRINCIPLE 35: COMPETENCE AND INTEGRITY OF INSOLVENCY ADMINISTRATORS Insolvency administrators should be competent to exercise the powers given to them and should act with integrity, impartiality and independence.	*This principle is fully or almost fully adopted in the U.S. and in all EU Member States.*

The Union was, therefore, confronted with a great task: ensuring that the different local systems would act harmoniously to undertake the reforms necessary to support the European efforts to reach the da Feira goals.

2. Early evaluations of progress toward achieving the da Feira goals: the Green Paper on Entrepreneurship of 2003 and the Opinion of the European Economic and Social Committee of 2004

The first years after the deployment of the Lisbon strategy were characterized by intense activity in a multitude of areas. The Union had much to accomplish if it wanted to achieve the demanding targets it had set upon establishing the 2010 deadline.

To avoid derailment, the Community wisely planned checkpoints to verify progress as different actions were undertaken.

In this section, we will discuss two documents that gave an assessment of early accomplishments in the development of the Lisbon strategy before the midterm checkpoint of 2005: the Green Paper[81] on Entrepreneurship published in 2003 and the Opinion given on the very same Green Paper by the European Economic and Social Committee in 2004[82].

The Green Paper recapped objectives and strategies, and distilled the relevant concepts contained in the numerous documents published earlier. As such it had a positive impact within the Union.[83] The document's narrative, though, was pervaded by excessive, almost propagandistic, optimism. Enthusiastic evaluations were made of all of the actions that were developed and implemented (including the ones we have just discussed).

Such a positive approach was bound to be mitigated, unfortunately, by the difficulties that would be faced in the following years. These difficulties which were, to a certain extent, foreseen by the second official document that we will use in comparison. The Opinion, through its dry and down-to-Earth exposition, made relevant observations and expressed concerns about the assessments made by the Green paper and the capacity of the Union to reach its goals in general.

We will compare the contents of these two documents and their unique approaches. Quotes from the positive and inspirational Green Paper are shifted towards the right margin, and quotes from the more critical Opinion are shifted towards the left. The following main topics which are great interest to our research:

- Entrepreneurship – discussing how the documents evaluate the importance of developing an entrepreneurial mentality in Europe and the positive results that could be achieved through it;
- SMEs – discussing their evaluation of the importance of SMEs for the future of the European market;
- The stigma of failure and insolvency law in general – discussing their understanding of stigma.

2.1 Entrepreneurship

The Green Paper addressed the topic of entrepreneurship with great emphasis, underlining the importance of creating a "new" society where business ideas could be pursued and turned into success. The document states, in fact, that the future of the Community depended on creative people that had the courage to imagine and create a better position and a better future for themselves and for others:

[81] Green Papers are documents published by the European Commission to stimulate discussion on given topics at European level. They invite the relevant parties (bodies or individuals) to participate in a consultation process and debate on the basis of the proposals they put forward. Green Papers may give rise to legislative developments that are then outlined in White Papers. At http://eur-lex.europa.eu/summary/glossary/green_paper.html

[82] ***Official Journal of the European union, C 10/58,*** "*Opinion of the European Economic and Social Committee on the 'Green Paper –Entrepreneurship in Europe'*", (2004).

[83] See *Id.,* at 58: "The Committee welcomes the Entrepreneurship Green Paper and congratulates the European Commission for this excellent piece of work. It considers that the Entrepreneurship Green Paper provides an extremely useful inventory of the main challenges faced by future and existing business owner managers in Europe, offering a valuable overview of the reasons why entrepreneurial activity is relatively low in Europe."

"Exploitation of creativity or innovation
Entrepreneurship is first and foremost a **mindset**. It covers an individual's **motivation** and capacity, independently or within an organisation, to **identify an opportunity** and to pursue it in order to produce new value or economic success. It takes **creativity** or innovation to enter and compete in an existing market, to change or even to create a new market. To **turn a business idea into success** requires the ability to blend creativity or innovation with sound management and to adapt a business to optimise its development during all phases of its life cycle. This goes beyond daily management: it concerns a business' ambitions and strategy."[84]

"Entrepreneurs
Entrepreneurship is about people, their choices and actions in starting, taking over or running a business, or their involvement in a firm's strategic decision-making. Entrepreneurs are a heterogeneous group and come from all walks of life. Yet there are certain common characteristics of entrepreneurial behaviour, including a readiness to take risk and a **taste for independence and self-realisation**. The British Household Survey found that individuals seriously considering starting a business regard themselves as relatively **more imaginative** and creative than others."[85]

*"Entrepreneurship is **crucial** to competitiveness*
New entrepreneurial initiatives, either starting a new firm or reorienting an existing one (e.g. after the transfer of a business to a new owner), boost productivity. They increase competitive pressure, forcing other firms to react by improving efficiency or introducing innovation. Increased efficiency and innovation within firms, whether in organisation, processes, products, services or markets, enhances the competitive strength of an economy as a whole.
This process offers consumers benefits through greater choice and lower prices."[86]

*"Entrepreneurship **unlocks personal potential***
An occupation is not just a way to earn money. People have other criteria in their career choices, such as security, level of independence, variety of tasks and interest in their work. Higher income levels may prompt people to fulfil 'higher needs', such as **self-realisation** and independence through entrepreneurship. The British Household Survey found that, in addition to material motivations (money and status), people chose to become entrepreneurs as a means to self-fulfilment (freedom, independence and challenge).
For some, who cannot find a regular job to their satisfaction, the choice of becoming an entrepreneur may stem partly or entirely from economic necessity. Becoming an entrepreneur may provide them with the prospect of **creating a better position** for themselves.
Job satisfaction among entrepreneurs is higher than among the employed. In a survey, 33% of self-employed without employees and as many as 45% of self-employed with employees reported being very satisfied with their working conditions against only 27% of employees."[87]

Entrepreneurshipm in the view of the Green Paper was the "key" to unlock "happiness"; a "miraculous formula" to achieve self-realization and individual growth.[88]

On this topic, the paper also made the following very relevant point:

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[84] **(2003) COM 27 Final**, "*Green Paper on Entrepreneurship (presented by the Commission)*", at 2.
[85] *Id*., at 2-3.
[86] *Id*., at 8.
[87] *Id.*
[88] *Id*., at 10.

> *"Entrepreneurship and societal interests*
> Entrepreneurs are the drivers of the market economy and their **achievements** provide societies with wealth, jobs and diversity of choice for consumers. In response to growing public expectations regarding the impact of business activities on society and the environment, many large companies have adopted formal strategies on Corporate Social Responsibility. This includes voluntarily integrating social and environmental concerns in their business operations and in their interaction with stakeholders, recognising that responsible business behaviour can support business success. Such behaviour can include, for example, a commitment to producing in an environmentally friendly manner ('*eco-efficiency*') or respecting consumer concerns and doing business in a consumer-friendly manner. SMEs demonstrate 'responsible entrepreneurship' in a more informal way but they provide the fabric and focal point for many communities.
> Entrepreneurship can also play a positive role in delivering health, education and welfare services efficiently. Social economy enterprises encourage the participation of stakeholders in the management and delivery of such services, enhancing innovation and client-orientation.
> Such an approach can supplement public resources and extend the range of services offered to consumers."[89]

It is not just the individual who would benefit from the expansion of entrepreneurial activities and a new era of courage and personal growth, but also society as a whole.

On such statements, the Committee made extremely interesting (and reasonable) observations, which contrasted with most of the documents published in previous years (many of which have been discussed in the previous pages):

"5.3. It is important to underline that entrepreneurship is not the solution to all of society's problems and that not everyone is potentially a successful entrepreneur. The follow up to this paper must remember this fact. The AP should consequently focus on identifying, encouraging and supporting those who want to become successful entrepreneurs, rather than trying to convince people to become entrepreneurs against their better judgment, or indeed compelling employees and the unemployed people to become self-employed."[90]

"5.8. The Committee would argue that the pursuit of greater entrepreneurial dynamism should concentrate on the quality of entrepreneurs, not quantity. Encouraging more people to become self-employed, or even involved in a business start-up will not necessarily lead to an increase in successful, sustainable entrepreneurial activity. The displacement effects of an over vigorous start-up policy on existing businesses need to be considered and the AP should include more options for existing businesses."[91]

In the opinion of the Committee, therefore, "entrepreneurship" alone could not be a perfect panacea capable of solving all of Europe's problems. The Committee, in fact, further commented that:

"5.9. All enterprises have an impact on society, positive and negative, intended and unintended. Given the vision for European economic development outlined by EU Heads of State at Lisbon in 2000 and the central role that SMEs play in this process, it is important that the follow-up to the Green Paper provides a more comprehensive view of entrepreneurs' contribution to society. Many SMEs may practice 'responsible entrepreneurship', while many equally may not. An

[89] *Id*., at 9
[90] ***Official Journal of the European union, C 10/58,*** "*Opinion of the European Economic and Social Committee on the 'Green Paper – Entrepreneurship in Europe'*", (2004), at 60.
[91] *Id.*, at 61.

appropriate non-legislative policy approach needs to be found for promoting responsible entrepreneurship."[92]

Therefore, while the drafters of the Green Paper viewed entrepreneurship as the indisputable solution to the problems and barriers that limited Europe's capacity to unlock its full potential, the Committee expressed a more balanced opinion on this topic. Moreover, the remark underlining the lack of a direct link between the creation of new businesses and an "increase in successful sustainable entrepreneurial activity" is extremely relevant, since it challenges the core of the strategies which were being implemented.

2.2 Small and Medium Enterprises

The value of SMEs in the general strategy for the success of Europe in the new Millennium was also optimistically emphasized by the Green Paper:

> "In the middle of the last century, economists predicted the dominance of large firms. Size was needed to obtain economies of scale, to exploit foreign markets and to keep abreast of regulations and of new opportunities in technology. Indeed, in the 1960s and 1970s, large companies dominated the economy. Since then, the trend has started to reverse. Large firms rationalised by restructuring, outsourcing or downsizing and the number of business owners in OECD countries increased from 29 million to 45 million between 1972 and 1998. Structural changes in the economy shifted Europe's comparative advantage towards knowledge-based activities. Globalisation increased competitive pressure on manufacturing firms in high-cost locations, which led not only to a shift in production capacity to low cost countries, but also to increasing productivity by using technological inputs. Meanwhile 'Information and Communication Technologies' (ICTs) gave rise to new markets, such as personal computers, software and ICT-based services, which revolutionised production processes in many industries and led to growth of the service sector."[93]
>
> "The European Union's persistent high unemployment rate, again a more pressing problem for some Member States than others, suggests that efforts should be made to better exploit the job creation potential of entrepreneurial activity. Besides encouraging new entrepreneurial initiatives, the growth potential of the European Union's existing firms should be unlocked. They are the core of the Union's economy and provide continuity, jobs and sound experience. Out of roughly 20 million SMEs in Europe, some 30% declare growth as their main ambition."[94]
>
> "To act as catalysts for private investors and to increase the supply of SME guarantees, public institutions have developed programmes in support of SMEs covering a range of instruments from micro-credits to venture capital. At EU level, the European Investment Fund manages a series of financial instruments funded under the Multiannual Programme for Enterprise and Entrepreneurship.63 Within the Structural Funds, the European Commission has asked Member States to privilege risk capital financing; this has resulted in a doubling of such financing under these programmes."[95]
>
> "A friendly environment for starting and developing businesses is central to reaching these goals. The Council adopted the Charter for Small Enterprises, setting out recommendations for small enterprises to take full advantage of the knowledge economy. The European Commission develops initiatives in this area, including

[92] *Id.*
[93] **(2003) COM 27 Final**, "Green Paper on Entrepreneurship (presented by the Commission)", at 4, quoting 'Entrepreneurship: Determinants and policy in a European US comparison', David B. Audretsch et al., 2002.
[94] *Id.*, at 9.
[95] *Id.*, at 19.

> annual implementation reports on Member States' and the Commission's efforts towards reaching the objectives of the Charter for Small Enterprises, the report on the Activities of the SME Envoy and the forthcoming Communication on Innovation Policy. In particular the Commission has adopted last December a Communication on industrial policy in an enlarged Europe and the discussion on the Green Paper on entrepreneurship has to be seen also in this context."[96]

SMEs were, therefore, the future: a modern form of entrepreneurship which could replace the one constituted by large enterprises as if they were old, heavy dinosaurs. Thanks to their light structure and capacity to innovate, they could improve the levels of competitiveness within the market of the Eurozone and internationally. Moreover, the great number of SMEs could also help increase levels of employment.

The Committee, although agreeing on the potential benefits that could derive from fostering a strong network of small businesses, did not limit itself to acknowledging the importance of SMEs or the improvements which were already made, up to that point, at a local and European level. The Opinion, in fact, also discussed the great barriers and difficulties that still had to be removed in order to effectively attain all the benefits listed within the Paper, and made helpful suggestions:

> "4.1. There is a certain feeling of disillusionment within the SME community about EU-initiated policy aimed at helping entrepreneurs. Indeed, there is a commonly held belief that the way the EU institutions can best help SMEs is to do less in certain areas. The SME community perceives the EU to be the source of much onerous legislation whilst, on the other hand, finding it difficult to grasp and appreciate measures designed to promote business ownership emanating from the EU."[97]

> "6.17.1. As the Committee has stated in the past, SMEs are 'a pillar of the transition process and make a large contribution to GNP and employment' in the new Member States. SMEs in these countries face exaggerated difficulties in several areas, notably in terms of access to finance, training, support and advice (2)."[98]

> "4.3. Given the proliferation of enterprise initiatives at European level and the disillusionment of the SME community, it is essential that the AP demonstrates continuity with previous and ongoing activities and relevance to achieving the goals of the Lisbon Agenda. In particular, continuity from the 2000 European Charter for Small Enterprises is needed and the AP must seek to complement and incorporate recommendations on achieving the Charter's 10 lines for action."[99]

> "5.2. There are many more examples of business owners seeking stability and survival than there are of the kind of entrepreneurs to which the Green Paper refers. SMEs are run by people with varying aspirations for their enterprise, with different talents and management capabilities, are based in prosperous and deprived locations and in a variety of industry sectors — some traditional, some cutting edge. The follow-up to the Entrepreneurship Green Paper need not be prescriptive about what constitutes entrepreneurship and should instead seek to embrace all types of entrepreneur, running all types of business and based in different local and sectoral contexts."[100]

> "6.2.6. There is sometimes a considerable gap between business-owner-managers and policy-makers. This gulf can be bridged by consulting intermediary organisations and representative bodies on all relevant policy initiatives throughout

[96] *Id.,* at 2.
[97] ***Official Journal of the European union, C 10/58,*** "*Opinion of the European Economic and Social Committee on the 'Green Paper –Entrepreneurship in Europe*'" (2004), at 60.
[98] *Id.,* at 65.
[99] *Id.,* at 60.
[100] *Id.*

the various stages of drafting. This will allow the SME sector to embrace the policy process, influence policy outcomes and better appreciate the efforts of the policy-makers."[101]

"6.2.7. The European Economic and Social Committee has done much valuable work in the area of better regulation and simplification in the past, most recently in the form of its opinion on Simplification (1). This is an area that needs to continue to improve if policy-making is to be more sympathetic to entrepreneurs whilst simultaneously taking into account the perspectives and interests of other stakeholders. Greater efforts should be made to engage entrepreneurs directly in the decision-making process at a much earlier stage. Impact assessments need to be carried out thoroughly, based on wide consultations, systematically taking into account alternative solutions and, in the case of proposals for regulation, explaining why a non-regulatory option has not been chosen."[102]

"6.9.5. The Committee feels that the solutions proposed in the Green Paper, such as micro-loans and risk capital or business angels, are only partially suited to the needs of small businesses. The Commission needs to consider the development of professional and mutual guarantee funds so as to facilitate access to credits for the development of the business. The Committee calls for the European Investment Fund to reinforce the financial instruments for guaranteeing loans to SMEs by gearing them more appropriately to the needs of small and micro enterprises and craft businesses, particularly for investment associated with standardisation, the environment and the acquisition of production and communication technologies."[103]

"6.10.1. Amongst the most obvious, efficient and direct measures that can be taken by public authorities to help entrepreneurs is to enhance small business access to public contracts. However, in the same way that small businesses feel a natural affinity to other small businesses (2), it seems that public administrations, when allocating contracts, gravitate more to big businesses that are run in a similar way. This important cultural barrier, caused by both public authority and SME attitudes, needs to be surmounted if public procurement is to be taken up by small firms."[104]

"6.16. *The Internal Market*
6.16.1. The European Single Market still remains a distant concept to many SMEs, a high proportion of which will never seek to exploit opportunities beyond their local or national markets. Nonetheless, other smaller firms are well placed to sell their goods and services across-borders and in other Member States. They could, in particular, be supported in this process through the ongoing development of an infrastructure that supports the movement of goods, people and information and increased mutual recognition of professional qualifications."[105]

2.3 Insolvency regulations and of the stigma of failure

The pursuit of growth in entrepreneurship levels and in the number of SMEs led the debate on to the topic of insolvency regulations. The Green Paper, following a train of thought on the topic of entrepreneurship, focused the discussion on the negative effects of the stigma of failure:

"A failed entrepreneur faces the stigma of failure. When the Eurobarometer asked Europeans to identify their primary concerns in relation to the risk associated with entrepreneurship, going bankrupt and losing personal property were prevalent. In

[101] *Id.,* at 61.
[102] *Id.*
[103] *Id.,* at 64.
[104] *Id.*
[105] *Id.,* at 65.

addition to the social stigma, a personal bankruptcy implies severe legal consequences. Discharge of remaining debts may take years, bankrupts may lose their possessions and be subject to certain restrictions. Such consequences are justified in cases of fraud or dishonesty, but failure is an intrinsic part of economic life and a proportion of entrepreneurs go bankrupt because they cannot compete in the market. Insolvency laws could be reviewed to reduce barriers to making a fresh start for honest entrepreneurs. This should not, of course, unduly harm creditors' interests, which might increase their reluctance to invest in small and new ventures."[106]

"Risk-taking should be rewarded, rather than punished. Social security and tax provisions must be re-assessed in the light of their effects on entrepreneurs' willingness to take the risk to start a business or grow. Taking over an existing firm should be encouraged and the potential of 'entrapreneurship' could be further explored. To reduce the negative effects of bankruptcy, appropriate measures such as earlier discharge of debts, the retention of certain assets or lifting certain restrictions on bankrupts should be considered."[107]

"Although many people express a preference for being an entrepreneur, many lack the confidence and skills to turn their ambitions into action. Young people should be exposed to entrepreneurship and be supported, along with their trainers, in developing entrepreneurship skills. Campaigns could provide role models and success stories to showcase entrepreneurs and highlight the benefits that they bring to society. These should particularly address those that can play a key role in supporting prospective entrepreneurs, such as schools, universities, investors, local communities, regions, business organisations, advisers and the media."[108]

"Despite evidence that failed entrepreneurs learn from their mistakes and perform better in their next businesses, they nevertheless face the stigma of failure. They are confronted with a lack of trust among consumers and are often required to provide additional guarantees by investors and business partners. 45% of European citizens said, in the Eurobarometer survey, that they would be less inclined to place an order with such a business. Society should rather give failed entrepreneurs a chance to make a fresh start."[109]

The Green Paper, therefore, aimed to support entrepreneurs and risk-taking, affirming that a "true" second chance should have been made available to those that failed "honestly". Mistakes had to be considered not as a "death sentence" but as part of the learning process that would be ongoing within business activities, just as it is in several other phases of our lives. Such a "benevolent" approach had to be furthered in combination with specific campaigns to:

- increase the levels of knowledge on insolvency matters and the efficiency of tools for assisting entrepreneurs facing difficulties;
- fight the effects of stigma, which negatively affects the debtor's capacity to obtain a meaningful "fresh start."

Interestingly enough, the Committee did agree fully on this particular point of view expressed in the Paper. The Opinion, in fact, underlined the importance of bringing further improvements to fight the perverse effects of stigma:

"6.15. *Stigma of failure*
6.15.1. The Committee welcomes the Green Paper's recognition of the need to address the damaging tendency in Europe to stigmatize as a failure an owner-

[106] **(2003) COM 27 Final**, "*Green Paper on Entrepreneurship (presented by the Commission)*", at 11-2.
[107] *Id.,* at 24.
[108] *Id.,* at 25.
[109] *Id.,* at 22.

> manager who has run a business that has gone bankrupt. Potential investors and financial institutions, in particular, need to take a more positive attitude to such business experience which, it can be argued, is a valuable stage in an entrepreneur's learning curve and often leads to more successful future business ventures."[110]

The fact that the two documents agreed on this particular point is significant. It proves its relevance and shows the importance of making improvements in this key area.

2.4 Conclusion: comparing the Green Paper and the Opinion

Reading the Opinion and the Green Paper is like seeing two completely different paintings on the same subject. If the task was to picture a fruit basket, for example, the Green Paper's would be blooming and luxuriant, filled with bright colors; the Opinion's one would be dark and wintery, and the fruit would probably be bare and unripe.[111]

At the time it was not possible to clearly see which was the correct representation of the actual state of progress of the Union towards the Lisbon goals, but an answer would become available not long after their publication. The following year, in fact, the so-called "Kok Report" was released with the precise goal to provide an accurate analysis of the state of the European Union.

3. The Kok Report of 2004; approaching the midterm check-point

In the previous section we examined two documents that attempted to give a picture of the progress made up to 2003 toward reaching the Lisbon Goals. A sort of pre-midterm checkpoint before the true, designated midterm checkpoint. The Green Paper on Entrepreneurship presented an optimistic point of view; the Opinion, a more cautious and critical one.

In order to bring clarity, in March 2004, the Council invited the Commission to form a committee of experts to file a specific and analytic report:

> "The European Council held in Brussels in March 2004 invited the Commission to establish a High Level Group headed by Mr. Wim Kok to carry out an independent review to contribute to the mid-term review. Its report should identify measures which together form a consistent strategy for the European economies to achieve the Lisbon objectives and targets. The group was to be composed of a limited number of highly qualified individuals able to reflect the views of all stakeholders. Its report was due to be made public and submitted to the Commission by 1 November 2004."[112]

The "High Level Group" presided by Mr. Kok was soon formed and operated to carry out an independent review in support of the mid-term evaluations of 2005[113]. The study analyzed all the different areas in which Europe should have been active if it was effectively following its strategies:

- Structuring an advanced knowledge based society;
- Keeping commitments to the internal market;
- Creating the right climate for entrepreneurs;
- Building an inclusive labor market for stronger social cohesion;
- Working towards an environmentally sustainable future.

In this section we will discuss some of the most relevant findings included in this official document, focusing on the areas which are of greatest interest to us.

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[110] ***Official Journal of the European union, C 10/58,*** "*Opinion of the European Economic and Social Committee on the 'Green Paper –Entrepreneurship in Europe'*", (2004), at 65.

[111] Caravaggio's painting "*La canestra di frutta*", with its impressive ability to show the imperfections of reality, would probably be a great match.

[112] **Report from the high level group chaired by Wim Kok**, "*Facing the challenge – The Lisbon strategy for growth and employment*", Office for Official Publications of the European Communities, (2004), at 4.

[113] *Id.*, at 5.

Overall, the results of the Kok Report, emblematically entitled “Facing the challenge”, contrasted with the optimism that permeated the Green Paper and supported the more cautious and critical statements contained in the Opinion. The report, in fact, concluded that Europe did not make sufficient progress and that, in 2005, it would be found to be missing several of its extremely relevant goals:

> “At risk — in the medium to long run — is nothing less than the sustainability of the society Europe has built. Europeans have made choices about how to express the values they hold in common: a commitment to the social contract that underwrites the risk of unemployment, ill-health and old age, and provides opportunity for all through high-quality education, a commitment to public institutions, the public realm and the public interest, and that a market economy should be run fairly and with respect for the environment. These values are expressed in systems of welfare, public institutions and regulation that are expensive in a world where low cost and highly efficient producers are challenging the old order. If Europe cannot adapt, cannot modernise its systems and cannot increase its growth and employment fast enough then it will be impossible to sustain these choices. Europe, in short, must focus on growth and employment in order to achieve the Lisbon ambitions.”[114]

The evaluation made by the expert committee showed that several elements caused Europe to be “late” on its ambitious schedule, such as:

- The economic crises and recent market difficulties:

> “The last four years have not been kind to the chances of achieving the Lisbon goals. The ink had scarcely dried on the agreement before the worldwide stock market bubble imploded, the epicenter of which was the collapse of the overvalued prices of American dot.com and telecom shares amid evidence of financial and corporate malpractice. Skepticism mounted about the potential of the knowledge economy. The US suffered two years of economic slowdown and recession and the European economy followed suit. Raising R & D expenditure, for example, is made very much harder in a climate of stagnating output and general pressure on government and corporate budgets.
> The terrorist attacks on the US on 11 September 2001 and subsequent events further darkened the international climate. Although governments committed to a further round of trade opening negotiations to boost world trade at Doha, turning intentions into concrete measures has proved stubbornly difficult. There has been a worrying growth in bilateral rather than multilateral trade agreements, and tensions between Europe and the US have resulted in some bitter trade disputes. A growing number of worrying environmental events have further increased the unease about the human impact on world climate. Recently, oil prices have increased, due to a combination of higher demand and insecurity surrounding supply, both dampening current economic activity and lowering forecasts for the immediate future. The cumulative impact of all these events has been to sap European consumer and business confidence.
> Over the last four years, the overall performance of the European economy has been disappointing. The economic upturn in Europe has been weaker than in the US and Asia over the last two years, in part because of continuing structural weaknesses and in part because the rate of growth of public and private demand has been low. It is true that Europe’s public sector deficits have risen as the so-called automatic stabilisers — rising social security payments and falling tax receipts — have kicked in, but this has been inadequate to counter the cyclical downturn. The room for fiscal manoeuvre in Europe was limited by the weak budgetary positions with which some European Member States entered the economic downturn, insufficiently consolidating their finances during the previous economic upturn. As a consequence the operation of the Stability and Growth Pact could not sufficiently support growth enhancing macroeconomic policies that would have further countered the downward component of the economic cycle.
> Thus many Member States have been caught in a conundrum. Because of structural weaknesses and low demand, national economic performance has been poor. As national

[114] *Id.*, at 16.

economic performance has been poor, it has been more difficult to implement the Lisbon strategy."[115]

> "Europe's economy, bluntly, is growing less quickly than the US and has suffered recently from a lower rate of productivity growth. The post-war catching-up process of the EU with the US in terms of output per head had come to an end in the mid-1970s (see Figure 1) but then broadly stabilised. However, since 1996 the average annual growth in EU output per head has been 0.4 percentage points below that of the US. From holding its own, Europe is now losing ground."[116]

- The lack of coordination by, and of adequate action among Member States:

> It has been harder in this low growth environment for some governments to keep their commitments. It must be said, however, on top of that many Member States have not taken the execution and delivery of the agreed measures seriously enough. Completing the single market, for example, has not been given the priority it required. This has kept Europe too far from the goals it must reach."[117]

- A formidable increase of international competition within the globalized market:

> "International competition is intensifying, and Europe faces a twin challenge from Asia and the US. The potential rapid growth of the Chinese economy will create not only a new competitor to Europe, but also a vast and growing market. For Europe to take advantage of the opportunity, it needs to have an appropriate economic base, recognising that over the decades ahead competition in manufacturing goods at home and abroad, especially those with a high wage content and stable technologies, is going to be formidable. Indeed China, industrialising with a large and growing stock of foreign direct investment together with its own scientific base, has begun to compete not only in low but also in high value-added goods. Although Chinese wages are a fraction of those in Europe, it is clear that the difference in quality of goods produced in China or the EU is already small or non-existent. India's challenge is no less real — notably in the service sector where it is the single biggest beneficiary of the 'offshoring' or 'outsourcing' of service sector functions with an enormous pool of educated, cheap, English speaking workers. Asia's collective presence in the world trading system is going to become more marked."[118]

In the opinion of the Expert Committee, though, there was more. Despite all the relevant external factors which negatively affected the development of European initiatives, Member States were also to blame for their approach, which became, with time, a primary barrier in holding back European progress:

> "In March 2000, European leaders committed the EU to become by 2010 'the most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment'. The Lisbon strategy, as it has come to be known,
> was a comprehensive but interdependent series of reforms. Actions by any one Member State, ran the argument, would be all the more effective if other Member States acted in concert. External events since 2000 have not helped achieving the objectives but the European Union and its Members States have clearly themselves contributed to slow progress by failing to act on much of the Lisbon strategy with sufficient urgency. This disappointing delivery is due to an overloaded agenda, poor coordination and conflicting priorities. Still, a key issue has been the lack of determined political action. The Lisbon strategy is even more urgent today as the growth gap with North America and Asia has widened, while Europe must meet the combined challenges of low population growth and

[115] *Id.*, at 10.
[116] *Id.*, at 14.
[117] *Id.*, at 9-10.
[118] *Id.*, at 13.

> ageing. Time is running out and there can be no room for complacency. Better implementation is needed now to make up for lost time."[119]

> "Actions by any one Member State, ran the argument, would be all the more effective if all other Member States acted in concert; a jointly created economic tide would be even more powerful in its capacity to lift every European boat. The more the EU could develop its knowledge and market opening initiatives in tandem, the stronger and more competitive each Member State's economy would be. The Lisbon strategy, as it has come to be known, was a comprehensive, interdependent and self-reinforcing series of reforms."[120]

> "It is clear that the progress of the Lisbon strategy has suffered from incoherence and inconsistency, both between participants and between policies. Coherence and consistency means that those involved should all be aware of and share the same goal. Policies pulling in contradictory directions must be realigned so that instead they are mutually reinforcing. To achieve the goals of more growth and employment means ensuring that there is clear alignment between participants, policies and objectives. Member States inevitably play a crucial role in achieving growth and employment — not only for their own countries but because, in a European context, a good performance by one Member State will lift the performance of other Member States and vice versa. As the High Level Group has said, a rising European tide lifts every European boat. The lack of commitment at both the national and European level has meant that these benefits have not been captured, exposing inconsistencies and incoherence. Europe as a whole can no longer pay the price in lost employment and foregone growth. Up until now national parliaments and citizens have not been sufficiently associated with the process, so that pressure on governments has been less than it should and could have been. The same applies to social partners and other stakeholders. Closer cooperation between the various stakeholders is needed, who must commit themselves to the process of encouraging and supporting each other. All of this confirms the need for a partnership for reform constructed within each Member State's particular national context."[121]

Despite the optimism that permeated the Green Paper and several other official documents published from the nineties, in 2004 the situation appeared to be critical and potentially irreparable:

> "Clearly there are no grounds for complacency. Too many targets will be seriously missed. Europe has lost ground to both the US and Asia and its societies are under strain."[122]

The High Level Group found itself, therefore, faced with a great challenge. In its report it had to answer a very difficult, yet vital question: given the difficulties faced and the imminent failure to meet the midterm targets, was it time for the ten-year strategy to be modified, or even abandoned (!)?[123]

The answer given by the Expert Committee on this relevant point was negative.

In its analysis, the Report stated, in fact, that the Lisbon objectives had not lost their key relevance and that they should not have been modified. Reaching the targets that had been set just few years before remained an "urgent"[124] priority and no benefit would been gained with a sudden change of trajectory:

[119] *Id.*, at 14.
[120] *Id.*, at 8.
[121] *Id.*, at 40.
[122] *Id.*, at 11.
[123] As requested by its mandate, the Expert Report did not limit itself to giving an assessment of the status of the progress that had been made until that point by the Union, but focused also on the steps necessary to bring further improvements in the future.
[124] "The Lisbon strategy is even more urgent today as the growth gap with North America and Asia has widened, while Europe must meet the combined challenges of low population growth and ageing. Time is running out and there can be no room for complacency. Better implementation is needed now to make up for lost time", *Id.*, at 6.

> "Clearly there are no grounds for complacency. Too many targets will be seriously missed. Europe has lost ground to both the US and Asia and its societies are under strain. Does that mean the ambition is wrong? The answer is no. The ambition is needed more than ever, whether to meet the challenges of enlargement, an ageing population or the intensified global competition — let alone the need to lower current levels of unemployment. Is Lisbon over-ambitious? Again no. Even if every target were to be hit on schedule, Europe would not be on safe ground. Competitor countries and regions are moving on as well, threatening Europe's position in the global economic league table. Europe must find its place in a global economy, which will nonetheless enable it to uphold its own distinctive choices about the social model that it rightly wants to retain. Whether it is life expectancy, infant mortality rates, income inequality or poverty, Europe has a much better record than the US. The objective of Lisbon is to uphold this record in an environment where the challenges are multiple and growing."[125]

> "Should the 2010 deadline be lifted? Again no. The 2010 deadline is important for signalling and reinforcing the urgent need for action. Setting a new, later deadline would imply that the situation is now less urgent and thus would be wrong. The ongoing challenge of the 2010 deadline is needed to galvanise Member States to make serious efforts at improvement. In any case Lisbon should not be regarded as a one-off objective to be disregarded after 2010 even if every target had been achieved. It is an ongoing process aimed at securing Europe's future as a high productivity, high value-added, high employment and eco-efficient economy. The process will never end on a single date, rather it will be subject to continual renewal, reappraisal and recommitment. It is all the more important that political leaders show the required determination now to take advantage of the current fragile improvement of the economic climate and rise in business confidence to recover as much as possible of the ground lost over the last four years."[126]

Lisbon continued, therefore, to be considered a key step (maybe *the* key step) forward towards a better future; this despite the Union's poor performance up that point:

> "The Lisbon strategy was and is Europe's best response to these multiple challenges. It represents a framework of ambition and targets which set out the broad direction of necessary change to sustain a European economy that is genuinely innovative, operates at the frontiers of technology and creates the growth and the jobs that Europe needs. The view of the High Level Group is that Lisbon's direction is right and imperative, but much more urgency is needed in its implementation — and more awareness of the high cost of not doing so.
> The problem is, however, that the Lisbon strategy has become too broad to be understood as an interconnected narrative. Lisbon is about everything and thus about nothing. Everybody is responsible and thus no one. The end result of the strategy has sometimes been lost. An ambitious and broad reform agenda needs a clear narrative, in order to be able to communicate effectively about the need for it. So that everybody knows why it is being done and can see the validity of the need to implement sometimes painful reforms. So that everybody knows who is responsible.
> To restate, Lisbon is about Europe becoming an integrated, competitive, dynamic knowledge-based economy that is among the best in the world. It wants to embed Europe's commitment to social cohesion and the environment in the core of the growth and jobs generation process so they
> are part of Europe's competitive advantage. This cannot be done against a background of stagnating or slowly rising demand. The wider macroeconomic framework, both the pursuit of monetary and fiscal policy, must be as supportive of growth as possible. In light of this, the High Level Group supports the recent proposed reforms by the European Commission of the Stability and Growth Pact. These reforms offer the flexibility to pursue economic policies that lessen the impact of the economic cycle without losing sight of the

[125] *Id.*, at 11.
[126] *Id.*, at 11.

importance of stability. Strengthening governments' fiscal positions in the current fragile upturn is required in order to have more latitude in any subsequent downturn with increased spending or sustainable tax cuts. The need is to give business the confidence to invest and innovate in the knowledge that the over-riding objective is to sustain the current upswing and with it the chances of implementing Lisbon.
> For achieving the Lisbon strategy will benefit every Member State. The principle underpinning the European Union is well established: Europeans better hang together or they will hang separately. The single market in goods and services promotes trade that benefits every Member State. The euro creates a monetary union of predictable, stable low interest rates and low inflation that benefits every Member State. No single European country can achieve an improved environment in isolation; and the better the European economy performs, the more investment flows to every Member State to take advantage of the improved general European business climate. In the same way, the effects of building a European knowledge economy spill over to benefit all."[127]

Nevertheless, the Member States and the Community as a whole had to renew their commitment. They had to start bringing concrete results. All strategic areas were found to be in need of immediate, and uniform, improvement:

> "In this context, if we are to deliver the Lisbon goals of growth and employment then we must ***all*** take action. To achieve them will require everyone to engage. This means more delivery from the European institutions and Member States through greater political commitment, broader and deeper engagement of Europe's citizens, and a recognition that by working together Europe's nations benefit all their citizens.
> Each element of the Lisbon strategy is still needed for the success of the whole. Improved economic growth and increased employment provide the means to sustain social cohesion and environmental sustainability. In their turn, social cohesion and environmental sustainability can contribute to a higher growth and employment.
> For Europe to increase its living standards, it needs to accelerate employment and productivity growth via a wide range of reform policies as well as a wider macroeconomic framework as supportive as possible of growth, demand and employment. No single action will deliver higher growth and jobs. Rather, there are a series of interconnected initiatives and structural changes that through concurrent action in the European Union will release its undoubted potential. This requires urgent action across five areas of policy:
> • **the knowledge society**: increasing Europe's attractiveness for researchers and scientists, making R & D a top priority and promoting the use of information and communication technologies (ICTs);
> • **the internal market**: completion of the internal market for the free movement of goods and capital, and urgent action to create a single market for services;
> • **the business climate**: reducing the total administrative burden; improving the quality of legislation; facilitating the rapid start-up of new enterprises; and creating an environment more supportive to businesses;
> • **the labour market**: rapid delivery on the recommendations of the European Employment Taskforce; developing strategies for lifelong leaning and active ageing; and underpinning partnerships for growth and employment;
> • **environmental sustainability**: spreading eco-innovations and building leadership in eco-industry; pursuing policies which lead to long-term and sustained improvements in productivity through eco-efficiency."[128]

Partial successes, accomplished by just some Member States, or in some areas only, could not bring the necessary degree of progress and avoid the decay of European society as a whole:

[127] *Id.*, at 16-17.
[128] *Id.*, at 6.

> "Individual Member States have made progress in one or more of these policy priority areas but none has succeeded consistently across a broad front. If Europe is to achieve its targets, it needs to step up its efforts considerably."[129]

> "Actions by any one Member State, ran the argument, would be all the more effective if all other Member States acted in concert; a jointly created economic tide would be even more powerful in its capacity to lift every European boat. The more the EU could develop its knowledge and market opening initiatives in tandem, the stronger and more competitive each Member State's economy would be. The Lisbon strategy, as it has come to be known, was a comprehensive, interdependent and self-reinforcing series of reforms."[130]

> "Lisbon, because of the range of its ambition, covered a number of areas in which the EU had no constitutional competence and which were the preserve of Member States. Therefore, it was designed to proceed by a combination of the traditional 'Community method' of EU legislation brought forward by the European Commission and via a new process known as the 'open method of coordination'. Under this process, Member States agree to voluntarily cooperate in areas of national competence and to make use of best practice from other Member States, which could be customised to suit their particular national circumstances. The European Commission's role is to coordinate this process by ensuring that Member States have full information about each other's progress and policies whilst making sure that those areas for which it has competence — notably the single market and competition policy — would reinforce the Lisbon goals by application of the Community method. Moreover, the Commission's monitoring would stimulate and create the necessary peer pressure to achieve these goals by publicising the results achieved by the individual Member States. The Lisbon strategy would thus deliver much needed growth and jobs while requiring Member States voluntarily to coordinate their policies."[131]

> "Member States inevitably play a crucial role in achieving growth and employment — not only for their own countries but because, in a European context, a good performance by one Member State will lift the performance of other Member States and vice versa. As the High Level Group has said, a rising European tide lifts every European boat. The lack of commitment at both the national and European level has meant that these benefits have not been captured, exposing inconsistencies and incoherence. Europe as a whole can no longer pay the price in lost employment and foregone growth.
> Up until now national parliaments and citizens have not been sufficiently associated with the process, so that pressure on governments has been less than it should and could have been. The same applies to social partners and other stakeholders. Closer cooperation between the various stakeholders is needed, who must commit themselves to the process of encouraging and supporting each other. All of this confirms the need for a partnership for reform constructed within each Member State's particular national context."[132]

In order to fully meet the preset targets, the Community and the Member States had to cooperate and to coordinate their efforts:

> "However, there are five broad priority areas of policy where the European Union and individual Member States need to make progress to help both ensure its own economic dynamism and the vigour of the whole European economy from which each Member State benefits. The realisation of the knowledge society, the completion of the internal market and promotion of competition, including services and financial services, the establishment of a favourable climate to business and enterprise, building an adaptable

[129] *Id.*, at 7.
[130] *Id.*, at 8.
[131] *Id.*, at 6.
[132] *Id.*, at 40.

and inclusive labour market, and the vigorous promotion of win-win environmental economic strategies are together sources of economic growth and higher productivity. And all, in the view of the High Level Group, are more likely to take place against a background of growth supporting macroeconomic policies.
Perhaps individual Member States can boast achievement in two or even three of these policy priority areas. None can boast success in all five, which is what is required if Lisbon's ambition — after all no more than giving Europe's citizens the opportunity and quality of life they want — is to be achieved. The task is to convince Europe's leaders and publics intellectually of Lisbon's case; to develop policies in each Member State, supported by an appropriate European-wide framework, that address particular Member State's circumstances; and then to act in a more determined way than we have so far witnessed.
In conclusion: it is not the pursuit of any one of these objectives that will raise Europe's productivity and growth, but all of them — obviously tailored to the particular position of national economies. And the more buoyant the wider economy, the easier it will be to introduce difficult reforms. The rest of this chapter contains specific recommendations, with which government leaders can show their commitment to a strategy for growth and employment.
Europe's leaders need to instil hope that tomorrow will be better than today. Europe has considerable economic and social strengths, as the High Level Group has identified. The programme of reform outlined in this report is eminently deliverable and will bring improvement. It needs to be clearly understood and explained, and then delivered. The act of delivery, along with the associated improvement, will start to put Europe on a virtuous circle of better economic performance, rising confidence and expectations, and improved trust."[133]

Based on the analysis of the Kok report, the first years of the Lisbon strategy had a negative outcome. Critiques to European performance were available even before the midterm checkpoint, a glaring sign of the fact that things were not going as planned. The situation was critical due to external factors, but also due to the behavior of Member States which acted in an uncoordinated fashion, constituting a relevant internal barrier.

The Green Paper on Entrepreneurship, which we discussed in the previous section, was indeed effective in providing a roadmap of the steps made up to that point. But, together with other relevant official documents of the time, it erred in its optimistic approach, which was ultimately misleading.[134] The confidence that permeated countless official documents released up to 2004 (and that would remain constant, despite the difficulties that would be met in the following years, as we are about to see) had dangerously contributed to hiding failures in several key areas.

Europe therefore had to change its approach and renew its efforts, taking immediate and uniform actions in an attempt to catch up. The 2010 deadline was not far, but there still was time to make relevant reforms.

4. The renewed Lisbon strategy of 2005

"Today, there is general consensus that Europe is far from achieving the potential for change that the Lisbon strategy offers. While both the diagnosis and the remedies are not contested, the reality is that not enough progress has been made.
This Report, at the mid-point stage of Lisbon, now sets out how we can work together for Europe's future and put the Lisbon agenda back on track."[135]

[133] *Id.*, at 42.
[134] A weakness which may have also been caused by the lack of a subsequent white paper on the same topics and by the urge to support the new initiatives. *Id.,* at 17.
[135] **(2005) COM 24 Final**, "*Communication to the spring European Council – Working together for growth and jobs – A new start for the Lisbon strategy – Communication from President Barroso in agreement with Vice-President Verheugen*", at 7.

Following the findings of the High Level Group, Europe had to swiftly get back to work. The focus was placed on delivering results.[136] As we have discussed, by 2005 not enough was achieved compared to what was expected in the beginning of the race, while the difficulties that had to be faced had multiplied and intensified themselves:

> "The EU needs to step up its investment in higher education (the EU currently spends only 1.28% of GDP compared to 3.25% in the USA: the gap is mainly a result of greater private funding). By the end of 2007, universities should be allowed and encouraged to seek complementary private sources of funding; legal and other barriers to public-private partnerships between universities and businesses should be removed; all technical universities should have a technology transfer office; and a European Institute for Technology should be set up. Proficiency in math and science will need to be stepped up to enhance people's ability to innovate; Member States should provide for compulsory teaching of two foreign languages in their national education systems. The aim should be for the EU to devote at least 2% of GDP to higher education by 2010."[137]

Several barriers preventing Europe from expressing its full potential were still unaddressed, and other international players seemed to be able to outperform the "Old Continent" within the global market:

> "Compared with other successful regions in the world, Europe's markets, in particular in services, remain badly fragmented. This carries a serious price tag in the form of lower levels of innovation and lagging productivity growth. Far too often, poor or late implementation of Community directives denies our companies the benefits of easy access to a large internal market. This can only weaken them in the face of international competition. If some Member States fail to act, they tilt the playing field and end up harming the interests of all."[138]

Just as suggested by the Kok Report, though, the original goals were not abandoned or delayed. Europe persevered in its strategies.

Efforts were placed on the implementation of a *renewed* Lisbon strategy, in an attempt, as it is often said in the field of insolvency laws, to obtain a "fresh start", making up for lost time and opportunities. The Community and the Member States were believed to have all the necessary qualities to correct their course and regain lost ground:

> "**Growth and jobs: A New Start for the Lisbon Strategy**
> Just think what Europe could be. Think of the innate strengths of our enlarged Union. Think of its untapped potential to create prosperity and offer opportunity and justice for all its citizens. Europe can be a beacon of economic, social and environmental progress to the rest of the world.
> It is in this spirit of realistic optimism that the new European Commission has put together our policy recommendations for the Mid-Term Review of the Lisbon Strategy – our ambitious agenda for reform launched by the European Council in March 2000.
> Europeans have every reason to be positive about our economic potential. The successes of the second half of the 20th century have left a strong legacy. After half a century of peace we have one of the most developed economies in the world united together in a unique political Union of stable and democratic Member States. That Union has created a Single Market underpinned for participating members by a single currency that consolidates economic stability and deepens the potential of economic integration. We have consolidated a unique participative social model. Our standards of basic education are high and the science base is historically well developed. Europe is home to dynamic

[136] **(2005) COM 30 Final**, "*Communication from the Commission to the Council and the European Parliament – Report on the implementation of the European Charter for Small Enterprises*", at 3.
[137] *Id.,* at 16.
[138] *Id.,* at 17.

and innovative companies with extraordinary competitive strength. At their best, they are demonstrating a remarkable capacity for renewal. We have made more progress towards sustainable development than any other region of the world.

We have done this by acting in partnership – Europe's institutions, government and administrations at a national, regional and local level, our social partners, civil society – all moving together towards a common goal.

This legacy represents a substantial down-payment towards the vision that binds us together; a vision, confirmed in the Constitution, of ensuring "the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress and a high level of protection and improvement of the quality of the environment".

The past 50 years have seen extraordinary progress, but in a changing world Europe cannot stand still. This is why five years ago Heads of State and Government signed up to an ambitious programme of change. They committed themselves to making the European Union the most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment.

Today, we see that progress has at best been mixed. While many of the fundamental conditions are in place for a European renaissance, there has simply not been enough delivery at European and national level. This is not just a question of difficult economic conditions since Lisbon was launched, it also results from a policy agenda which has become overloaded, failing co-ordination and sometimes conflicting priorities. **For some this suggests that we should abandon the ambition of 5 years ago**. The Commission does not agree. The challenges we face are even more urgent in the face of an ageing population and global competition. Unless we reinforce our commitment to meeting them, with a renewed drive and focus, our model of European society, our pensions, our quality of life will rapidly be called into question.

The need for urgent action is confirmed by the report from the High Level Group chaired by Wim Kok last November. It identifies a daunting challenge. According to Kok, *"The Lisbon strategy is even more urgent today as the growth gap with North America and Asia has widened, while Europe must meet the combined challenges of low population growth and ageing. Time is running out and there can be no room for complacency. Better implementation is needed to make up for lost time".* Faced with this challenge Europe needs to improve its productivity and employ more people

On current trends, the potential growth of the European economy will halve over the coming decades and reach just over 1% per year. Europe's performance has diverged from that of our competitors in other parts of the world.

Their productivity has grown faster and they have invested more in research and development. We have yet to put in place the structures needed to anticipate and manage better the changes in our economy and society. And we still need a vision for society which can integrate both the ageing and the young, particularly for the development of our workforce, where current dynamics cast a shadow over both long-term growth and social cohesion.

The Commission has risen to this challenge in presenting it proposals for the Union's Strategic Objectives, '*renewed growth is vital to prosperity, can bring back full employment and is the foundation of social justice and opportunity for all. It is also vital to Europe's position in the world and Europe's ability to mobilise the resources that tackle many global different challenges*'.

We need a dynamic economy to fuel our wider social and environmental ambitions. This is why the renewed Lisbon Strategy focuses on growth and jobs. In order to do this we must ensure that:

- **Europe is a more attractive place to invest and work**
- **Knowledge and innovation are the beating heart of European growth**
- **We shape the policies allowing our businesses to create more and better jobs**

Making growth and jobs the immediate target goes hand in hand with promoting social or environmental objectives. The Lisbon Strategy is an essential component of the overarching objective of sustainable development set out in the Treaty: improving welfare and living conditions in a sustainable way for present and future generations. Both Lisbon

and the Sustainable Development Strategy contribute to ensuring this goal. Being mutually reinforcing, they target complementary actions, use different instruments and produce their results in different time frames.
The Commission is fully committed to sustainable development and to modernising and advancing Europe's social model. Without more growth and jobs this will not be possible. Our Sustainable Development Strategy and our Social Agenda have been under review and proposals, ahead of the Spring European Council, will be presented in the coming weeks. In addition, we have to continue working with our international partners to address global macro-economic unbalances, as boosting growth is as beneficial to our partners as to the Union.
"Lisbon" therefore requires immediate action and the case for acting together in Europe is strong.
The costs of not doing so are large and quantifiable. The 'costs of non-Europe' have been substantiated through a large volume of academic evidence. One can argue with the figures.
But not achieving "Lisbon" does have a cost. The best evidence can be found in the widening gap of Europe's growth potential compared to other economic partners. However, the potential gains from wider and deeper economic integration in an enlarged Europe are massive.
This mid-term review sets out how we can help Europe to meet its growth and jobs challenge.
It launches the idea of a Partnership for Growth and Jobs, supported by a Union Action Programme and National Action Programmes containing firm commitments. It builds on three central concepts:
− First, **Europe's actions need more focus**. We must concentrate all our efforts on delivering on the ground policies that will have greatest impact. This means keeping existing promises, building on the reforms already underway in every Member State and launching new action where it is needed to keep us on target. It requires a rigourous prioritisation on the part of the Commission and must be anchored in the firm support of the European Council and the European Parliament.
− Second, we have to **mobilise support for change**. Establishing broad and effective ownership of the Lisbon goals is the best way to ensure words are turned into results. Everyone with a stake in Lisbon's success and at every level must be involved in delivering these reforms. They must become part of national political debate.
− Third, we need to **simplify and streamline Lisbon**. This means clarifying who does what, simplify reporting and backing up delivery through Union and National Lisbon Action Programmes. There should be an integrated set of Lisbon "guidelines" to frame Member State action, backed up by only one report at EU level and only one report at national level presenting the progress made. This will significantly reduce the national reporting burden placed on Member States.
All this must be set against the backdrop of wider reforms. Our ambition for change must be matched by the necessary resources at both EU and national level.
Sound macroeconomic conditions are essential to underpin a credible effort to increase potential growth and create jobs. The changes proposed to the European Union's stability and growth pact – the rules at EU level that govern national budgetary policies – should further stabilise our economy, while ensuring that Member States can play a full role in creating conditions for long-term growth.
At a European level, the debate on the future financial framework for the Union up to 2013 ("the Financial Perspectives") must draw the consequences of our Lisbon ambition, supporting Lisbon priorities within the future EU budget. We must provide the support and investment a modern, knowledge-economy needs, use our resources in ways which help us to adapt to changing economic and social conditions, and operate programmes which provide the right incentives for Member States to focus their own national public spending on Lisbon objectives. The Commission's proposals for the Financial Perspectives reflect these priorities.
If we can match ambition, resources and good ideas; if we can transform them by the end of the decade into lasting change on the ground; and if we can support Lisbon by closing

> the gap on investment in our economy and launching a new drive for stronger cohesion across our continent then we can bring our Lisbon goals back into sight.
> This is the new start that Europe needs."[139]

The Commission continued, therefore, to hold high expectations. It refused to abandon the ambitious goals set five years earlier, and prepared its fresh start. The key to success lied in perseverance and unity. The Member States, European institutions, governments, and regional and local administrations had to find an effective formula to coordinate their initiatives and actions.

Their joint efforts would allow them to make the urgent and necessary steps discussed by the Kok Report and advance toward the preset targets by 2010. Europe had to swiftly get back on track following the spirit of *realistic optimism* which still permeated the Union. The ambitious project that had been crafted just few years before, at the time, was considered far from failure; not achieving the Lisbon goals could cause the gap between the Union and its competitors to widen irreparably.

In order to attain the necessary levels of progress and catch up, the key areas which had been discussed in the previous years were given renewed attention. Great energies were placed in the process of improving and consolidating all the European strategies.

4.1 Major areas in need of renewed attention

Bearing the importance of cohesion and coordination in mind, the Commission outlined the necessary actions to be taken to obtain a fresh start in the race toward reaching the Lisbon goals on time:

> *"The renewed Lisbon Strategy – what will change?*
> The Commission proposes a new start for the Lisbon Strategy, focusing our efforts around two principal tasks – **delivering stronger, lasting growth and creating more and better jobs**. Meeting the Europe's growth and jobs challenge is the key to unlocking the resources needed to meet our wider economic, social and environmental ambitions; meeting those wider goals will anchor the success of our reforms. For this to be possible, sound macroeconomic conditions are crucial, in particular the pursuit of stability-oriented macroeconomic policies and of sound budgetary policies.[140]
> This Report does not attempt to rewrite the Lisbon strategy, but it does identify new actions at European and national level which will help to see our Lisbon vision is achieved."[141]

The focus remained placed on SMEs, which never ceased to be considered the key element in achieving success:

> "Action here is of **particular importance for Europe's small and medium sized businesses (SMEs)** which constitute 99% of all enterprises and two third of employment. There are just too many obstacles to becoming an entrepreneur or starting a business, and, therefore, Europe is missing opportunities. Encouraging more entrepreneurial initiative implies promoting more entrepreneurial attitudes. The balance between risk and reward associated with entrepreneurship should be reviewed. The stigma of failure complicates a fresh start and even deters many from starting a business in the first place. Finally, in Europe, despite progress during the first five years of Lisbon, there is still insufficient risk capital available to start up innovative young businesses and current tax rules discourage the retention of profits to build up equity."[142]

Focus was therefore also placed on the effective implementation of the Charter for Small Enterprises:

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[139] **(2005) COM 24 Final**, "*Communication to the spring European Council – Working together for growth and jobs – A new start for the Lisbon strategy – Communication from President Barroso in agreement with Vice-President Verheugen*" – Foreward-.
[140] *Id.,* at 7.
[141] *Id.*
[142] *Id.* at 16. See also **Resolution of the Committee of the Regions on revitalising the Lisbon strategy** (2005/C 164/13)

> “The Charter helps focus the attention of policy-makers at the highest level on the need for continuous improvement, not least through learning from each others’ best practices. The new Member States have been particularly active in learning from others and early results demonstrate that this approach is successful. The Charter is an effective tool to bridge performance gaps in the EU, even though the real impact on the small business environment sometimes takes considerable time to show.”[143]

Nevertheless, several actions had to be re-launched, renewed and improved. For example, although positive developments had been achieved up to that point in the area of entrepreneurship education, the general framework continued to lack the levels of uniformity needed to effectively support growth in the number of quality of SMEs:

> “Developments show a dynamic picture for entrepreneurship education. However, coherent framework is still missing in many cases. As entrepreneurship education has a horizontal dimension, a necessary first step is establishing formal links between different sectors of the public administration, notably Ministries of Economy and Education, with the aim of setting up a global strategy. Such cooperation already exists in several countries, including **France, the Netherlands, Finland and Norway**. Recent steps in this direction have also been taken by some of the new Member States, in particular **Lithuania**.”[144]

The steps taken to alleviate both the burdens caused by dissonant legal frameworks and the weight of excessive legal and administrative requirements had proven insufficient and needed immediate improvements:

> “The over-proportional negative effects on small businesses are hardly ever assessed. Only seven countries carry out tests on impact on small enterprises. Exempting small enterprises from certain regulatory obligations, as proposed by the Charter, can also be useful in alleviating the burden on small enterprises. However, only a few countries allow such exemptions.”[145]
>
> **“Candidate countries: The need to promote entrepreneurial skills and improve the legal framework**
> The main challenge for the candidate countries is to improve the competitive performance of their enterprises. For **Bulgaria and Romania**, part of the challenge is to improve the legal framework and favor the creation and growth of new enterprises.”[146]

So did the process of refoundation of insolvency frameworks, which, despite several reforms that took place at the local level, still required great improvements[147]:

> “During the past year, half of the Member States have either reviewed national bankruptcy laws or are in the process of doing so. An interesting recent example is **Spain**, which has substantially improved its insolvency law. As for rescue and restructuring procedures aiming at the survival and continuity of viable enterprises, they do not exist in all countries and, where they do, they usually need improvement. The new **French** bill for rescuing enterprises, which aims at early detection of financial difficulties and promotes a second chance, and the **Dutch** project *Debt restructuring for entrepreneurs,* which aims at

[143] **(2005) COM 30 Final**, “*Communication from the Commission to the Council and the European Parliament – Report on the implementation of the European Charter for Small Enterprises*”, at 4.
[144] *Id*., at 5.
[145] *Id.,* at 6.
[146] *Id*., at 7.
[147] See Chapter III, for example, discussing the process that brought to the enactment of the first cross-border Regulations.

> streamlining the process of extrajudicial debt restructuring, are promising recent developments."[148]

The midterm checkpoint of 2005 was, therefore, a more significant step in the development of European strategies than could have been anticipated. It was not a mere occasion to verify the status of the process of reform, but the time to reorganize the troops, renew efforts, and reset actions before the situation, which was already critical after the initial false start, became irreparable.

Europe had by then clear evidence of the fact that too many targets had already been missed. Much had changed in just five years; a "decisive shift" [149] was absolutely necessary for the Union to get back on its feet and in the race with the other major economies frantically competing in the globalized market.

4.2 The "decisive shift"; "Time to move up a gear"

In 2005 much had changed; the potential of an enlarged Europe was not anymore taken for granted. Just five years after the grand goals at Lisbon had been set, it was widely acknowledged that much had to be accomplished to keep on track and follow the original plan. European institutions still shared a feeling of optimism about the future, though, and accepted the challenge with great determination:

> **"Time to move up a gear.**
> Last year saw a decisive shift in the European Union, with a new momentum agreed for growth and jobs. In 2005, the logic that our common challenges need common responses was recognised as never before. The renewed Lisbon strategy showed how a European growth and jobs strategy could be, and must be, more than the sum of its parts. The meeting of European leaders at Hampton Court made clear that Europe is indispensable in the search for solutions to global problems. There was full support for the European Commission's analysis of the challenges ahead, and for an ambitious framework for tackling them. All agreed that the potential of the enlarged Europe could not be taken for granted – action is needed to exploit that potential to the full and to secure sustainable development into the future. This emerging consensus has again been shown in the national reform programmes prepared by every Member State. They add up to a promising start for the new approach. Now the momentum needs to be stepped up and the national programmes put into action.
> What are the most urgent steps needed? We need more research and development, with more efficiency and better coordination. We need to work together on a European scale to ensure that research is translated into innovative products and services, which feeds into growth and jobs. For our companies, particularly small and medium-sized companies, to compete successfully on an increasingly competitive global market, they must be able to draw strength from a European-wide home market. A market free of barriers and red tape, where rules are predictable and where dynamic companies can prosper.
> We need more people in work to finance pensions and health care as populations get older.
> We need a lifecycle approach to work. Young people need help starting their working lives.
> Parents need affordable childcare and a decent work-life balance. And we cannot afford to have people drop out of the labour market when they are in their fifties.
> We have been reminded in recent times, in various ways, of the importance of energy to our economies. We cannot afford to waste it. We need to get more of it from renewable, nonpolluting sources. And we need security of supply at affordable prices. Competition can help here too. But Europe also needs to speak with one voice in ensuring supply from beyond its borders.

[148] **(2005) COM 30 Final**, "*Communication from the Commission to the Council and the European Parliament – Report on the implementation of the European Charter for Small Enterprises*", at 6-7.
[149] **(2006) COM 30 Final**, "*Communication from the Commission to the Spring European Council – Time to move up a gear – The new partnership for growth and jobs*", at 2.

So we know what we are aiming for, and we know how to get there. But now for the difficult part: turning good intentions into action. Reform needs to be the guiding principle for national as well as European economic policy. It is vital that Member State and EU measures complement each other to create a powerful growth and jobs engine. This is our common responsibility, and the job is not finished until every worker, every business, every consumer can enjoy the benefits of reform.

The first year of the strategy has offered real hope that progress towards economic reform is under way, that Europe is on the move. If we can redouble our energies and make reform our top priority, the renewed Lisbon strategy will be seen as a genuine turning point towards growth and jobs in Europe. It is up to us all to make that happen.

It is time to move up a gear.

José-Manuel Durão Barroso"[150]

Armed with renewed courage the Union moved forward in the process of improvement and consolidation of its strategies and programs in all areas:

"The programmes must be strengthened so that reform covers all the key policy areas for growth and jobs in all Member States. As the meeting of European leaders in Hampton Court has shown, there are key areas where Europe could make a difference, where implementing bold decisions will give a new impetus to reform:

• A decisive leap in investment for research and innovation will realise Europe's potential to offer the goods and services citizens will want. This needs more public investment, with existing spending shifted to research and innovation and with better coordination between Member States. Just as importantly, the environment must be right to carry research through to innovation and to spur growth: the fruits of research excellence must not be squandered by unnecessary barriers to commercial use or by tying the hands of the universities.

• Unlocking Europe's business potential means creating a business climate that encourages businesses to start and to grow. Europe must have the confidence to let entrepreneurs flourish by clearing the way for new businesses. Governments must be ready to help smooth the path for businesses at every stage of their development, with less red tape to help SMEs develop at home and cross-border, as well as positive action to ease access to the finance they need.

• An ageing population means that European society must be ready to help more people to work, to work longer, and work in a way that uses their talents to best effect. That means employment policies that help people to find jobs at every stage of their working lives and remove barriers for those who wish to work. People need the right skills at the right time, they need help in facing change and finding new openings, and they need to be able to fit the demands of work into the rest of their lives.

• A secure, affordable energy supply is a crucial springboard for growth. But energy is a finite resource to be shepherded with care. A European energy policy is needed to offer a real internal market, to maximise the benefits of energy efficiency and renewables, and to safeguard supply inside EU borders and beyond. National experience shows what is possible, and what needs to be done. Member States should exploit this potential and do more to draw lessons from their partners. Alongside full delivery of the national programmes, the next steps should centre on key actions to maintain the momentum:

• The Commission calls upon the European Council to commit themselves to a series of precise, time-limited actions across all these areas: on research and education spending, on the ease of starting and running a business, on helping the jobless to find work, on childcare, on an integrated energy policy in Europe. Citizens, workers, entrepreneurs must feel that public policy is designed to help what they are trying to achieve, not to hold them back.

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[150] **(2006) COM 30 Final**, "*Communication from the Commission to the Spring European Council – Time to move up a gear – The new partnership for growth and jobs*", at 2.

• Efforts to build a real national consensus behind the programmes should be stepped up. The EU institutions and the Member States should ensure that a dedicated communication strategy should be established involving all."[151]

Relevant steps were made toward the creation of a modernized, integrated, internal market which could better compete in a globalized arena:

> "This commitment was given further weight by agreement on the integrated guidelines for growth and jobs, which provide a clear roadmap for the design of national reforms, and by the informal meeting at Hampton Court in October. At Hampton Court, EU leaders analysed how European values can underpin modernisation in our economies and societies and help us to tackle key challenges in a distinctively European way. And at the end of last year, the agreement in the European Council on the financial perspectives meant another step forward: once finalised with the European Parliament, this will open the way to new investment to modernise the European economy."[152]

The growth in numbers and quality of SMEs was supported through continuous attempts to implement a positive attitude towards entrepreneurship and by improving and reforming the existing laws and regulations:

> "Regarding SMEs, most programmes do not go far enough to foster a more positive attitude towards entrepreneurship and to encourage more people to start their own business. There is an important role here for education, for making it easier to transfer existing businesses, and for reducing the stigma of failure. Additional measures regarding access to finance or related targeted measures to improve investment should also be considered.
> • Better regulation is crucial to creating a more competitive business environment and removing obstacles to innovation and change. Nearly all Member States address parts of this agenda, but in many cases, a more integrated approach is necessary. Action at Community level is necessary, but will not in itself be sufficient. Much of the rule-making affecting business, for example in taxation, social security or regional planning, is done at national (or local) level. There are also important differences in the way Community directives are implemented by Member States, which may give rise to administrative costs which the Community measure itself does not require. To see a real difference in the business environment, a culture change in the way decisions are prepared and taken will be needed."[153]

At such a decisive time, the process of refounding European insolvency regulations gained even more strategic relevance. The Union had to hurry in tackling the two main barriers that limited the effectiveness and efficiency of the its insolvency scenario at the local and at cross-border level: stigma, which lowered the levels of entrepreneurship and weakened the growth of SMEs; and the lack of uniformity among local regulations, which decreased the levels of transparency and predictability and hence deterred cross-border investments.

4.2.1 The stigma of failure under the renewed Lisbon strategy: integrating (and boosting) "second chance" policies within the European insolvency scenario to increase entrepreneurship levels and support the market

In 2007 the Commission published Communication Number 584, entitled "Communication from the European Social and Economic Committee and the Committee of the Regions - Overcoming the stigma of business failure – For a second chance policy - Implementing the Lisbon Partnership for Growth and Jobs".

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[151] *Id.,* Executive summary, at 3-4.
[152] *Id.,* at 6.
[153] *Id.,* at 12.

This relevant document presented a thorough analysis of the role of insolvency laws within the Lisbon Strategy.

Modern businesses had to be "flexible" to be competitive. Hence, modern bankruptcy frameworks had to understand the new scenario and support honest re-starters in their efforts to compete. Over a third of the Member States were active in reforming their laws[154] at the time and their focus had to be directed toward developing effective "second chance" policies[155]. Despite the actions developed to bring change in previous years, several factors still contributed to make bankruptcy hell for businesses.

The Communication focused on several key points, such as:

- The inherent relationship between entrepreneurship and a certain degree of failure, which should lead to a different, ameliorative treatment to honest debtors;
- The lack of effective support for re-starters;
- The need to improve the perception of bankruptcy within the media;
- The importance of reducing burdensome disqualifications for honest debtors and actively supporting re-starters.

[A] "Renewed" actions: Fighting the "stigma" – accepting the inherent risks of business activities

Fighting the stigma of failure remained a key priority. Seven years into the development of the Lisbon Strategy, stigma remained strong and, despite the actions and initiatives launched in previous years, it still deeply permeated European society. The Communication pointed out several important factors underlining the need to remove archaic views on insolvency and accept the inherent risks connected with business activities:

> "**Entrepreneurship** is inherently risky and it requires self-confidence and autonomy as well as a certain readiness for risk-taking, as business creation, business success and business failure are inherent to the reality of the market economy. However, as part of the general lack of societal appreciation and understanding of entrepreneurship, business distress or even business failure is not yet sufficiently understood as a normal economic development and an opportunity for a new start.
> The Commission considers that a more supportive environment for businesses at risk may prevent failure. Furthermore, addressing the negative consequences of business failure when it occurs and its negative image would help **make the best possible use of human creativity in Europe**, boost entrepreneurship and promote innovation and job creation. It

[154] **(2006) COM 816 Final**, "*European Commission Annex to the Communication from the Commission to the Spring European Council: Implementing the renewed Lisbon Strategy for Growth and Jobs – 'A year of delivery'*", 7-10.

[155] See **(2007) COM 584 Final**, "*Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions – Overcoming the stigma of business failure – for a second chance policy – Implementing the Lisbon Partnership for Growth and Jobs*": "The Commission has started addressing the need for a new policy to tackle the issue of business at risk and the negative effects of business failure since 2001 and, subsequently, as part of the **Entrepreneurship Action Plan**. It renewed its commitment to such a policy in the **Modern SME policy**, launched in 2005. In particular, the Commission has flagged the need to improve bankruptcy procedures. Given its limited competencies in the area the Commission has limited itself to collecting data on the legal and social consequences of business failure, facilitating the identification and dissemination of good practices and recently to working on early warning tools as a means of reducing the stigma of failure. This has helped trigger reform across the EU and many Member States have already drawn some inspiration from the good practices and policy conclusions collected at European level.
There is in many EU countries – although to varying degrees – a **policy commitment** at the level of national and regional authorities to address the issue of business failure and promote fresh starts. In the context of the renewed Lisbon Strategy, around one third of the Member States have put forward plans to reform the national insolvency legislation in their National Reform Programmes. As a result, progress has been made in **improving insolvency law**: half of the Member States have taken measures to reduce the discharge periods, remove restrictions or streamline bankruptcy proceedings (see Annex). The UK addressed most issues already in 2002. Spain and Italy introduced similar measures in their laws more recently. However, almost half of the EU countries still need to take the first steps in this direction. Also, no Member State has yet set up a **comprehensive strategy** for a second chance policy – only Austria has announced new plans for 2008. Indeed, there is still room to go further to foster a more positive attitude towards entrepreneurship, to encourage more people to start up and to reduce risks and the stigma of failure", at 5.

> would also help **foster a more favourable societal climate** in Europe towards entrepreneurship where only fraudulent and criminal behaviour is punished. Member States and the business community are therefore invited to further work on a supportive environment for entrepreneurs at risk and those who have experienced a business failure with a view to turning the EU into a more dynamic place for entrepreneurship and second chance."[156]

Honest, natural failures could not anymore be perceived by the general public as a reason for shame without causing excessive and unnecessary negative repercussions to the European economy. The document, in fact, confirmed that the number of fraudulent bankruptcies was too limited to justify the levels of social affliction present in European societies:

> "Out of all company closures, bankruptcies account for some 15%, while 11 to 18% of all company creators have experienced some failure. Even though there is a natural correlation between the business cycle and the number of insolvencies, bankruptcies also happen in periods of high GDP growth. There is a strong case for believing that bankruptcy is in essence a direct consequence of entrepreneurial renewal: only 4-6% of bankruptcies are fraudulent.
> However, the role of business failure in economic life is not well understood in our society. Public opinion makes a strong link between business failure and personal incapacity or fraud. In the EU, stigma is present in the business environment, the legal framework and also in cultural and societal behaviour. This creates unnecessary hurdles to entrepreneurs who wish to restart. Despite existing knowledge of restarters' performance, customers and financiers are reticent to place orders and invest. 79% of EU citizens affirm that they would give a second chance to those who have previously failed. But attitudes change when it comes to "practice": 47% of Europeans would be reluctant to order from a previously failed business; 51% of them would never invest in businesses in financial difficulties."[157]

Approaches to insolvency had, therefore, to be modified to strengthen their capacity to support flexible players within a mutable market:

> "50% of enterprises do not survive the first five years of their life. The yearly average death rate of companies in the EU-25 is 7%. Economic literature see business closure as an element compatible with economic development in a global economy, something also recognised in the Charter for small enterprises. A low survival rate is thus not necessarily a cause for concern – entry by new firms is part of the process whereby entrepreneurs react to market reality. A recent OECD study shows that survival rates of companies over a four-year period appear to be even lower in the US than in continental European countries, illustrating that the death of companies can be compatible with **economic dynamism**. There is reason to believe that increasing global competition is forcing entrepreneurs to react more rapidly and more flexibly, even by closing their business and opening another one. The data confirm a high correlation between entry and exit rates in both the EU and the US, suggesting a continuous process of creative destruction by which low productivity firms exit the market and are replaced by new ones."[158]

The concept of failure had to be rethought. It had to cease being a death sentence for all entrepreneurs, honest and dishonest alike. As many debtors as possible had to live through their mistakes and make a positive learning experience out of them so that the whole market could be healthier:

> "Finally, while being part of economic life, insolvency has a negative impact on jobs, consumers and public and private creditors. In 2006, some 135 000 company insolvencies

[156] *Id.*, at 3.
[157] *Id.*
[158] *Id.*

> in the EU-15 threatened the jobs of 1.4 million employees (1.5 million in 2005) and the number of personal insolvencies amounted to more than 237 000 in Germany and the UK alone. The same year in Austria outstanding debts to employees represented 243 million euros. As regards other unpaid debts, in Germany 50% of debtors were active enterprises and self-employed. In France, where the yearly estimated costs of insolvency proceedings are 13.7 billion euros, some 55-60% of unpaid debts are due to tax and social security authorities and banks, this percentage being 70-80% in the case of bankrupt services companies. Unpaid debts in Germany amounted to 31.1 billion euros in 2006 (37.5 in 2005; 39.4 in 2004), in Italy 9.6 billion in 2004, in Finland 1.37 billion in 2003. The wide range of costs that bankruptcies entail would be reduced if businesses at risk were better assisted and, in case of bankruptcy, a fresh start was facilitated."[159]

As a first step, the Communication mentioned the need to raise awareness on these relevant topics within the public image and the media:

> "The first step to tackle the negative effects of business failure is to publicly discuss it, address the entrepreneurs of the future and raise **awareness** of the benefits of renewed entrepreneurship. Research indicates that **cultural support** (e.g. through promotional campaigns) is positively linked to the amount of entrepreneurial activity in the EU.
> Many young people never become entrepreneurs in the end. Entrepreneurship education is a fundamental means to materialise their entrepreneurial spirit and make them aware that business failure is the starting point of a new beginning. Nowadays Europeans are reluctant to take up opportunities for self-employment and entrepreneurial activities and are clearly **afraid of bankruptcy**. National lifelong learning strategies can play a key role in developing and updating entrepreneurial and business skills.
>
> | A Dutch booklet presents seven cases where entrepreneurs share their own experience about bankruptcy and explain how they became successful restarters. It can be downloaded from the website of the **Dutch** Ministry of Economic Affairs. |
> |---|
>
> In the EU **the general public** often perceives bankruptcy as a criminal affair, no matter the cause. **The media** have a positive role to play in tackling this misperception and in disseminating information on the benefits our society can derive from the experiences of failed entrepreneurs. So do relevant awards.
>
> | In the last two years in **Germany** there has been a START AWARD with a category called RESTART. Sponsored by the two public support banks and a regional start-up support agency, it was given to honest entrepreneurs who learned from business failure and succeeded with their second start-up. Mainstream media were eager to report more on the topic. |
> |---|
>
> *Lessons to be learnt*
>
> - *The benefits of a fresh start should be put forward in information campaigns and education programmes, showing that making several attempts goes hand in hand with a normal learning process, research and discovery.*
> - *The media can play a role in dissociating bankruptcy and fraud and disseminating the benefits of renewed entrepreneurship, thus improving the image of business restarters among the public at large and valuing their experience.*
> - *Further discussing the issue with all relevant actors should help uncover the many facets of stigma surrounding business failure."*[160]

Then it focused on creating an environment of trust and on structuring organic reforms to embody second chance policies within modern European frameworks.

[159] *Id.*, at 5.
[160] *Id.*, at 6

[B] Renewed actions: creating an environment of trust through effective "early warning" systems

Due to the fear of incurring heavy punishments and what we may term the "social weight" of the stigma, debtors still tended to delay action. They avoided sharing the details of their difficulties and they did not look for expert advice.

Structuring effective early-warning tools could allow debtors to solve their difficulties before the situation became irreparable:

> "The stigma of business failure is one reason why many SMEs in financial trouble conceal their problems until it is too late. Timely action is crucial to avoid bankruptcy and a rescue is in many cases preferable to liquidation. This is why the legal systems of countries like France, Estonia, Spain, Malta or Italy now opt rather for restructuring and business continuity.
> Many entrepreneurs often lack the necessary resources and experience for successful crisis management. If mistakes occur at this stage, or if there is no proper advice available in time, bankruptcy can become inevitable.
>
> | Denmark is introducing a pilot "early warning system" modelled on the Dutch Ondernemersklankbord. With 4-year funding, this system will help viable enterprises that are headed for insolvency owing to temporary problems by giving them practical know-how and advice. |
> |---|
>
> Early warning tools can be of many kinds, ranging from on-line resources, through relevant publications to more direct involvement of those actors who are better equipped to follow the financial situation of businesses. Additional funding to overcome an unstable period can also be crucial. To help entrepreneurs assess their financial health at an early stage, the Commission has put a self-assessment tool on-line.
>
> | In the reminders for VAT non-payment, France includes information on where entrepreneurs who are facing financial problems can seek advice. Also, entrepreneurs can take out an insurance policy covering expenses (legal advice and mediator fees) for settling debts at an early stage. |
> |---|
>
> Lessons to be learnt
>
> - The number of insolvencies cannot be reduced to zero, but early support for viable enterprises will help keep insolvencies to a minimum. Support measures should focus on bankruptcy prevention, expert advice and timely intervention.
> - Attention needs to be paid to the accessibility of support, as businesses at risk cannot afford expensive advice.
> - The networking opportunities offered by the EU and European business organisations should be fully exploited.
> - Insolvency laws should provide an option to restructure and rescue rather than focus solely on liquidation."[161]

[C] Renewed actions: reforming insolvency frameworks to provide a meaningful and effective second chance

Insolvency frameworks had to be redrafted to offer ample support, effective rescue measures and education schemes to rehabilitate debtors:

> "The main constraints entrepreneurs face when setting up a second venture – resources, relevant skills and psychological support – are not sufficiently addressed by public support. Being **alone** as an entrepreneur is among the top four difficulties when starting up.
> In general, fresh starts are deterred because of the lack of resources to set up a new business, notably of **financial means.** Often restarters plan to start with less capital than other new starters, plan businesses with relatively few employees and choose a limited company as legal form. During the early months of their start-up their main problems are finding clients and customers, liquidity and obtaining public financial support.

[161] *Id*., at 8-9.

> In Saxony (**Germany**), SMEs that, in the context of insolvency proceedings, prove their ability to reorganise can obtain funding from the Public Development Bank of Saxony with a view to drawing up an insolvency plan, continuing in business and starting afresh once the insolvency proceedings are closed.
> It is vital to ensure that bankrupts take stock of their experience and are then well **trained** for their new business. The existence of entrepreneurial role models, being mobile and having a higher education would increase the probability of starting anew. Also younger exentrepreneurs are much more likely to be renascent entrepreneurs than are older ones. These are some common trends, but the needs of restarters are rather singular and require a flexible approach when designing support measures.
> Since 2004, **Luxembourg** has offered some non-fraudulent bankrupts a tailor-made training course on management issues to better equip them for their fresh start.
> Bankrupts can lose confidence in their own capabilities and be emotionally affected. Specific professional and psychological **advice** on how to overcome bankruptcy is then crucial. Reentry into the business community would also be facilitated by matching restarters with market niches, new partners and potential investors.
> The **French** association Re-créer, created in 1999 with the backing of the French Chamber of Commerce and Industry and the French Association of Bankers, works on boosting the confidence of restarters who underwent business failure."[162]

The Communication made suggestions on measures that should been taken to cure all such weaknesses. The process of refounding European insolvency frameworks should effectively support bankrupts so that they could find new opportunities to redeem themselves while empowering the whole community:

> **"**Good national **framework conditions** for entrepreneurship are crucial to the full exploitation of the EU's entrepreneurial potential and to the creation of dynamic companies. The **societal appreciation** of successful entrepreneurship, vital to this end, should go hand in hand with a policy of **promoting a second chance** for entrepreneurs who are at risk or have failed.
> Consequently, the Commission invites EU countries to engage more vigorously in reducing the stigma of business failure as part of their commitment to promote entrepreneurship under the Growth and Jobs Strategy and within the context of a comprehensive entrepreneurship policy. The Commission will continue to support the Member States' efforts by raising the visibility of national good practices. To speed up the pace of reforms, the Commission will also provide communication material to be used for campaigns in order to promote a better image of business failure."[163]

In conclusion, with the above mentioned official document, the Commission attempted to bring a decisive shift in the refoundation of European insolvency frameworks. It promoted the adoption of the so-called "second chance policy" and proposed substantial modifications to the existing status quo based on the data collected over the past years to support the challenges of the renewed Lisbon Strategy.

The deadline of the first ten-year plan was approaching swiftly and much still had to be done.

What was unforeseeable at the time, though, was the fact that soon market conditions would greatly worsen. The subprime crisis[164] was about to burst, hitting stronger than any of the other crises that had affected the Community previously. The changes that the Community had supported in previous years and not yet realized would therefore soon become even more vital, urgent, and necessary.

4.3 Toward the end of the Lisbon strategy: the impact of the global financial crisis on the European path towards growth and the importance of coordinating actions

The biennium that closed the ten-year term of the Lisbon strategy was a very problematic one.

[162] *Id.,* at 9.
[163] *Id.*, at 10.
[164] See **Shiller Robert J**., "*The subprime solution-How today's global financial crisis happened, and what to do about it*", Princeton University Press, Princeton, New Jersey, USA, ISBN 9780691156323, (2012).

Although some progress was indeed made by Member States in the previous years[165], the targets that had been missed caused the gap with the US to remain wide:

> "In general, EU SMEs still have lower productivity and grow more slowly than their counterparts in the United States. In the US, surviving firms on average increase their employment by 60% by their seventh year, while employment gains among surviving firms in Europe are in the order of 10% to 20%."[166]

> "The euro, in particular, has proven to be an invaluable asset for the EU economies and an essential element of stability. Supported by the strong role played by the independent European Central Bank, the euro protects against destabilising exchange rate movements, which would have greatly complicated the national responses to the crisis."[167]

The maneuvers to bring a "decisive shift" were not sufficient nor fully successful.

Despite Europe's goodwill, the situation remained extremely problematic. The statistics on the number of cases commenced in bankruptcy (which were often used in official documents as an indicator of the bad health of the European market) were on the rise:

> "Bankruptcies account for some 15% of all company closures. Some 700.000 SMEs are affected on average every year, and some 2.8 million jobs are involved throughout Europe on annual basis. In the EU, the stigma of failure is still present and society underestimates the business potential of re-starters. Today 47% of Europeans would be reluctant to order from a previously failed business. At the same time, making a new start is complicated by lengthy bankruptcy proceedings. The average time to complete a bankruptcy in the EU varies between 4 months and 9 years."[168]

The general picture still was not clear as to the gravity of the global situation. At the time, both the Union and Member States were unable to foresee the magnitude, length, and impact of the challenges that would derive from the subprime mortgage crisis[169]:

> "Growth in the Union is close to zero, the European economy starts contracting and unemployment is on the rise; the Euro area and a number of Member States individually were already in recession with high risks for a worsening of the general situation in the following years."[170]

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[165] The EU has also implemented new strategies such as the one for better regulation aimed to reduce the administrative burdens for SMEs by 25% by 2012. See **(2008) COM 394 Final**, "*Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions – "Think Small First" – A "Small Business Act" for Europe",* at 1-2.

[166] *Id.,* at 2.

[167] **(2008) COM 800 Final**, "*Communication from the Commission to the European Council a – A European economic Recovery Plan*", at 4.

[168] See **(2008) COM 394 Final**, "*Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions – "Think Small First" – A "Small Business Act*" for Europe", at 7.

[169] The crisis was leading to unforeseen consequences, the gravity of the situation requested a coordinated international action. See on the topic **Shiller Robert J**., "*The subprime solution-How today's global financial crisis happened, and what to do about it*", Princeton University Press, Princeton, New Jersey, USA, ISBN 9780691156323, (2012); **Amato Massimo and Fantacci Luca**, "*Fine della Finanza – da dove viene la crisi e come si può pensare di uscirne*", Donzelli Editore, Roma, ISBN 9788860363855, (2009).
See also http://www.ilsecoloxix.it/p/italia_e_mondo/2008/09/16/ALllY74B-draghi_peggiori_storia.shtml

[170] **(2008) COM 800 Final**, "*Communication from the Commission to the European Council a – A European economic Recovery Plan*", at 4.

The Commission had, therefore, to take strong action to push Europe to react. In an emblematic communication published at the time, Members States were asked to coordinate their efforts, showing determination, imagination, and flexibility:

> ***"Acting in a coordinated way at EU level***
> The unprecedented crisis in international financial markets has created major challenges for the EU. Co-ordinated action at EU level by all 27 Member States has been effective in stabilising Europe's banking system. Implementation of measures has to be rapid so as to put much needed liquidity back into the financial system. But the financial crisis is not yet over and is already feeding into a serious downturn affecting the wider economy, hitting households, businesses and jobs. The shocks hitting the European economy are expected both to reduce the potential growth rate in the medium term and cut actual growth significantly in 2009 and 2010. As investment shies away from risk, productivity will be put under downward pressure and innovation may suffer. Europe's strength lies in its solidarity and our ability to act together. All Member States will be affected, albeit in different ways and to different degrees, and it is likely that unemployment will increase, demand will fall, and fiscal positions will deteriorate. Acting jointly means a more effective and credible response. In contrast, if each Member State acts alone, their efforts will fall short. There is also a risk of unwelcome spillover effects on other Member States.
> The fact that the EU was able to take collective action when the pressure on financial markets was at its most intense was central to the stabilisation of the banking sector. Coordinating national action inside a set of clear EU principles, complemented with direct EU action, proved to be the right approach. It was backed up with decisive, coordinated and effective action: at the EU level by the French Presidency of the Council, the Commission and the European Central Bank, and at the national level by the Member States, with full support and cooperation from the European Parliament.
> The EU should build on this success and decide to tackle the next stages of the crisis in a united, co-ordinated manner turning these challenges into opportunities; adding selected short term measures to the Lisbon Strategy for growth and jobs. This paper sets out a three part approach which will be developed into an overall EU recovery action plan/framework:
> - *A new financial market architecture at EU level*
> - *Dealing with the impact on the real economy*
> - *A global response to the financial crisis*
>
> This Communication is presented as a Commission contribution to ongoing debate inside the EU and with our international partners on how best to respond to the current crisis and its aftermath. On 26 November the Commission will propose a more detailed EU recovery framework, under the umbrella of the Lisbon strategy for growth and jobs, bringing together a series of targeted short term initiatives designed to help counter adverse effects on the wider economy and adapting the medium to long term measures of the Lisbon strategy to take account of the crisis."[171]

Europe had to fight the temptation to feel powerless:

> "A Europe ready to take swift, bold, ambitious and well-targeted action will be a Europe able to put the brakes on the downturn and begin to turn the tide. We sink or we swim together."[172]

and it had to (finally) act as one to exploit its full potential:

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[171] **(2008) COM 706 Final**, "*Communication from the Commission – From the financial crisis to recovery: A European framework for action*", at 2.
[172] **(2008) COM 800 Final**, "*Communication from the Commission to the European Council a – A European economic Recovery Plan*", at 2.

> "The EU needs to take effective action now to counter the crisis. This action needs to be smart so that it stimulates the right changes in our economy ensuring that we emerge from this crisis ready to take full advantage of the upturn when it comes. It can best do this if we seize opportunities to continue to restructure our economies, train and equip our citizens for new challenges while taking care of the most vulnerable people in our societies in the spirit of Article 2 of the Treaty. We know from past experience that our success is based on moving away from economic nationalism and that the drivers of European growth come from removing barriers between Member States, capitalising on the scale and strength of our Internal Market.
> The EU has faced different kinds of crisis in its history and has always managed to emerge from them stronger and more united. We have already shown that when our 27 Member States and the European Institutions decide to act together, we are able to get results and deliver for our citizens. The current crisis can also be an opportunity for Europe and the actions outlined in this paper show how we can work together to put the EU on the road to recovery."[173]

Several new initiatives were studied and enacted to organize the response of the Union and bring improvements. The European Economic Recovery Plan structured at the time, for example, was based on the coordination of national efforts to accomplish relevant targets. It proposed a counter-cyclical, macro-economic response in the form of an ambitious set of actions that would support the real economy. The strategic aims of the recovery plan were to:

> "Swiftly stimulate demand and boost consumer confidence;
> Lessen the human cost of the economic downturn and its impact on the most vulnerable. Many workers and their families are or will be hit by the crisis. Action can be taken to help stem the loss of jobs; and then to help people return rapidly to the labour market, rather than face long-term unemployment;
> **Help Europe to prepare to take advantage when growth returns** so that the European economy is in tune with the demands of competitiveness and the needs of the future, as outlined in the Lisbon Strategy for Growth and Jobs. That means pursuing the necessary structural reforms, supporting innovation, and building a knowledge economy;
> Speed up the shift towards a low carbon economy. This will leave Europe well placed to apply its strategy for limiting climate change and promoting energy security: a strategy which will encourage new technologies, create new 'green-collar' jobs and open up new opportunities in fast growing world markets, will keep energy bills for citizens and businesses in check, and will reduce Europe's dependence on foreign energy.
> In pursuing these aims, the European Economic Recovery Plan is designed to:
> Exploit synergies and avoid negative spill-over effects through co-ordinated action;
> Draw on all available policy levers, fiscal policies, structural and financial market reforms and external action;
> Ensure full coherence between immediate actions and the EU's medium- to longer term objectives;
> Take full account of the global nature of the problem and shape the EU's contribution to international responses."[174]

The Recovery Plan was structured on two key pillars, ten actions for recovery, and one underlying principle:

> The first pillar is a major injection of purchasing power into the economy, to boost demand and stimulate confidence. The Commission is proposing that, as a matter of urgency, Member States and the EU agree to an immediate budgetary impulse amounting

[173] **(2008) COM 706 Final**, "*Communication from the Commission – From the financial crisis to recovery: A European framework for action*", at 9.
[174] **(2008) COM 800 Final**, "*Communication from the Commission to the European Council a – A European economic Recovery Plan*", at 5-6.

to € 200 billion (1.5% of GDP), to boost demand in full respect of the Stability and Growth Pact.
The second pillar rests on the need to direct short-term action to reinforce Europe's competitiveness in the long term. The Plan sets out a comprehensive programme to direct action to "smart" investment. Smart investment means investing in the right skills for tomorrow's needs; investing in energy efficiency to create jobs and save energy; investing in clean technologies to boost sectors like construction and automobiles in the low-carbon markets of the future; and investing in infrastructure and inter-connection to promote efficiency and innovation.
At the same time, the ten Actions for Recovery included in the Plan will help Member States to put the right social and economic levers in place to meet today's challenge: to open up new finance for SMEs, cut administrative burdens and kick-start investment to modernise infrastructure. It will drive a competitive Europe ready for the low-carbon economy.
The fundamental principle of this Plan is solidarity and social justice. In times of hardship, our action must be geared to help those most in need. To work to protect jobs through action on social charges. To immediately address the long-term job prospects of those losing their jobs, through the European Globalisation Adjustment Fund and an accelerated European Social Fund. To cut energy costs for the vulnerable through targeted energy efficiency. To address the needs of those who cannot yet use the internet as a tool to connect."[175]

Smart investments gave impulse to efficient and innovative activities, but much was still to be done and achieved. The general situation continued to cause great concerns.

Growing levels of unemployment[176] forced Europe to think ahead in an attempt to build progress for the decades to come. A cure had to be found urgently; mere palliatives could not be of help anymore. The strategies to build growth continued to revolve around improving the levels of competitiveness among SMEs, which were ill equipped to face an even more arid and harsh economic environment, but could, if provided the necessary support, continue to represent the most relevant weapon in Europe's arsenal to invert negative trends:

"SMEs are competitive and innovative provided that they are allowed to do what they do best – their business."[177]

The Commission took action, publishing a specific Communication, Number 394 of 2008, entitled: "Think small first – a 'small business act' for Europe".[178] It was a key document structured to renew common efforts to support SMEs.

4.4 "Think small first": The Small Business Act for Europe

Despite the difficulties faced, the Union continued to address the issues connected to the transition toward a knowledge-based society. In the last years of the Lisbon Strategy, Europe kept setting ambitious policy agendas and proposing genuine partnerships between EU and Member States. The Small Business Act (SBA) of 2008, which embodied the "think small" principle, was a key part of this process.

The SBA recognized the central role of SMEs in the EU economy and aimed to boost the growth of EU's SMEs in order to create more and better jobs[179]:

[175] *Id.,* at 2-3.

[176] Unemployment will become one of the main areas of action of the "2020 strategy", as we will discuss in the next pages. On this topic we will also discuss the studies of frameworks to support the rehabilitation of over-indebted consumers or natural persons in general (see Chapters II, V, VI).

[177] **European Commission - Enterprise & Industry Directorate General**, "*Think Small First – Considering SME Interests in Policy-Making Including the Application of an 'SME test'*", Report of the Expert Group, (2009), at 4.

[178] See European Commission - Enterprise & Industry Directorate General, "Think Small First – Considering SME Interests in Policy-Making Including the Application of an 'SME test'", Report of the Expert Group, (2009).

> *"A 'Small Business Act' for Europe*
> The "Small Business Act for Europe" was adopted by the European Commission on 25 June 2008. It contains a set of common principles in ten different areas to make policies more SME friendly. The European Commission has also resolved to propose new legislation in four areas that affect SMEs in particular company law, taxes, competition and late payments.
> The SBA for Europe proposes a genuine political partnership between the EU and the Member States reflecting the political willingness to recognise the central role of SMEs in the EU economy and to put in place for the first time a comprehensive policy framework for the EU and its Member States. At the heart of the SBA is the objective to achieve the best possible framework conditions for SMEs based on the application of the "Think Small First" principle."[180]

At the heart of the "Act" was a special attention to the needs of small businesses – a further acknowledgment of the key role of the entrepreneurial spirit of European citizens within the economy of the Union. At a time of such great economic crisis and of skyrocketing unemployment rates, a positive attitude toward self-employment had to become a vital lifeline, pushing people toward becoming active developers of innovative ideas and thus fostering growth and economic prosperity for society as a whole[181]:

> "This is why the 'Small Business Act' aims to improve the policy approach to entrepreneurship, to irreversibly anchor the 'Think Small First' principle in policy-making from regulation to public service, and to promote SMEs growth by helping them tackle the remaining problems which hamper development"[182]

4.4.1 Lifting barriers preventing the development of small businesses

The SBA set ten principles, corresponding to an equal number of practical policy actions, to guide and coordinate efforts at both the EU and Member State level:

I- Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded;
II- Ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance;
III- Design rules according to the 'Think Small First' principle;
IV- Make public administrators responsive to the needs of SMEs;
V- Adapt public policy tools to SME needs, including facilitating the participation of SMEs in public procurement and better use of State Aid;
VI- Facilitate SMEs' access to finance and develop a legal and business environment supportive to timely payments in commercial transactions;
VII- Help SMEs to benefit more from the opportunities offered by the Single Market;
VIII- Promote the upgrading of skills in SMEs and all forms of innovation;
IX- Enable SMEs to turn environmental challenges into opportunities;
X- Encourage and support SMEs to benefit from the growth of markets.

To achieve such targets, the SBA aimed to find a solution to those great barriers that were already spotted in previous years but still could not be removed. Europe, at that point, was unable to:

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[179] **(2008) COM 394 Final**, "*Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions – "Think Small First" – A "Small Business Act" for Europe*", at 1.
[180] See European Commission - Enterprise & Industry Directorate General, "*Think Small First – Considering SME Interests in Policy-Making Including the Application of an 'SME test'*", Report of the Expert Group, (2009); at 7.
[181] **(2008) COM 394 Final**, *"Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions – "Think Small First" – A "Small Business Act" for Europe*", at 2.
[182] *Id.,* at 3.

1) Improve the dialogue with small businesses – the relevant difficulties caused by their great numbers, countless differences, and limited size still impeded the necessary levels of progress to be attained[183];
2) Effectively deploy the so-called "SME test", which aimed to provide an effective system to assess the effects of EU legislative proposals on SMEs. Determining beforehand the costs and benefits of policy options would have helped local and European authorities to 'Think Small' and to design actions would improve the business environment for SMEs[184]:

> "What is relevant is that any proposal that imposes or reduces the costs on business requires an SME Test that seeks to develop a policy proposal in a way that meets its objective, without unduly limiting or damaging opportunities for small businesses."[185]
>
> "Since 2005 The SME Test analyses the possible effects of EU legislative proposals on SMEs. By assessing the costs and benefits of policy options, it helps implement the 'Think Small Principle' and improve the business environment.
> The SME Test implements the 'Think Small Principle' through:
> - consultation with SMEs and SME representative organisations (SMEs, Envoys, EEN);
> - preliminary assessment of businesses likely to be affected;
> - measurement of the impact on SMEs (cost-benefit analysis);
> - use of mitigating measures, if appropriate."[186]
>
> **"2 The « SME Test »**
> **The SBA text**
> *The Commission will, and the Member States are invited to:*
> *- rigorously assess the impact of forthcoming legislative and administrative initiatives on SMEs ("SME test") and take relevant results into account when designing proposals*
> *- use specific measures for small and micro-enterprises, such as derogations, transition periods and exemptions, in particular from information or reporting requirements, and other tailor –made approaches, whenever appropriate*
> The SME test should be considered an integral part of any regulatory impact assessment. Impact assessment (IA) is a process aimed at structuring and supporting the development of new and amended policies. It identifies and assesses the issues at stake and the objectives pursued. It identifies the main options for achieving objectives and analyses their likely impacts in the economic, environmental and social fields. It outlines costs and benefits of each option and examines possible unintended consequences, synergies and trade-offs. Impact assessments are an aid to the *political decision* making process, not a substitute for it.
> It informs decision-makers of the likely impacts of proposals, but it leaves it up to them to take the decisions.
> What is relevant is that any proposal that imposes or reduces the costs on business requires an SME Test that seeks to develop a policy proposal in a way that meets its objective, without unduly limiting or damaging opportunities for small businesses.
> However, in certain cases, regulation might give priority to certain overarching societal goals (e.g. environmental protection, health and safety considerations etc.) over the direct interests of the SMEs, thus diluting the application of the "Think Small First" principle. It would then be appropriate to give the principle a broader interpretation and consider the use of specific provisions for SMEs. These measures would allow preserving the given overarching goal of the regulation while mitigating some of its effects on SMEs in respect with the principle of proportionality. There is no an exhaustive list of these types of

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[183] **European Commission - Enterprise & Industry Directorate General -,** "*Think Small First - Considering SME Interests in Policy-Making Including the Application of an 'SME test'*", Report of the Expert Group, (2009), at 8-10.
[184] See https://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act/sme-test_it
[185] **European Commission - Enterprise & Industry Directorate General** -, "*Think Small First - Considering SME Interests in Policy-Making Including the Application of an 'SME test'*", Report of the Expert Group, (2009), at 12-13.
[186] See https://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act/sme-test_it

measures but the most regularly used are: thresholds (or size-related exemptions), reduced obligations, simplified
reporting requirements, longer transition periods, reduced fees, and exemptions. Support measures to facilitate the implementation of given legislation, such as helpdesks, awareness raising and training activities, on-line services, etc. could also constitute part of the solution.[187]

In the UK, the **Small Firms Impact Test (SFIT)** becomes a mandatory part of the Impact Assessment (IA) process when a new or amended policy proposal imposes or reduces costs on business. The government's manifesto commitment in 2001 ensures the 'think small first' principle is followed as part of UK policy development and the UK's National Audit Office regards any IA for a measure bearing on business that lacks a SFIT as 'deficient'.

The SFIT is intended to provide sufficient guidance for policymakers, to confidently establish impacts on small businesses and how it is possible to minimise the impact of the requirements on small firms through flexibilities such as exemptions, simplified inspection, less frequent reporting etc. for businesses with fewer than 20 employees.

The process gained more "bite" in 2008, when Government announced that there would be greater public explanation for changes to both Primary and Secondary legislation, submitted to Parliament that would explain:

- If and why the legislation applies to small business
- What consideration has been given to minimise the impact of the requirements on small firms. For example: simplified inspection, less frequent reporting, exemptions etc
- The basis for the final decision on what action to take to assist small business and how it was reached.

The aim of these changes is to contribute to making legislation more effective and it also makes departments and other regulators accountable for their approach when regulating small firms, through a public explanation of the thinking behind the regulation and any measures adopted for them.

Policy-makers have discretion over exactly how to answer these questions, which are free text, as each instrument is likely to have different relevance for small firms. The purpose is to show that the Impact Assessment process has taken account of small firms Guidance on the UK's SFIT can be found by visiting the Department for Business, Enterprise and Regulatory Reform's website – www.berr.gov.uk/sfit.

On 1 January 2007 a new ordinance, the Regulatory Impact Assessment Ordinance
(2007:1244) on impact assessment of regulations came into force in Sweden. The ordinance replaced the Ordinance (1998:1820) on the special impact analysis of rules on small enterprises and Ordinance on Government Agencies an Institutes (1995:1322). The purpose of the new ordinance is to let the Swedish businesses have a chance to influence new regulations at an early stage. It states that guidelines for Impact Assessment in the Government Offices and for the Inquiry Committees are now mandatory.

Impact assessments address the social, environmental and economic impacts. The EU dimension of the regulation should be taken into account. Furthermore the administrative costs should be included in the assessment. Measuring the administrative costs for businesses is vital to regulatory simplification and is done in close cooperation with the business sector.

The SME perspective is given a special consideration in the ordinance and in the impact assessments. If the regulation is likely to significantly affect the operational conditions of enterprises, their competitiveness or other conditions, the impact analysis shall contain, to the extent possible, a description of the following:

1. the number of enterprises affected, the industries that these enterprises represent and the size of the enterprises,
2. the period of time required for the regulation to be implemented by the enterprises and how the regulation would affect enterprises' administrative costs,

[187] **European Commission - Enterprise & Industry Directorate General** -, "*Think Small First - Considering SME Interests in Policy-Making Including the Application of an 'SME test'*", Report of the Expert Group (2009), at 12.

3. the other costs to enterprises entailed by the proposed regulation and the changes in their activities that enterprises may need to make as a result of the proposed regulation,
4. the extent to which the regulation may affect the competitive conditions for the enterprises,
5. the way in which the regulation may affect the enterprises in other respects, and
6. whether particular account needs to be taken of small enterprises when designing the regulations.
Furthermore, a Regulatory Council, Regelrådet, has been set up. The Council will provide independent scrutiny of all proposals for new regulations that that could affect the working conditions, competitiveness or other similar conditions of businesses and of the impact assessments that should accompany all proposals. All regulators will have to submit their regulation proposals to the Council for a quality check. The Council will thus fulfill a similar function as the Dutch Advisory Board on Administrative Burdens (Actal) and the German National Regulatory Control Council.
In the European Commission, the SME test is an integral part of the revised in January 2009 Commission Impact Assessment Guidelines and does not stand as some separate analysis of the impacts on SMEs. A crucial element of the SME test is the consultation of small business representative bodies or SMEs themselves. The SME test requires that the interests of SMEs are taken into consideration at each of the analytical steps of an impact assessment."[188]

3) Reduce those administrative burdens which placed a disproportionate weight on small business entities. Measures and policies had to be carefully tailored to prevent disproportionate burdens on fragile economic actors:

"**The "Think Small First" principle and Better regulation**
The application of the "Think Small First" principle and the models and tools for better regulation are closely interlinked. Applying "Think Small First" implies regulating better. It is largely recognised that SMEs are one of the prime beneficiaries of the better regulation initiatives6. The *Third strategic review of Better Regulation in the European Union7* presents the progress in the field of simplification of legislative acts, administrative burdens reduction and regulatory impact assessments and their relevance for SMEs.
How is the "Think Small First" principle defined?
The definition of the "Think Small First" principle implies that policy makers give full consideration to SMEs at the early policy development stage. Ideally rules impacting on business should be created from the SMEs point of view or in other words, SMEs should be considered by public authorities as being their "prime customers" as far as business regulation is concerned. The principle relies on the fact that "one size does not fit all" but a lighter touch approach can also be beneficial to larger businesses. Conversely, rules and procedures designed for large companies create disproportionate, if not unbearable burdens for SMEs as they lack the economies of scale.
Designing policies and creating rules from the SMEs point of view would also seem logical since they represent the overwhelming majority of all businesses. Yet, this is far from being the case. Indeed, one could argue that it is much easier for public authorities to picture the business environment from the point of view of larger companies because of their greater visibility and access to Ministers and policy makers. Moreover, generally, larger companies would simply be able to mobilise more resources to comply with the burden imposed by regulation. Hence, the risk is to produce rules that create a disproportionate burden for SMEs, thus, hampering their competitiveness and innovation capacity and eventually damaging the European economy.
The application of the "Think Small First" principle comes as a solution to this situation by proposing practical solutions that would ensure that SMEs voices are heard, that their interests are taken on board by policy makers and that the business environment is favourable to the development of SMEs.

[188] *Id.,* at 12-14.

There is no exhaustive list of solutions since the "Think Small First" principle is not a rigid concept. On the contrary, innovative solutions to compensate the lack of resources of SMEs to participate in the design of the business environment, but also in fully and rightly exploiting it are needed. SMEs are competitive and innovative provided that they are allowed to do what they do best – their business."[189]

4.4.2. Positive developments deriving from the enactment of the SBA

Despite a level of flexibility in the application of the "Think Small First" principle, from 2009, several concrete actions[190] were taken to support the growth of SMEs in all such areas. Modifications were made to improve the consultation capacities of SMEs and to ensure that new regulations would have a positive impact on them through the application of the SME test and also in reducing the administrative burdens on small business:

> "Consulting small businesses is not an easy task and as a general rule, the smaller the business, the more difficult it is to consult them. A scattergun approach is unlikely to be successful. Running a small business is tough and few are likely to have the time to respond. Many rely on trade associations to represent their views but many more are unlikely to be members of any representative organisations. Undertaking a specific SME Test (as part of your policy development process) helps to deal with these issues head on. The stakeholder mapping exercise that should take place during the planning of the consultation exercise should inform the decisions around the channels you will make available for stakeholders to feed in their views and inform the decisions as to the formats in which the written consultation document should be made. It should also be borne in mind that the consultation process itself could create a heavy burden for SMEs. A proportionate approach should be adopted in most cases. Building this into your consultation process for future or amended legislation bearing on business is at the heart of the application of the "Think Small First" principle.
> Better communication with, and consideration of SMEs, could also be ensured through the nomination or appointment of an SME Envoy i.e. a person or service within the administration, that acts as the "voice of small business" within Government, with the express task of ensuring that SMEs' interests are considered in all relevant policy areas, at the early stages of development."[191]

> "Improving the relationship between SMEs and the administration through the application of the « only once » principle and one stop shops."[192]

> "The good practice cases presented in this brochure provide a sample of the different ways public administrations can make life easier for Europe's small and medium-sized enterprises (SMEs) by targeted policy measures.
> This collection of good practices was done within the framework of the European Charter for Small Enterprises, created at the request of the Lisbon European Council in 2000. In signing the Charter, the Heads of State committed themselves to taking action for small businesses in key policy areas. To encourage Member States to learn from each other, the Commission annually publishes a selection of the best policy measures.
> In 2008, the new Small Business Act (SBA) created a new framework for SME policy in Europe. The latest collection of good practices therefore focuses on topics of particular relevance under the SBA:
> 1. Cash flow for business growth - Incentives for reinvesting profits and reducing late payments

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[189] **European Commission - Enterprise & Industry Directorate General -,** "*Think Small First - Considering SME Interests in Policy-Making Including the Application of an 'SME test'*", Report of the Expert Group, (2009), at 7-8.

[190] The Communication mentions: the General Block Exemption Regulation on State Aids; the Regulation providing for a Statute for a European Private Company, the Directive on reduced VAT rates. *Id*. at 4.

[191] *Id.,* at 8.

[192] *Id.,* at 17-21.

> 2. Easier access to public procurement
> 3. Business dynamics: easier bankruptcy procedures and business transfers
> 4. Fostering creativity in entrepreneurship
> 5. Fostering Women's entrepreneurship
> 6. Fostering eco-innovation and energy efficiency in SMEs
> In this brochure, each of the six areas is covered by a separate chapter."[193]

Moreover, other relevant barriers were also tackled in an attempt to create the best possible business environment for small entities. Action was taken, for example, to tackle the negative effects businesses derived from late payments:

> "The "European Charter for small enterprises 2009 good practice section" informed that "In the EU, most goods and services that businesses provide to other businesses and to public authorities are not paid for upon delivery "often, **payments are made later than provided for** in the contract or invoice creating financial problems and uncertainty, particularly for SMEs"[194]. Despite such evidence of a common behavior as a viral cause of honest bankruptcies business and entrepreneurs that fail – whatever the reason – continue having a bad image in most countries[195] creating a barrier at the entrance of the independent business market."

Initiatives to bring long lasting change continued also in the field of insolvency laws, a key area in the struggle to incentivize entrepreneurship, and included a process to review the existing cross-border model which would soon be reformed to include reorganizations. The positive impact of reorganized businesses and of fresh starters could not be underestimated: Europe needed all the help it could get to revitalize its markets and exit the crisis.[196] [197]

All such actions and improvements were, nevertheless, insufficient; 10 years of the Lisbon strategy ended without reaching the desired results. Too many goals remained unreached and much still had to be done to make up for time lost due to the external and internal factors we have discussed. By then, though, Europe was at a much greater competitive disadvantage compared to the first decade of the new millennium and the financial crisis was still far from reaching its climax.

The political and economic environment in which the new ten-year plan was to begin, therefore, was far from ideal.

In the next section, we will discuss further developments which have occurred since 2010 and European strategies developed for the second decade of the new Millennium. As we will see, some lessons will be learnt and some improvements will indeed be made. Several targets will still, nevertheless, be missed and the overall scenario will remain extremely problematic.

The emphasis placed on the da Feira goals and the ambitions propagandized in so many official documents were bound to become utopian.

5. The European Strategy for growth, 2010-2020: the new beginning

The European scenario in 2010, at the end of the Lisbon strategy, was considered to be critical.

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[193] *Id.,* at 3.

[194] **European Commission - Enterprise and Industry**, "*European Charter for Small Enterprises - 2009 Good Practices Selection*" (2009), at 5.

[195] *Id.,* at 17.

[196] **(2008) COM 394 Final**, "*Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions – "Think Small First" – A "Small Business Act" for Europe*", at 7.

[197] **European Commission - Enterprise and Industry**, "*European Charter for Small Enterprises - 2008 Good Practices Selection*" (2008), at 24.

The crisis continued to hit hard.[198] Skyrocketing unemployment and an increasingly high number of bankruptcies challenged the capacities of an entire continent to react. The following speech by President Barroso gives an invaluable picture of the situation as it was perceived at the time, of the challenges that were faced, and of the Union's desire to persevere:

> "2010 must mark a new beginning. I want Europe to emerge stronger from the economic and financial crisis.
> **Economic realities are moving faster than political realities**, as we have seen with the global impact of the financial crisis. We need to accept that the increased economic interdependence demands also a more determined and coherent response at the political level. The last two years have left millions unemployed. It has brought a burden of debt that will last for many years. It has brought new pressures on our social cohesion. It has also exposed some fundamental truths about the challenges that the European economy faces. And in the meantime, the global economy is moving forward. How Europe responds will determine our future.
> The crisis is a wake-up call, the moment where we recognise that "business as usual" would consign us to a gradual decline, to the second rank of the new global order. This is Europe's moment of truth. It is the time to be bold and ambitious. Our short-term priority is a successful exit from the crisis. It will be tough for some time yet but we will get there. Significant progress has been made on dealing with bad banks, correcting the financial markets and recognising the need for strong policy coordination in the eurozone. To achieve a sustainable future, we must already look beyond the shorterm. Europe needs to get back on track. Then it must stay on track. That is the purpose of Europe 2020. It's about more jobs and better lives. It shows how Europe has the capability to deliver smart, sustainable and inclusive growth, to find the path to create new jobs and to offer a sense of direction to our societies. European leaders have a common analysis on the lessons to be drawn from the crisis. We also share a common sense of urgency on the challenges ahead. Now we jointly need to make it happen. Europe has many strengths. We have a talented workforce, we have a powerful technological and industrial base. We have an internal market and a single currency that have successfully helped us resist the worst. We have a tried and tested social market economy. We must have confidence in our ability to set an ambitious agenda for ourselves and then gear our efforts to delivering it. The Commission is proposing five measurable EU targets for 2020 that will steer the process and be translated into national targets: for employment; for research and innovation; for climate change and energy; for education; and for combating poverty. They represent the direction we should take and will mean we can measure our success. They are ambitious, but attainable. They are backed up by concrete proposals to make sure they are delivered. The flagship initiatives set out in this paper show how the EU can make a decisive contribution. We have powerful tools to hand in the shape of new economic governance, supported by the internal market, our budget, our trade and external economic policy and the disciplines and support of economic and monetary union.
> The condition for success is a real ownership by European leaders and institutions. Our new agenda requires a coordinated European response, including with social partners and civil society. If we act together, then we can fight back and come out of the crisis stronger. We have the new tools and the new ambition. Now we need to make it happen. José Manuel BARROSO" [199]

This speech was a wake-up call made in an attempt to shake a sleeping giant from its numbness.

A bold and ambitious Union had to chase a new beginning at its moment of truth, before being locked in the second rank of a new global order.

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[198] See **(2010) COM 2020 Final**, "*Communication from the Commission – Europe 2020 – A strategy for smart, sustainable and inclusive growth*", at 1: "The crisis has wiped out years of economic and social progress and exposed structural weaknesses in Europe's economy."

[199] *Id.*

As President Barroso affirmed, Europe had many strengths and much could be still done to deliver smart, sustainable growth. Nevertheless, the goals to meet were not anymore the da Feira ones; the window to become the most competitive knowledge-based society in the world was, probably, irredeemably closed. A more vital target had to be prioritized in the new decade: the one of avoiding (further) excessive decline in the years to come.[200]

Europe, in fact, lagged behind in too many relevant areas compared to its competitors already before the subprime crisis and, in the last years of the first decade, the situation had certainly not improved. Gaps with other major competitors within the globalized economy had widened greatly and the Commission had, therefore, to fight on two fronts: a) it had to push for progress to help the Union to find its way out of the swamps, but it also had to, b) prevent Member States from being tempted to return to a pre-crisis situation (which was already inefficient):

> "Moving out of the crisis is the immediate challenge, but the biggest challenge is to escape the reflex to try to return to the pre-crisis situation. Even before the crisis, there were many areas where Europe was not progressing fast enough relative to the rest of the world:
> – Europe's average growth rate has been structurally lower than that of our main economic partners, largely due to a productivity gap that has widened over the last decade. Much of this is due to differences in business structures combined with lower levels of investment in R&D and innovation, insufficient use of information and communications technologies, reluctance in some parts of our societies to embrace innovation, barriers to market access and a less dynamic business environment.
> – In spite of progress, Europe's employment rates – at 69% on average for those aged 20-64 – are still significantly lower than in other parts of the world. Only 63% of women are in work compared to 76% of men. Only 46% of older workers (55-64) are employed compared to over 62% in the US and Japan. Moreover, on average Europeans work 10% fewer hours than their US or Japanese counterparts.
> – Demographic ageing is accelerating. As the baby-boom generation retires, the EU's active population will start to shrink as from 2013/2014. The number of people aged over 60 is now increasing twice as fast as it did before 2007 – by about two million every year compared to one million previously. The combination of a smaller working population and a higher share of retired people will place additional strains on our welfare systems."[201]

The ultimate risk was to make some, individual steps forward while weakening the whole integration process. A general disenchantment felt among Member States and a dangerous tendency to go back to nationalism were heavily-feared factors.[202] Individualism, in fact, lead to great bottlenecks[203] and damaged the growth of the European market; the Union had to improve its teamwork:

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[200] **(2010) COM 2020 Final**, "*Communication from the Commission – Europe 2020 – A strategy for smart, sustainable and inclusive growth*", at 8.

[201] *Id.,* at 7.

[202] *Id.,* at 20.

[203] *Id.,* at 21: "The Commission will propose action to tackle bottlenecks in the single market by:
– Reinforcing structures to implement single market measures on time and correctly, including network regulation, the Services Directive and the financial markets legislative and supervision package, enforce them effectively and when problems arise, resolve them speedily;
– pressing ahead with the Smart Regulation agenda, including considering the wider use of regulations rather than directives, launching ex-post evaluation of existing legislation, pursuing market monitoring, reducing administrative burdens, removing tax obstacles, improving the business environment, particularly for SMEs, and supporting entrepreneurship;
– adapting EU and national legislation to the digital era so as to promote the circulation of content with high level of trust for consumers and companies. This requires updating rules on liability, warranties, delivery and dispute resolution; – Making it easier and less costly for businesses and consumers to conclude contracts with partners in other EU countries, notably by offering harmonised solutions for consumer contracts, EU model contract clauses and by making progress towards an optional European Contract Law;

"There are several lessons we can learn from this crisis:
– The 27 EU economies are highly interdependent: the crisis underscored the close links and spill-overs between our national economies, particularly in the euro area. Reforms, or the lack of them, in one country affect the performance of all others, as recent events have shown; moreover, the crisis and severe constraints in public spending have made it more difficult for some Member States to provide sufficient funding for the basic infrastructure they need in areas such as transport and energy not only to develop their own economies but also to help them participate fully in the internal market.
– Coordination within the EU works: the response to the crisis showed that if we act together, we are significantly more effective. We proved this by taking common action to stabilise the banking system and through the adoption of a European Economic Recovery Plan. In a global world, no single country can effectively address the challenges by acting alone;
– The EU adds value on the global scene. The EU will influence global policy decisions only if it acts jointly. Stronger external representation will need to go hand in hand with stronger internal co-ordination.
The crisis has not just been a one-off hit, allowing us to resume "business as usual". The challenges that our Union faces are greater than before the recession, whilst our room for manoeuvre is limited. Moreover, the rest of the world is not standing still. The enhanced role of the G20 has demonstrated the growing economic and political power of emerging countries.
Europe is left with clear yet challenging choices. Either we face up collectively to the immediate challenge of the recovery and to long-term challenges – globalisation, pressure on resources, ageing, – so as to make up for the recent losses, regain competitiveness, boost productivity and put the EU on an upward path of prosperity ("sustainable recovery").
Or we continue at a slow and largely uncoordinated pace of reforms, and we risk ending up with a permanent loss in wealth, a sluggish growth rate ("sluggish recovery") possibly leading to high levels of unemployment and social distress, and a relative decline on the world scene ("lost decade")."[204]

The need to coordinate all efforts among Member States grew stronger than ever before. The implementation of better common policies became an increasingly relevant target. Uniformity was perceived as the key towards achieving the levels of successes that had eluded the Union in the previous decade.

The basic recipe of the 2020 strategies remained overall un-altered; following the advice of the Kok Report, though, a roadmap of targets was set and stated more clearly. The new plan had, in fact, to cure the mistakes made in pursuing the Lisbon goals (or at the least it had to try not to repeat them), especially the ones made them in early years. The 2020 program had to operate as a solid landmark for all of the Member States which were struggling greatly at a local level.

The following five main goals and areas were set within the new strategy:

"Employment
- 75% of people aged 20-64 to be in work

Research and development (R&D)
- 3% of the EU's GDP to be invested in R&D

Climate change and energy
- greenhouse gas emission 20% lower than 1990 levels
- 20% of energy coming from renewable
- 20% increase in energy efficiency

Education

– making it easier and less costly for businesses and consumers to enforce contracts and to recognise court judgments and documents in other EU countries."

[204] *Id.,* at 8-9.

- rates of early school leavers below 10%
- at least 40% of people aged 30-34 having completed higher education

Poverty and social exclusion

- at least 20 million fewer people in – or at risk – of poverty/social exclusion."[205]

In addition, seven flagship initiatives were conceived to integrate the goals in an attempt to make them more exhaustive:

> "The targets are representative of the three priorities of smart, sustainable and inclusive growth but they are not exhaustive: a wide range of actions at national, EU and international levels will be necessary to underpin them. The Commission is putting forward seven flagship initiatives to catalyse progress under each priority theme:
> – "Innovation Union" to improve framework conditions and access to finance for research and innovation so as to ensure that innovative ideas can be turned into products and services that create growth and jobs.
> – "Youth on the move" to enhance the performance of education systems and to facilitate the entry of young people to the labour market.
> – "A digital agenda for Europe" to speed up the roll-out of high-speed internet and reap the benefits of a digital single market for households and firms.
> – "Resource efficient Europe" to help decouple economic growth from the use of resources, support the shift towards a low carbon economy, increase the use of renewable energy sources, modernise our transport sector and promote energy efficiency.
> **– "An industrial policy for the globalisation era" to improve the business environment, notably for SMEs, and to support the development of a strong and sustainable industrial base able to compete globally.**
> – "An agenda for new skills and jobs" to modernise labour markets and empower people by developing their of skills throughout the lifecycle with a view to increase labour participation and better match labour supply and demand, including through labour mobility.
> – "European platform against poverty" to ensure social and territorial cohesion such that the benefits of growth and jobs are widely shared and people experiencing poverty and social exclusion are enabled to live in dignity and take an active part in society. These seven flagship initiatives will commit both the EU and the Member States. EU-level instruments, notably the single market, financial levers and external policy tools, will be fully mobilised to tackle bottlenecks and deliver the Europe 2020 goals. As an immediate priority, the Commission charts what needs to be done to define a credible exit strategy, to pursue the reform of the financial system, to ensure budgetary consolidation for long-term growth, and to strengthen coordination with the Economic and Monetary Union."[206]

Europe continued to trust in the beneficial effects of the empowerment of SMEs. Small and medium enterprises did not cease to be the backbone of the European economy and the segment to bet on to strengthen Europe's frail economy:

> "Small and Medium Enterprises (SMEs) remain the back bone of the EU economy. Given that 99.8 percent of all enterprises are SMEs – a ratio that has been fairly stable over the past years – the typical EU´s enterprise is an SMEs, or more specifically a micro-enterprise with less than ten employees. In 2010, 19.2 million micro-enterprises operated in the EU, comprising 92 percent of all European enterprises. This is in stark contrast with the number of large enterprises, accounting for only 0.2 percent. In employment terms, as in previous years, SMEs provided about two-thirds of workers in the nonfinancial business economy in 2010. Large enterprises accounted for the remainder. Due to larger scales and higher capital intensity, the picture for gross value added (GVA) is less skewed, although SMEs still accounted for nearly 59 percent of GVA in 2010.

[205] https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/framework/europe-2020-strategy_en

[206] **(2010) COM 2020 Final**, "*Communication from the Commission – Europe 2020 – A strategy for smart, sustainable and inclusive growth*", at 5-6.

Sector wise, SMEs are more likely to be active in service than in manufacturing activities when compared to large enterprises. In 2010 for instance, some 12.6 million SMEs or more than half of all European SMEs were engaged in trade (NACE sector G), real estate, renting and business activities (NACE sector K)9 (See Table 2.2). Forty percent of larger enterprises were active in manufacturing, while the corresponding share for SMEs was just above ten percent in 2010. Part of the reason for the prominent representation of SMEs in services is the fact that services tend to be less capital-intensive than most manufacturing activities which in turn is conducive to SMEs which – in general- tend to have more difficulties in building up larger capital stocks as compared to larger firms."[207]

"In absolute terms, SMEs shed more jobs than large enterprises. This is hardly surprising, given than in 2009 the SME labour force was twice that of large enterprises. Hence, since 58 percent of the total loss of employment in the EU occurred within SMEs in 2010, in relative terms the losses in the SME segment were more limited."[208]

Members, though, continued to progress at different speeds and SMEs, which had suffered greatly from the instability of the market, were in need of immediate support:

"Notwithstanding the EU's GDP growth in 2010, the EU economy as a whole is still frail and growth among Member States is highly fragmented. Some EU Member States have built up large economic, financial and fiscal imbalances, which have raised the deficit of vulnerable economies.
Governments – in particular in Eurozone countries – have recently focused principally on budget consolidation by imposing strict saving programmes on public expenditure. The short-term ramifications of this strategy in terms of curtailing overall demand are starting to make themselves felt in slowing down the economic recovery with negative implications also for most SMEs. The financial crisis also continues to cast it shadows over SMEs' ability to access finance. Credit standards for SMEs have tightened in many Member States.
On the level of individual Member States, Germany is the leading economy in the EU consisting of 20 percent of the EU's GDP. Germany's GDP growth of 3.6 percent in 2010 is expected to remain well above the Euro average in 2011. Poland is the only country that managed to avoid a recession since the onset of the crisis in 2008, demonstrated by a GDP growth of 1.7 percent in 2009 and a continued growth of 3.8 percent in 2010. Slovakia and Sweden showed growth rates in 2010 of 4.0 percent and 5.5 percent respectively, whereas countries such as Greece, Portugal and Ireland have performed poorly due to budgetary problems and the subsequent implementation of tough austerity programmes.
Based on this mixed macroeconomic picture within the EU the following picture appears to emerge: while on the EU aggregate level EU SMEs are recovering, on a more disaggregate/country level, the SME sectors in Member States are following actually different trends determined largely by macroeconomic and structural factors (including innovative capacity)."[209]

Moreover, difficulties were still found in developing the necessary levels of entrepreneurship and a positive attitude towards self-employment:

"**Great impulse is still given towards improving the levels of entrepreneurial activity:**
To bring Europe back to growth and higher levels of employment, Europe needs more entrepreneurs. As a follow up to the Small Business Act review of April 2011 and of the Industrial policy communication adopted last October, the proposed Action Plan sets out a

[207] **Wymenga Paul; Dr. Viera Spanikova, Dr. James Derbyshire, A. Baker**, "Are EU SMEs recovering from the crisis? – Annual Report on EU Small and Medium Enterprises 2010/2011", ECORYS, Rotterdam / Cambridge, (2011), at 7-8.
[208] **(2010) COM 2020 Final**, "*Communication from the Commission – Europe 2020 – A strategy for smart, sustainable and inclusive growth*", at 13.
[209] *Id.* at 7.

renewed vision and a number of actions to be taken at both EU and Member States' level to support entrepreneurship in Europe. It is based on three pillars : developing entrepreneurial education and training; creating the right business environment; role models and reaching out to specific groups.[…] Entrepreneurship makes economies **more competitive and** innovative and is crucial in achieving the objectives of several European sectorial policies**.** Commercialising new ideas improves productivity and creates 0wealth. Without the jobs from new firms, average net employment growth would be negative. **New companies,** especially SMEs, **represent the most important source of new employment:** they create more than 4 million new jobs every year in Europe. Yet the engine for this recovery has been stuttering: since 2004, **the share of people preferring self-employment to being an employee has dropped** in 23 out of the 27 EU Member States.6 While three years ago for 45% of Europeans self-employment was their first choice, now **this percentage is down to 37%**. By contrast in the USA and China this proportion is much higher: 51% and 56% respectively. Moreover, when **new enterprises are founded**, **they grow more slowly in the EU** than in the USA or emerging countries, and **fewer of them join the ranks of the world's largest firms."**[210]

"Not only is the environment challenging, but there is also a widespread **culture that does not recognise or reward entrepreneurial endeavours enough** and does not celebrate successful entrepreneurs, as role models who create jobs and income. To make entrepreneurship the growth engine of our economy **Europe needs a thorough, far-reaching cultural change**."[211]

Although progress was, indeed, made in improving policies in support of businesses, they remained insufficient at a time of such great systemic instability:

"The effects of the financial and economic crisis of 2009 were still felt by European SMEs in 2010. The number of SMEs stabilised in 2010, albeit with declines in the small and medium size classes, while the micro enterprises by and large stood up well to the adverse economic conditions. By 2010, the turnover of European SMEs recovered with a growth of 2.6 percent in the aggregate. The beginning recovery of EU SMEs in 2010 has, therefore, been mainly featured growth in numbers of turnover and value added, whereas only from the year 2011 they will be joined by employment. This forecast, however, critically depends on the further macro-economic and political developments, especially, but not exclusively, as regards the Eurozone. Despite a recent increase in the levels of investment by European SMEs in 2010, after two years of decline and reduced profitability, the beginning recovery looks still fragile.
In addition, the turnaround does not cover all Member States. The picture of SME performance in 2010 in terms of value added and employment in the EU can be drawn up in triplicate."[212]

"The fragile and only partial recovery of SMEs in the EU 2010 further increases the pressure on policy makers, both on the EU as well as on the national level, to speedily implement what they have committed to under the SBA agenda. Decisive and rapid improvements towards a friendlier SME administrative and legislative environment are an indispensable precondition for an SME recovery."[213]

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[210] **(2012) COM 795 Final**, "*Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Entrepreneurship 202 Action Plan - Reigniting the Entrepreneurial Spirit in Europe*", at 3-4.
[211] *Id*., at 4.
[212] **Wymenga Paul; Dr. Viera Spanikova, Dr. James Derbyshire, A. Baker**, "*Are EU SMEs recovering from the crisis? – Annual Report on EU Small and Medium Enterprises 2010/2011*", ECORYS, Rotterdam / Cambridge, (2011), at, 38.
[213] *Id.,* at 39.

Studies showed that the most relevant barriers that afflicted SMEs and prevented them from expressing their potential had not changed from the previous decade. They still, in fact, were:

1) The costs of opening and running small and medium businesses – which were proportionally much higher than the ones of opening and running larger business;

2) Administrative burdens which continued to persist in the European environment despite the steps taken to reduce them made in the previous years. The duplication of documents to be sent to different offices of public administrations and tax agencies, for example, constituted a waste of time and energies and had a far greater negative impact on small businesses compared to larger ones. Large enterprises could count on sufficient man power to deal with extra burdens and, when needed, on expensive expert advice:

> "Small and medium-sized enterprises (SMEs) play a key role in shaping Europe's economy, accounting for 99% of enterprises, of which 92% are micro-enterprises. They provide more than two thirds of private sector employment and play a key role in economic growth. They have a crucial importance to the European economy as employers and sources of innovation. The Commission is committed to support their development, notably through the "Small Business Act" with its "Think Small First" principle and by facilitating, amongst other things, access to EU funding. The Commission's Smart Regulation agenda also aims to help small businesses by minimizing the regulatory burden of legislation that is deemed necessary at EU level.
> The EU's growth strategy for the coming decade, Europe 2020, highlights the importance of improving the business environment, including through smart regulation, to make European enterprises more competitive at the global scale. However, the financial crisis is having a severe impact on many of the smallest companies in the EU economy. It is, therefore, essential to free up micro enterprises to allow them pursue their business goals without unnecessary regulation. The Commission is aware that the smallest firms face the greatest costs in complying with regulations. Compliance with legislation stemming from the regional, national or European level will always be more burdensome for the smaller enterprise."[214]

> "The Commission is taking action to produce SME friendly legislative proposals, like that exempting micro-entities from unnecessary legal requirements in accounting directives. It is fully committed to assessing the impacts of new or revised legislation on SMEs through its well developed impact assessment process; it also regularly evaluates whether legislation is delivering what it was intended to do. Through the Small Business Act (SBA) and Single market Act (SMA) it is taking steps to facilitate access to finance for SMEs, one of the biggest challenges they face in the current crisis. Extensive simplification measures are being applied to help SMEs take part in EU funded programmes. The latest Commission proposal on Cohesion Policy, for example, introduced a core set of common rules for the five funds concerned, including simplified reimbursement methods, which will significantly simplify the conditions for access to EU funds for SMEs."[215]

3) The failure in harmonizing the great disparities among the many legal systems present within the Union, which continued to represent a great barrier towards the deployment of a more active and productive entrepreneurial environment in Europe:

> "The level of entrepreneurship and its nature vary widely between Member States, and the reasons for low enthusiasm for an entrepreneurial career are therefore diverse. Some Member States with higher levels of entrepreneurship are less successful than others at helping new and small enterprises to grow. Generally **would-be entrepreneurs in Europe find themselves in a tough environment:** education does not offer the right foundation for an entrepreneurial career, difficult access to credits and markets, difficulty in transferring businesses, the fear of punitive sanctions in case of failure, and burdensome administrative procedures. The Annual Growth Survey 2013 has recently emphasized the

[214] **(2011) COM 803 Final**, "*Report from the Commission to the Council and the European Parliament – Minimizing regulatory burden for SMEs – Adapting EU regulation to the needs of micro-enterprises*", at 2.
[215] *Id.,* at 3.

> need to improve the business environment to increase the competitiveness of EU economies. Furthermore, **support measures for SMEs remain unbalanced**, with a substantial number of EU Member States still neglecting to take into account the characteristics of small businesses, in particular micro-businesses, when designing legislation or not facilitating a second chance for honest bankrupt entrepreneurs."[216]

Several steps were taken from 2011 in an attempt to achieve an effective and definitive "new beginning" through the implementation of the "Europe 2020" strategy. The Union had wished to turn the situation around and deliver results since the very beginning of the new plan. To do so, the Small Business Act was placed under revision.

The SBA of 2008 was considered overall successful, but the Union was under urgent pressure to cure the disparities that were still present among the different Members[217]:

> "2.2. Developments in the Member States
> Progress in improving the business environment is slow.
> All Member States have acknowledged the importance of a rapid implementation of the SBA, but the approach taken and the results achieved vary considerably between Member States. While most of them have adopted national targets for reducing administrative burdens, not all Member States have effectively reduced them. Only a few Member States have integrated an SME Test into their national decision making approach (Belgium, Denmark, Finland, Germany)."[218]

Great relevance continued to be placed on the "Think Small First" principle enshrined in the SBA, in an attempt to make sure that rules and policies impacting SMEs could be developed from the small businesses' point of view. "One size", in fact, could *not* fit all[219] [220]:

> *"The impact regulations can have on SMEs*
> While the benefits of regulations tend to be rather evenly distributed over companies of different sizes, because of their smaller size and scarcer resources, SMEs can be affected by the costs of regulations more than their bigger competitors. The expert group report "Models to reduce the disproportionate regulatory burden on SMEs" asserted that on

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[216] **(2012) COM 795 Final**, "*Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Entrepreneurship 202 Action Plan - Reigniting the Entrepreneurial Spirit in Europe*", at 4.

[217] **(2011) COM 78 Final**, "*Communication from the Commission to the European Parliament, the Council, Economic and Social Committee and the Committee of the Regions - Review of the 'Small Business Act' for Europe*", at 5.

[218] *Id.*

[219] "In line with the "Think Small First" principle enshrined in the "Small Business Act" for Europe, the report of the expert group is an attempt to provide guidance to policy makers on how to better treat their SMEs or simply on how to "Think small first". The report is a tool designed to help Member States with the implementation of the SBA for Europe.
The definition of the "Think Small First" principle implies that policy makers give full consideration to SMEs at the early policy development stage. Ideally rules impacting on business should be created from the SMEs point of view or in other words, SMEs should be considered by public authorities as being their "prime customers" as far as business regulation is concerned. The principle relies on the fact that "one size does not fit all" but a lighter touch approach can also be beneficial to larger businesses. Conversely, rules and procedures designed for large companies create disproportionate, if not unbearable burdens for SMEs as they lack the economies of scale.
The application of the "Think Small First" principle aims at ensuring that SMEs voices are heard, that their interests are taken on board by policy makers and that the business environment is favourable to the development of SMEs. There is no exhaustive list of SME favourable practices since the "Think Small First" principle is not a rigid concept. On the contrary, innovative solutions to compensate the lack of resources of SMEs to participate in the design of the business environment, but also in fully and rightly exploiting it are needed. SMEs are competitive and innovative provided that they are allowed to do what they do best – their business." See *Id.*, at 6.

[220] **COM (2011) 78 Final**, "*Communication from the Commission to the European Parliament, the Council, Economic and Social Committee and the Committee of the Regions - Review of the 'Small Business Act' for Europe*", at 6-7.

average, where a big company spends one euro per employee to comply with a regulatory duty a medium-sized enterprise might have to spend around four Euros and small business up to ten Euros. SMEs may have limited scope for benefiting from economies of scale. For example, regulation requiring fixed cost investments (e.g. retailers required to provide facilities for customers to return end of life electronic equipment) could be relatively more expensive for SMEs than for their bigger competitors, when dividing its cost by production volume or the number of employees or simply because they will make less use of it. Moreover, SMEs generally find it more difficult and costly to access capital than larger businesses, thus making investments more expensive. SMEs are also more constrained in passing on any increase in costs to their customers as they generally do not directly influence market prices (in other
words they are generally price takers). Further, indirect costs can have a greater impact on SMEs than on large businesses. For example SMEs could be obliged to pay for external advisor expertise or invest in extra training of staff to comply with new obligations since they might lack information or expertise in house or they may feel that it is cheaper or easier than following regulations on their own. This is particularly true for the environmental obligations. Possible changes in the market structure could also particularly affect SMEs competitiveness and even put them out of the business.
Finally, it should be borne in mind that SMEs are an extremely heterogeneous group and, to the possible extent, policy makers need to be mindful of the differences between micro, small and medium-sized companies when pursuing its analysis."[221]

The beginning of the new ten-year strategy was, therefore, characterized by fervent maneuvers. Despite the critical condition of its fragile market, Europe was facing the challenge with the intent to learn from its mistakes. The Union had attempted to take concrete steps towards progress since the very beginning of the decade and to conceive and structure actions and reforms.

In the next few pages, we will discuss the effects of several of such actions that were indeed positive. The European economy will indeed experience some (sudden) awakenings; yet overall, the scenario will remain critical.

5.1 The "mid-midterm" assessment of 2012: reigniting the entrepreneurial spirit of Europe

In 2012, it was time for a new mid-midterm[222] assessment of European performance before the midterm checkpoint of 2015. A progressive, more accurate, step-by-step evaluation of the developments of the different strategies was necessary to avoid the mistakes of the past and to obtain a general picture of the impact of the new actions and policies throughout the economic crisis. Despite the difficulties that had been encountered in previous years, the biennium 2012-2013 appeared to be a very important term for the development of the "Europe 2020" strategy. A new call was made towards "reigniting the entrepreneurial spirit in Europe."

The process to "lift the spirit" of the whole Union continued:

"Reigniting the entrepreneurial spirit in Europe
Since 2008 Europe has been suffering the effects of the most severe economic crisis it has seen in 50 years: for the first time in Europe there are over 25 million unemployed and in the majority of Member States small and medium-sized enterprises (SMEs) have not yet been able to bounce back to their pre-crisis levels.
Before the on-going economic and financial crisis, the European economy faced structural challenges to its competitiveness and growth, and obstacles to entrepreneurship. Many of these persist, but the crisis has also been a catalyst for deep change and restructuring. The

[221] See **European Commission - Enterprise & Industry Directorate General** -, "*Think Small First - Considering SME Interests in Policy-Making Including the Application of an 'SME test'*", Report of the Expert Group, (2009), at 6-7.
[222] We define it as such since it comes midway toward the true midterm assessment. This procedure was followed already in 2003 and brought important results with especially with the publication of the Kok Report which stressed the need to review actions urgently.

world economy has also been transformed over the last decade. Rapidly increasing demand and production in global markets has put pressure on resource and energy supplies leading to changing cost structures for Europe's companies, many of which are dependent on imports for these supplies.

The Europe 2020 Strategy responded to this by setting out the foundations for future growth and competitiveness that will be smart, sustainable and inclusive, and which would address our principal societal challenges. Correcting the problems of the past and putting the EU on a more sustainable development path for the future is a shared responsibility of the Member States and the EU Institutions. Recognising that our economies are closely intertwined, the EU is now reshaping its economic governance to ensure better policy responses to current and future challenges.

To bring Europe back to growth and higher levels of employment, Europe needs more entrepreneurs. As a follow up to the Small Business Act review of April 2011 and of the Industrial policy communication adopted last October, the proposed Action Plan sets out a renewed vision and a number of actions to be taken at both EU and Member States' level to support entrepreneurship in Europe. It is based on three pillars: developing entrepreneurial education and training; creating the right business environment; role models and reaching out to specific groups.

1. OUR CHALLENGE –MORE ENTREPRENEURS FOR EUROPE

Entrepreneurship is a powerful driver of economic growth and job creation: it creates new companies and jobs, opens up new markets, and nurtures new skills and capabilities. In the field of industry for instance, it is therefore particularly important to fast development of the six emerging growth sectors identified in the Commission's Industrial Policy update.

Entrepreneurship makes economies **more competitive and** innovative and is crucial in achieving the objectives of several European sectorial policies**.** Commercializing new idea improves productivity and creates wealth. Without the jobs from new firms, average ne employment growth would be negative4. **New companies,** especially SMEs, **represent the most important source of new employment:** they create more than 4 million new jobs ever year in Europe. Yet the engine for this recovery has been stuttering: since 2004, **the share of people preferring self-employment to being an employee has dropped** in 23 out of the 27 EU Member States.6 While three years ago for 45% of Europeans self-employment was their first choice, now **this percentage is down to 37%**. By contrast in the USA and China this proportion is much higher: 51% and 56% respectively. Moreover, when **new enterprises are founded**, **they grow more slowly in the EU** than in the USA or emerging countries, and **fewer of them join the ranks of the world's largest firms.**

The level of entrepreneurship and its nature vary widely between Member States, and the reasons for low enthusiasm for an entrepreneurial career are therefore diverse. Some Member States with higher levels of entrepreneurship are less successful than others at helping ne and small enterprises to grow. Generally **would-be entrepreneurs in Europe find themselves in a tough environment**: education does not offer the right foundation for an entrepreneurial career, difficult access to credits and markets, difficulty in transferring businesses, the fear of punitive sanctions in case of failure, and burdensome administrative procedures. The Annual Growth Survey 2013 has recently emphasised the need to improve the business environment to increase the competitiveness of EU economies. Furthermore, **support measures for SMEs remain unbalanced**, with a substantial number of EU Member States still neglecting to take into account the characteristics of small businesses, in particular micro-businesses, when designing legislation or not facilitating a second chance for honest bankrupt entrepreneurs.

Not only is the environment challenging, but there is also a widespread **culture that does not recognise or reward entrepreneurial endeavours enough** and does not celebrate successful entrepreneurs, as role models who create jobs and income. To make entrepreneurship the growth engine of our economy **Europe needs a thorough, far-reaching cultural change**.

Against the background of the current economic crisis and the new economic governance mechanism, this communication further develops and accentuates action in those fields

> where the Commission's Review of the Small Business Act identified a continued need for improvements on national and European level."[223]

The process, apparently, brought good results. Thanks to its enormous effort and commitment, the Union looked once again to the future with optimism and courage:

> "Europe must regain trust in its ability to invent, to undertake new ventures, to innovate and to grow. For this reason, Europe should put at the centre of the stage the real economy and industry, its strength."[224]

The results in 2013 even gave the impression that a true turning point had been reached; one which could finally justify years of European efforts:

> "2013 is likely to mark a turning point for the EU SMEs. After five years of an uncertain economic environment, 2013 is expected to be the first year since 2008 with a combined increase in aggregated employment and value-added of EU's SMEs. The total employment in the EU SMEs is expected to increase by 0.3% and value-added by 1% as compared to 2011. Preliminary forecasts expect the positive developments further accelerating in 2014. These promising projections are backed up by other positive signals. Over the last three years, an increasing number of Member States have seen their small business sectors returning to an expansion of employment and value-added, or at least a petering out of the decline. If the macroeconomic conditions hold, this development would mark the end of the most challenging crisis the European SMEs have experienced in the recent history."[225]

> "For the first time in a number of years, our annual EU SME report presents good news at a time when the EU has 23 million unemployed citizens, many of whom are young and have not yet started their careers.
> There are positive signs of a turn-around for Europe´s SMEs. As the report finds, a sizeable minority of SMEs have already expanded their businesses and workforces and it is particularly encouraging to note that many of these are young firms.
> The report also states that there is no reason for complacency. Many more SMEs need to join the club of job creators. In terms of policy, this means that Member States and the European Commission need to continue their efforts to create the best possible policy environment. This requires a comprehensive approach, with SMEs at the centre. A priority strongly endorsed by the European Commission under the mandate of President Juncker.
> Tangible progress has been made since the adoption of the Small Business Act for Europe (SBA) in 2008. The findings of DG GROW´s SME Performance Review– our analytical tool that monitors the SBA´s implementation – confirms such progress. However, further efforts are needed to fully implement the SBA in Member States. This Commission´s SME strategy encompasses all EU policy areas. All newly initiated EU policy packages are designed with SMEs in mind. The new Single Market Strategy (SMS) is an example. The SMS sees the potential of the EU as a tool for building a stronger and fairer EU economy, one market place with fewer obstacles to enable the free movement of goods and services.
> As the EU SME Envoy and Member of the Commission for the Internal Market, Industry, Entrepreneurship and SMEs, I am ideally placed to coordinate the SME policies of the Commission and of the Member States. For me, the findings of this report demonstrates

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[223] **(2012) COM 795 Final**, "*Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Entrepreneurship 202 Action Plan - Reigniting the Entrepreneurial Spirit in Europe*", at 3-5.

[224] See: **European Commission, Directorate – General for Communication**, "*The European Union explained – A new industrial revolution*", ISBN 978-92-79-42048-1, Luxembourg publication office of the European Union, (2013).

[225] **European Commission**, "*A recovery on the horizon? – Annual report on European SMEs 2012/2013 – Final report*", at 7.

> that our joint efforts are starting to show positive results as well as a positive and encouraging challenge to ensure that we remain engaged in pro-SME policy reforms in the EU."[226]

Once again, though, the optimism portrayed in official documents seemed not to match real life. Data showed, in fact, that despite improvements, the EU was still performing well behind the early years of the first decade of the millennium (which were already considered insufficient when the da Feira strategy was designed).

Unfortunately, due to their fragility, European SMEs continued to suffer greatly from the crisis that raged within the globalized market:

> "European SMEs were significantly more resilient than large enterprises to the 2008 crisis, particularly in employment terms. However, after the crisis it has been more difficult also for them to recover. After 2009, large enterprises were leading the recovery in terms of output (gross value added), but as of 2012 they have surpassed SMEs – albeit only slightly - also in terms of employment. Thus, by 2012, large enterprises managed to regain almost 1.1 million of the 1.6 million jobs lost in 2009. The SMEs, which lost comparatively fewer jobs in preceding years, went through a rough patch in 2012.
> SMEs also trail behind large enterprises in terms of value added, since the latter have been faster to recover after 2009 and were somewhat less affected by the slowdown in 2012. Whilst large enterprises posted a decline in value added of €8.6 billion in 2012, medium-sized enterprises posted the highest loss in value added amounting to €17 billion, followed by micro-enterprises (€14 billion) and small-sized enterprises (€13.2 billion). The difference between the value added performance of SMEs and large enterprises over the period 2008 to 2012 reflects the weakness in domestic demand, which is a key market driver for SMEs, while large enterprises benefited from a better export performance. However, as domestic demand is expected to recover to some extent in 2013 and 2014, SMEs are forecast to perform somewhat similar to large enterprises over these two years."[227]

While the Small Business Act and the policies and strategies that had been enacted up to 2013 continued to be key in creating a safety net for SMEs, their end results could not go beyond a partial mitigation of the negative effects of the crises and of the losses that were suffered during those years:

> **"In 2012, the GDP of the European Union declined by 0.3%** and the GDP per capita did not recover to 2007/2008 levels. GDP data and other macroeconomic indicators show a mild growth forecast from the second quarter of 2013."[228]
> "The improvements in SMEs' performance are underpinned by an impressive number of policy measures by the EU and the Member States since 2008. These policy developments, taken under the umbrella of the Small Business Act (SBA) for Europe have been instrumental in mitigating the effects of the crisis and in creating a pro-SME policy momentum across the European Union. In 2010-2012 only, the EU's Member States implemented a total of almost 2,400 policy measures to support SMEs, i.e. an average of 800 measures per year, and almost 90 measures per country."[229]

Just like its predecessor, therefore, at this stage the 2020 strategy seemed to be, overall, unsuccessful.

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[226] **Muller Patrice, Gagliardi Dimitri, Caliandro Cecilia, Unlu Bohn Nuray, Klitou Demetrius,** "*European Commission – Enterprise and Industry – Annual Report on European SMEs 2013/2014 – A partial and Fragile Recovery – Final report*", (2014), preface.

[227] **European Commission**, "A recovery on the horizon? – Annual report on European SMEs 2012/2013 – Final report", at 7.

[228] *Id*., at 9.

[229] *Id.,* at 8.

Too many systemic weaknesses were still not cured. The growth in the number of SMEs (together with other positive statistics that were enthusiastically announced in previous documents) was not a sufficient indicator to guarantee that the crisis was about to be left behind or that the enacted strategies could produce positive effects:

> "In 2009, the European economy suffered an unprecedented blow: a contraction of 4.5% in GDP. A temporary respite in economic decline in 2010 proved short lived and the negative trends continued through 2011 to 2012. A gradual recovery has set in since 2013 and is expected to continue, with real GDP projected to grow again by 1.5% in 2014 and 2.0% in the EU in 2015. The EU average expresses diverse growth trajectories and very different experiences during the crisis across Member States, with some countries particularly hard hit and others faring better over time. At the launch of the Europe 2020 strategy in 2010, the depth and length of the crisis were still largely unknown. Various scenarios were considered for the following decade, ranging from a return to " strong" growth, a scenario of "sluggish" recovery or the risk of a "lost decade". A lot depended on the ability of the EU to exit rapidly and strongly from the 2009 recession."[230]

> "Four years on, it has become clear that the likely growth trajectory for the EU over 2010-2020 is closer to the second scenario (i.e. around 1.3% per annum). As graph 1 indicates, the economic output in the EU in 2014 is expected to reach the same level as in 2008, with losses from the downturns now offset by the ongoing recovery.
> However, the impact of the crisis is both immediate and longer-term: it has already cost Europe a loss in wealth, and it has also eroded its potential for future growth as jobs, firms and "know-how" have been lost.
> According to the latest forecasts10, the EU's annual GDP growth could be in the order of 1.6% throughout the period 2014-2020, compared to 2.3% over 2001-2007 (prior to the crisis). Expressed in GDP per capita, average annual growth in the EU would thus be in the order of 0.9% over 2014-2020, compared to 1.8% over 2001-2007.
> A first critical step in designing a post-crisis growth strategy for the EU is to understand clearly the full impact of the crisis and to share a common diagnosis of where Europe stands. In so doing, it is also important to bear in mind that seeking to return to the growth "model" of the previous decade would be both illusory and harmful: fiscal imbalances; real estate bubbles ; widening social inequalities ; lack of sufficient entrepreneurship and innovation ; dysfunctional financial systems ; growing energy dependency ; multiple pressures on the use of resources and the environment; sharp increase in unemployment; weaknesses in education and training systems; underperforming public administrations – these were issues that could be observed but that were not resolved in the past. They contributed to the collapse of parts of our economies when the full crisis hit."[231]

A relevant point was made in the 2013 report on SMEs which highlighted the fact that the Union would be unable to get back on its feet unless it managed to create the systemic conditions needed to take advantage of European entrepreneurialism, a topic lengthily discussed already in previous years:

> "Recent studies on SMEs and their contribution to growth have shown that framework conditions within which they operate and the entrepreneurial culture are key factors in determining the extent of SME performance and consequently their contribution to macroeconomic growth. **Even in the presence of a strong entrepreneurial culture,**

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[230] **(2014) COM 130 Final**, "*Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Taking stock of the Europe 2020 strategy for smart, sustainable and inclusive growth*", at 5-6.
[231] *Id.,* 6-7.

> **however, SMEs would struggle to perform if basic framework conditions were not present**."[232]

One specific systemic weakness that remained painfully relevant in the European agenda and which heavily impacted entrepreneurial spirits was the one connected with the process of refounding the Union's insolvency frameworks, which still lagged behind schedule and had not achieved the necessary level of improvement:

> "About 50% of all new businesses do not survive the first five years of their life. 1.7 million jobs are estimated to be lost due to insolvencies every year. Growth has been put at the heart of the Commission's agenda on justice ('Justice for Growth'), in line with the growth strategy Europe 2020, the Annual Growth Survey and the recently adopted Single Market Act II.2 Modernising the EU's insolvency rules to facilitate the survival of businesses and present a second chance for enterpreneurs has been identified as a key action to improve the functioning of the internal market. The 2009 Stockholm Programme for the European area of justice highlighted the importance of insolvency rules in supporting economic activity." [233]

Since the new ten-year plan had not modified its focus on SMEs, the Union had to act swiftly to revise and ameliorate its process for the refoundation of European insolvency frameworks, which was facing a deep impasse.

5.2 Developments in the refoundation of European insolvency frameworks

As discussed in the previous sections, the process of refounding European insolvency frameworks held great relevance within the Lisbon strategy. Its importance did not fade in the new year-year plan; it actually increased due to the pressure placed on (finally) obtaining the necessary results.

The increasing levels of unemployment and the effects of the crisis called for renewed attention in the field of insolvency regulations:

> "The debt crisis has a direct effect on people, jobs and businesses. The economic crisis has led to an increase in the number of failing businesses. From 2009-2011, an average of 200.000 firms went bankrupt per year in the EU. About one quarter of these bankruptcies have a cross-border element. About 50% of all new businesses do not survive the first five years of their life. 1.7 million jobs are estimated to be lost due to insolvencies every year."[234]
>
> "The latest data indicate that in **the euro zone bankruptcy grew by 5% in 2010 after having grown by 46% in 2009[235].** The deterioration in 2009 came on top of a severe increase in 2008, that saw bankruptcies grow in Spain (+187%), Ireland (+113%), Portugal and Denmark (+67%), Italy (+45%) and the UK (+31%). In terms of total members, corporate insolvencies grew 22%

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[232] **European Commission**, "A *recovery on the horizon? – Annual report on European SMEs 2012/2013 – Final report*", at 10.

[233] See **(2012) COM 742 Final**, "*Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee - A new European approach to business failure and insolvency*", at 1:
"This Communication highlights those areas where differences between domestic insolvency laws have the greatest potential to hamper the establishment of an efficient insolvency legal framework in the internal market. It seeks to identify the issues, on which the new European approach to business failure and insolvency should focus so as to develop the rescue and recovery culture across the Member States."

[234] **(2012) COM 795 Final**, "*Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Entrepreneurship 202 Action Plan - Reigniting the Entrepreneurial Spirit in Europe*", at 2. .

[235] In 2011 "Bankruptcies account for 15% of all company closures, affecting 700.000 SMEs and around 2.8 million jobs every year. In 2009, most European Countries experienced a sharp rise in insolvencies as a consequence of the worldwide financial crisis and economic downturn". See "*European Commission – Thinking big for small businesses – what the EU does for SMEs*", Luxembourg: Pubblication Office of the European Union, ISBN 978-92-79-18954-8, (2011), at 7.

in 2009 to 185.111 for Western Europe (EU15 + Norway and Switzerland). This made in the worst year in more than a decade for countries such as Sweden (since 1996), the United Kingdom (since 1993), the United States and Norway (since 1992) and was an all-time negative record for countries such as France, Spain, Belgium, Switzerland, Austria, Finland and Portugal. The total number of insolvency related job losses in Europe in 2009 is estimated at 1.7 million (1.2 million in 2008)." presenting bankruptcy as a possible solution "Research shows that businesses set up by re-starters grow faster than businesses set up by first timers in terms of turnover and jobs creates. But acting on second chance would bring and even larger impact on entrepreneurship: many would-be entrepreneurs do not start a company because of their fear of the consequences of business failure and thousands of companies are not created and tens of thousands of jobs are not created every year in Europe. Fear of bankruptcy and its consequences acts as an effective deterrent to entrepreneurship. An effective second chance policy is fundamental to send a message that entrepreneurship may not end up as a "life sentence in case things go wrong."[236]

"To achieve the Europe 2020 objectives, we need to focus on the general objective of improving the efficiency of justice in the EU. Efficient justice systems can greatly contribute to reducing risks and legal uncertainties and encouraging cross-border business, trade and investment. In its experience with the Member States under an economic recovery program, the Commission has identified the key role of judicial reforms. Reforms of national insolvency law are an important tool to promote economic recovery."[237]

The creation of an effective, efficient and level playing ground in all aspects of insolvency laws (at both the local and cross-border level) within European borders remained a key necessity for the Union. Creating a new bankruptcy scenario served several purposes. Increasing the levels of predictability and transparency could incentivize cross-border investments, supporting a more active joint economy and speeding up the process of recovery:

"The challenge is to address adequately and swiftly the debtor's financial difficulties while protecting the creditor's legitimate interests and ensuring access to justice to all parties. During the last twenty years, the single market has been developed as an area without barriers. If a company is in trouble financially, it should be just as easy to get help cross-border as domestically. The creation of a level playing field of national insolvency laws should lead to greater confidence in the systems of other Member States for companies, entrepreneurs and private individuals willing to operate in the internal market. Efficient insolvency rules also improve access to credit, which encourages investment. Creditors are more likely to lend when they are confident that they will be able to collect their loans. Greater compatibility of the rules on insolvency proceedings can therefore improve the functioning of the internal market. Although diversity is part of legitimate regulatory competition based on national political choices, it generally leads to the problem of forum shopping."[238]

Four key areas were found to be in urgent need of revision:

a. The achievement of greater levels of uniformity among local regulations – disparities among local regulations decreased the levels of transparency and predictability, hence discouraging cross-border investments and weakening the European economy at all levels;
b. Improvements in the enacted cross-border frameworks – as we will discuss in Chapter III, much was done during the second decade of the new millennium to improve the cross-border insolvency framework, incentivizing reorganizations;

[236] **Wymenga Paul; Dr. Viera Spanikova, Dr. James Derbyshire, A. Baker**, "*Are EU SMEs recovering from the crisis? – Annual Report on EU Small and Medium Enterprises 2010/2011*", ECORYS, Rotterdam / Cambridge, (2011), at 3-4.
[237] **(2012) COM 742 Final**, "*Communication from the Commission to the European Parliament the Council and the European Economic and Social Committee – A new European approach to business failure and insolvency*", at 3.
[238] *Id.*

c. Eradicating stigmatizing factors – European societies had to abandon the stigma and opt for a supportive approach. Debtors could not suffer unreasonably heavy consequences due to their mistakes. Unless frauds had occurred, they had to be allowed to make of their mistakes a positive learning opportunity;
d. Improved administration of proceedings – systems had to increase their speed in closing proceedings and in awarding fresh starts to honest debtors. This process was key to supporting European entrepreneurialism, since honest debtors had to re-enter the market swiftly to benefit themselves and society as a whole.

All such areas, though, were extremely complex to reform. The Union continued to guide the process of modification, promoting among Member States the adoption of new approaches which had already been discussed within the Lisbon strategy. Adapting the existing laws to the new ten-year strategy continued to be a major challenge.

Bringing results through such process was (much) easier said than done!

5.2.1 Increasing the levels of uniformity among local European insolvency frameworks

Creating uniform, effective, and efficient insolvency frameworks was a key area in need of immediate improvement. We will discuss this topic in greater depth in Chapters II and III. For now, we will stick to the information provided by official documents to get a sense of how the matter of "harmonization" was perceived in Europe.

A specific study on this topic was presented in 2010. It stated that improvement in the levels of coordination among local framework was an important goal for:

> "(i) The present system of different national insolvency regimes may imply that the laws of one Member State could be more beneficial for one stakeholder and the laws of another Member State could be more beneficial for another stakeholder. In addition, it avoids global solutions for global problems such as occur with the insolvency of groups of companies. This may lead to either the management indulging in what is termed 'insolvency tourism' (forum shopping) by the attempted shift of the COMI of a company to a jurisdiction that is more "debtor friendly" or the debtor and the creditors possibly becoming involved in a race to the courts in different jurisdictions.
> (ii) Harmonisation of national insolvency regimes will inevitably lead to greater confidence in the insolvency systems of EU Member States; this increases transparency and therefore leads to a better understanding by the parties involved on the means and methods that are available to address the needs of commercial entities that get into financial difficulty and of the remedies available to the creditors and other stakeholders of those entities;
> (iii) Harmonisation of insolvency regimes will further promote a level playing field; and
> (iv) Harmonisation of the insolvency processes across the Member States of the EU will increase the efficiency of the insolvency and business reorganization processes in the EU and as a consequence, increase the return to creditors where it is decided to liquidate the assets or the prospects of reorganisation by getting a greater number of creditors to support plans for restructuring. These in total will increase the confidence that the commercial and financial sectors have in the efficiency of the financial infrastructure of the EU."[239]
>
> "There is a need for a balanced and thoughtful approach to harmonisation, which may modify or condition attempts at a wholesale harmonisation of all aspects of insolvency and restructuring law. By its very nature, insolvency law interfaces with many other laws and systems such as land, employment and contract laws and the court systems of each country. Until these are all harmonised, it will not be possible to harmonise all aspects of insolvency law. For example, because of the widely differing structures and roles that the courts play in insolvency proceedings, it will not be possible to harmonise the court's supervision of office holders.

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[239] **Directorate-General For Internal Policies, Policy Department Citizen's Rights and Constitutional Affairs**, "*Harmonization of insolvency law at EU level*", (2010), at 26-27.

> Therefore, at present, there are serious reservations as to whether full harmonisation would be attainable, even if it were deemed possible. However, striving for harmonisation of certain aspects of insolvency law would seem to be very worthwhile. The most appropriate issues for harmonisation would include:
> (i) The roles, responsibilities and procedures for the proposal, verification, adoption, modification and contents of reorganisation plans (see paragraph 1 (VI));
> (ii) Avoidance actions including the provisions relating to connected parties (see paragraph 1 (VIII));
> (iii) Rules on the variation and termination of contracts, in particular labour contracts. Different rules produce market distortion (see paragraph 1 (IX));
> (iv) Rules on the coordination and effective organisation of insolvency proceedings with respect to different economic entities belonging to the same economic group, international holding structures and the organization of financial groups according to business line (see paragraph 1 (XIII));
> (v) In addition, there is no general harmonized provision on the rules governing the effect of lawsuits on insolvency proceedings or lawsuits that are directly or indirectly connected with insolvency proceedings. Article 15 of EC Regulation No 1346/2000
> provides that the effects of insolvency proceedings on a lawsuit pending concerning an asset or a right of which the debtor has been divested shall be governed solely by the law of the Member State in which that lawsuit is pending. This will probably also be reviewed on the reform of the EC Regulation No 1346/2000 by 2012;
> (vi) The EU should consider embracing the concepts of the UNCITRAL Model Law on Cross-border Insolvency in its entirety, as it is not in conflict with any existing EU regulation."[240]

In 2011, the "Report of the Commission on bankruptcy proceedings" listed specific areas which were in great need of immediate harmonization:

1.1. "Recommendation on the harmonisation of certain aspects of the opening of insolvency proceedings;
1.2. Recommendation on the harmonisation of certain aspects of the filing of claims;
1.3. Recommendation on the harmonisation of aspects of avoidance actions;
1.4. Recommendation on the harmonisation of general aspects of the requirements for the qualification and work of liquidators;
1.5. Recommendation on the harmonisation of aspects of restructuring plans."[241]

This important document addressed several reforms which soon became cornerstones of the process of refoundingf European regulations within the second ten-year strategy. The Report emphasized the importance of shifting to abandon old principles which prioritized liquidations. The EU had to place a bet on reorganizations instead and of the implementation of an effective corporate rescue approach.

As discussed in the previous pages, in fact, liquidation proceedings became, with time, a last resort. Frameworks had to support entrepreneurs in their activities and the creation of new businesses so that the whole economy and society at large could prosper. The excessive use of liquidations (which, as we will discuss in the next Chapters, were greatly empowered in previous centuries) was not deemed to be of help in this critical phase of the growth of the Union:

> "G. whereas there is a progressive convergence in the national insolvency laws of the Member States;
> H. whereas insolvency has an adverse impact not only on the businesses concerned but also on the economies of the Member States, and whereas the aim should therefore be to safeguard all economic stakeholders, taxpayers and employers against the repercussions of insolvency;

[240] *Id.,* at 27.
[241] **Klaus-Heiner Lehne**, "*Committee on Legal Affairs - REPORT – with recommendations to the Commission on insolvency proceedings in the context of EU company law (20011/2006 (INI))*", A7 10 2011 A7-0355/2011, at 3.

> I. whereas the approach in relation to insolvency proceedings is now centred more on corporate rescue as an alternative to liquidation;
> J. whereas insolvency law should be a tool for the rescue of companies at Union level; whereas such rescue, whenever it is possible, is to the benefit of the debtor, the creditors and the employees;
> K. whereas insolvency proceedings should not be used abusively by a creditor to avoid joint action for the recovery of debts, and whereas it is therefore necessary to introduce appropriate procedural safeguards."[242]

The importance of "corporate rescue frameworks" was, once again, restated in 2014:

> "Several Member States are currently undertaking reviews of their national insolvency laws with a view to improving the corporate rescue framework and the second chance for entrepreneurs. Therefore it is opportune to encourage coherence in these and any future such national initiatives in order to strengthen the functioning of the internal market.
> It is necessary to encourage greater coherence between the national insolvency frameworks in order to reduce divergences and inefficiencies which hamper the early restructuring of viable companies in financial difficulties and the possibility of a second chance for honest entrepreneurs, and thereby to lower the cost of restructuring for both debtors and creditors. Greater coherence and increased efficiency in those national insolvency rules would maximise the returns to all types of creditors and investors and encourage cross-border investment. Greater coherence and increased efficiency in those national insolvency rules would maximise the returns to all types of creditors and investors and encourage cross-border investment. Greater coherence would also facilitate the restructuring of groups of companies irrespective of where the members of the group are located in the Union."[243]

Yet, the preset targets were not reached by the 2015 midterm deadline:

> "National insolvency rules vary greatly in respect of the range of the procedures available to debtors facing financial difficulties in order to restructure their business. Some Member States have a limited range of procedures meaning that businesses are only able to restructure at a relatively late stage, in the context of formal insolvency proceedings. In other Member States, restructuring is possible at an earlier stage but the procedures available are not as effective as they could be or involve varying degrees of formality, in particular in relation to the use of out-of-court processes.
> Similarly, national rules giving entrepreneurs a second chance, in particular by granting them discharge from the debts they have incurred in the course of their business vary as regards the length of the discharge period and the conditions under which discharge can be granted.
> The discrepancies between the national restructuring frameworks, and between the national rules giving honest entrepreneurs a second chance lead to increased costs and uncertainty in assessing the risks of investing in another Member State, fragment conditions for access to credit and result in different recovery rates for creditors. They make the design and adoption of consistent restructuring plans for cross-border groups of companies more difficult. More generally, the discrepancies may serve as disincentives for businesses wishing to establish themselves in different Member States."[244]

In the next chapters we will discuss this complex topic at length. We will attempt to understand:

- The difficulties that can be met in bringing uniformity among European insolvency laws;
- The steps that need to be undertaken to improve this key process;

[242] *Id.*
[243] *Id.*
[244] **(2014) 1500 COMMISSION RECOMMENDATION Final**, "*Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency*", at 1.

- The barriers (external and internal) which constitute powerful obstacles on the path to success.

We will also discuss the new formula which the Union attempted to impose on local regulations. It is evident that European strategies have designed, in the past twenty or so years, a clear path to be followed. The road toward the development of the entrepreneurial spirit of European citizens is made of tools such as fresh starts, exemptions, and discharges, and it is rooted in the reduction of crime and stigma.

All these elements, which aim to bring radical changes, are transplanted from foreign systems or absorbed from international best practices. This process proved to be extremely challenging and has not brought the expected results yet.

5.2.2 The need for improvements within cross-border European regulations

We will discuss this topic in greater depth in Chapter III. For now, we will limit ourselves to mentioning that the draft enacted in 2002 was an extremely relevant step forward. It took decades of negotiations, in fact, to see a regulation finally adopted and enacted. More, though, had to be urgently done.

The enactment of the European cross-border insolvency model was a first, vital step, but after ten years the feeling was that several improvements had to be made. Updates were necessary to ensure that the draft could support the steps made by Member States and by the Union to develop the new ten-year strategy:

> "The EU Regulation on insolvency proceedings was adopted to deal with issues of cross-border insolvency through the proper recognition and coordination of national insolvency proceedings and in order to avoid incentives for the parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favorable legal position (forum shopping). As its scope is cross-border, the Regulation however did not harmonise insolvency laws used for national insolvency cases. Thus, differences in national laws remain, and as a consequence, economic activities may be lost, creditors recover less than they otherwise would, and creditors from different Member States are not treated equally. The Commission is currently proposing the modernisation of the EU Regulation on insolvency proceedings but the changes proposed concern only cross-border cases."[245]

The first draft, in fact, limited its scope to liquidation proceedings only.

Modern European strategies, though, as we have just discussed, placed a bet on developing the entrepreneurial spirit of European citizens and on reorganizations. At a time of such great difficulties, in fact, actions had to be continued to ensure that the market could remain vital. The Union had to limit waste, offering an opportunity to businesses in distress to restructure themselves whenever possible (hence supporting the preservation of employment levels). Businesses would be liquidated only when it would be impossible to save them.

Failure ceased, therefore, to be a death sentence; debtors had to be granted access to quick fresh starts within the territory of the whole Union:

> "Council Regulation (EC) No 1346/2001 only deals with issues of jurisdiction, recognition and enforcement, applicable law and cooperation in cross-border insolvency proceedings. The Commission proposal for the amendment of that Regulation should extend the scope of the Regulation to preventive procedures which promote the rescue of an economically viable debtor and give a second chance to entrepreneurs. However, the proposed amendment does not tackle the discrepancies between those procedures in national law."[246]

[245] **(2012) COM 742 Final**, "*Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee - A new European approach to business failure and insolvency*", at 2.

[246] (**2014) 1500 COMMISSION RECOMMENDATION Final**, "*Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency*", at 3.

However, as we will discuss in greater depth in the next pages, as long as local regulations remain greatly discordant, it will not be possible to make the necessary improvements within cross-border frameworks.

5.2.3 The ongoing process of eradicating the stigma of failure

Much still had to be done also to eradicate the stigma of failure and implement a “second chance” policy at the local and cross-border level.[247] The social stigma affecting failures was still greatly present among European societies and continued to act as an obstacle to the development of higher levels of entrepreneurship and to the growth in numbers of SMEs:

> “Business failure, like business creation, is part of a dynamic, healthy market. **Evidence shows that by far the majority (96%) of bankruptcies are due to a string of late payments or other objective problems** – they are, in other words 'honest failures', without any fraud by the entrepreneur. Entrepreneurs are nevertheless treated by many bankruptcy laws as if they were fraudulent, having to go through complex procedures before they can be discharged. In some Member States the procedure may take such a long time that entrepreneurs will not consider another business venture55. In some cases they may be legally barred from starting a new enterprise for much or all of their lifetimes. Even after a discharge, former bankrupts are stigmatised and have difficulties financing a new enterprise. Therefore, many potential entrepreneurs simply give up and do not consider trying again.
> Yet research shows that **'second starters' are more successful and survive longer than average start-ups**; **they grow faster and employ more workers**. Thus, **a failure** in entrepreneurship **should not result in a "life sentence"** prohibiting any future entrepreneurial activity **but should be seen as an opportunity for learning and improving** – a viewpoint that we already today fully accept as the basis of progress in scientific research.
> Consequently, any move to encourage a new generation of entrepreneurs must include reassurance that, if their first idea does not fly, they will not be forever barred from trying to 'take off' again. Thus bankruptcy laws must provide for swift, efficient ways of lodging and recovering claims for creditor enterprises, while faster and more affordable procedures for winding up businesses and for discharge from bankruptcy should be put in place.”[248]

We will examine the stigma in depth in the next chapters.

In Chapter IV, in particular, we will discuss the ancestral origins of this stigma, making relevant observations on the reasons that make of this factor a difficult one to eradicate. For now, we can anticipate that what has made the stigma strong within European societies since medieval times is, ironically, its value for the economies of the City-states.

Fragile medieval economies relied on harsh punishments (including tools like torture) to ensure that debts would be paid regularly. The balance was fully shifted in favor of public authorities and to the advantage of the creditors so that defaults could be swiftly contained before they caused dangerous chain effects.

Bankrupts would be evicted from society; they would be banned or left to die in prison. Their faults would be passed on to their heirs and partners, spreading like a plague. The fear of the heavy

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[247] See **Mac Namara Bernard**, “Domestic and European perspectives on the reform proposal” in *‘The grand project: reform of the European insolvency Regulation – Papers from the INSOL Europe Academic Forum and Academy of European Law Joint Insolvency Conference Trier, Germany, 18-19 March 2013 and the INSOL Europe Academic Forum Annual Conference Paris, France, 25-26 September 2013’*, Ed. Bariatti Stefania and Omar Paul J., INSOL EUROPE, ISBN 978-0-9570761-8-1, (2014);

[248] **(2012) COM 795 Final**, “*Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Entrepreneurship 202 Action Plan - Reigniting the Entrepreneurial Spirit in Europe*”, at 17.

consequences of medieval bankruptcies protected European economies for centuries from the consequences of reckless behaviors.

This approach, though, was not considered to be the most efficient and effective in tackling the modern challenges of a globalized economy. The United States of American proved able to compete best, deploying a diametrically opposite philosophy. The Union followed this path with ambitious actions.

Despite almost two decades of attempts, though, reformers still struggled to shape a successful framework. The new "rescue mentality" and the tools transplanted from foreign frameworks did not find a good fit within the European scenario up to now.

5.2.4 "Speed" in bankruptcy: implementing swift, effective, and efficient models which could ensure a limited duration of proceedings and a quick fresh start

Only a decade was given to achieve the challenging goals set at da Feira. The new ten-year strategy was greatly concerned with obtaining swift results. Bankruptcy reforms had to occur swiftly too; therefore modern bankruptcy proceedings had to be swifter. The new local and cross-border models had to be designed to ensure that honest debtors could reorganize their finances or obtain quick discharges. If they did not, citizens would not be incentivized to make a good use of their second chances and their entrepreneurial spirit would not be fully deployed:

> "On top of the social stigma, business people in search of a second chance can be caught up in bankruptcy procedures for between 4 months and 9 years, depending on which Member State they are based in."[249]
>
> "Modern insolvency law in the Member States should help sound companies to survive and encourage entrepreneurs to get a second chance. It should ensure that procedures are speedy and efficient, in the interest of both debtors and creditors, and should help safeguard jobs, help suppliers to keep their customers, and owners to retain value in viable companies. To achieve the Europe 2020 objectives, we need to focus on the general objective of improving the efficiency of justice in the EU. Efficient justice systems can greatly contribute to reducing risks and legal uncertainties and encouraging cross-border business, trade and investment. In its experience with the Member States under an economic recovery programme, the Commission has identified the key role of judicial reforms. Reforms of national insolvency law are an important tool to promote economic recovery. The 2012 European Semester reflected the impact of justice systems on the economy by making recommendations to certain Member States relating to efficient insolvency proceedings.
> Giving entrepreneurs a second chance to restart viable businesses and safeguarding employment are key elements of the new European approach to business failure and insolvency. This approach aims to give a solid boost to European business in the internal market. The proposal to update the EU Regulation on insolvency proceedings in the crossborder context, adopted in parallell to this Communication, is already based on this new approach. It will also be supported by the forthcoming European Entrepreneurship Action Plan." [250]

Consequently, a specific target was set to bring the debt settlement and discharge period to three years[251]:

> "A three year discharge and debt settlement period should be a reasonable upper limit for an honest entrepreneur and as automatic as possible. It is crucial that entrepreneurship does not end up as a 'life sentence' if things go wrong. […] Shortening and aligning the 'time to discharge' would be an important step towards creating a friendlier and more

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[249] **Wymenga Paul, Dr. Viera Spanikova, Dr. James Derbyshire, A. Baker**, "*Are EU SMEs recovering from the crisis? – Annual Report on EU Small and Medium Enterprises 2010/2011*", ECORYS, Rotterdam / Cambridge, (2011), at 7.

[250] See: **(2012) COM 742 Final**, "*Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee - A new European approach to business failure and insolvency*",

[251] **See (2014) 1500 COMMISSION RECOMMENDATION Final**, "*Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency*".

> innovative business environment, allowing European enterprises to operate on a leveled playing field. It could be a first step towards a wider approximation of national bankruptcy laws."[252]

Although the swift administration of proceedings has always been a main target set within all proposals, the setting of a deadline raised several questions. Practitioners are well acquainted with the intricacies of this field of law and with the countless challenges that lie in any proceeding regardless of its mere economic value. Ensuring that it could be determined if a debtor had been "honest" and if he could be rehabilitated within three years would be an extraordinary challenge.

Complying with European strategies, though, was a priority.

5.2.5 Further developments in the refoundation of insolvency frameworks which occurred before the 2015 midterm deadline

In 2014, the Commission published a relevant recommendation[253] on a new approach to business failure and insolvency.[254] [255] The document, which focused on the value of reorganization proceedings, was inspired by the model enclosed in Chapter 11 of the United States Bankruptcy Code and which we will discuss in Chapter V. The goal pursued by the Commission was to realize the changes already discussed by the report and ensure that viable enterprises could find assistance in local insolvency frameworks, maximizing the system's efficiency.

If accomplished successfully, such a process would benefit:

a) Local and European markets and societies – improving current insolvency systems would bring great benefits to local economies and societies and to the Union as a whole.

> "The objective of this Recommendation is to ensure that viable enterprises in financial difficulties, wherever they are located in the Union, have access to national insolvency frameworks which enable them to restructure at an early stage with a view to preventing their insolvency, and therefore maximise the total value to creditors, employees, owners and the economy as a whole. The Recommendation also aims at giving honest bankrupt entrepreneurs a second chance across the Union."[256]

b) All of the parties involved in bankruptcy proceedings. In particular, it would :

- **Increase benefits for creditors** – the system would ensure greater levels of transparency and predictability, hence allowing investors to make better choices and reducing risks.

> "Greater coherence and increased efficiency in those national insolvency rules would maximise the returns to all types of creditors and investors and encourage cross-border investment. Greater coherence would also facilitate the restructuring of groups of companies irrespective of where the members of the group are located in the Union."[257];

[252] **(2012) COM 742 Final**, "*Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee - A new European approach to business failure and insolvency*", at 6.

[253] Recommendations (Article 288 TFEU) are non-binding acts included in the Treaty of Rome.

[254] **(2014) 1500 COMMISSION RECOMMENDATION Final**, "*Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency*".

[255] For an accurate discussion of the recommendation; a description of the US model; a comparative analysis of reorganization frameworks in the EU, see: Mc Cormack Gerard, Keay Andrew, Brown Sarah and Dahlgreen Judith, "*European Commission – Justice and Consumers – Study on a new approach to business failure and insolvency – Comparative and legal analysis of the Member States' relevant provisions and practices*", Tender No. JUST/2014/JCOO/PR/CIVI/0075, (2016), at 218-280.

[256] **(2014) 1500 COMMISSION RECOMMENDATION Final**, "*Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency*", at 1.

[257] *Id.,* at 4.

- **Increase benefits for debtors** – the system would support the continuation of businesses while reducing the impact of stigma.[258]

  "A restructuring framework should enable debtors to address their financial difficulties at an early stage, when their insolvency could be prevented and the continuation of their business assured."[259]
  "The effects of bankruptcy, in particular the social stigma, legal consequences and the on-going inability to pay off debts constitute important disincentives for entrepreneurs seeking to set up a business or have a second chance, even if evidence shows that entrepreneurs who have gone bankrupt have more chance to be successful the second time. Steps should therefore be taken to reduce the negative effects of bankruptcy on entrepreneurs, by making provisions for a full discharge of debts after a maximum period of time."[260]

- **Increase benefits for court systems** – improving insolvency frameworks would increase efficiency levels, reducing the length of proceedings and the burden on court systems.

  "To promote efficiency and reduce delays and costs, national preventive restructuring frameworks should include flexible procedures limiting court formalities to where they are necessary and proportionate in order to safeguard the interests of creditors and other interested parties likely to be affected. For example, to avoid unnecessary costs and reflect the early nature of the procedure, debtors should in principle be left in control of their assets and the appointment of a mediator or a supervisor should not be compulsory, but made on a case-by-case basis."[261]

c) Stakeholders in general.

- Increased benefits for employees – the discussion on the reform of insolvency system has often been focused in recent years on increasing the benefits for employees.

  "Furthermore, removing the barriers to effective restructuring of viable companies in financial difficulties contributes to saving jobs and also benefits the wider economy. Making it easier for entrepreneurs to have a second chance would also lead to higher self-employment rates in the Member States."[262]

- Increased benefits for investors.

  "Moreover, efficient insolvency frameworks would provide a better assessment of the risks involved in lending and borrowing decisions and smooth the adjustment for over-indebted firms, minimizing the economic and social costs involved in their deleveraging process."[263]

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[258] The Recommendation, at page 4, makes the following exclusions: "It is appropriate to exclude from the scope of this Recommendation insurance undertakings, credit institutions, investment firms and collective investment undertakings, central counter parties, central securities depositories and other financial institutions which are subject to special recovery and resolution frameworks where national supervisory authorities have wide-ranging powers of intervention. Although consumer over-indebtedness and consumer bankruptcy are also not covered by the scope of this Recommendation, Member States are invited to explore the possibility of applying these recommendations also to consumers, since some of the principles followed in this Recommendation may also be relevant for them."

[259] **(2014) 1500 COMMISSION RECOMMENDATION Final**, "*Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency*", at 4.

[260] *Id,* at 5.

[261] *Id,* at 4.

[262] *Id.*

[263] *Id.*

- Increased benefits for SMEs.

> "Small and medium sized enterprises would benefit from a more coherent approach at Union level, since they do not have the necessary resources to cope with high restructuring costs and take advantage of the more efficient restructuring procedures in some Member States."[264];

- Increased benefits for tax authorities and Member States in general.

> "Tax authorities also have an interest in an efficient restructuring framework for viable enterprises. In implementing this Recommendation, Member States should be able to take appropriate measures to ensure the collection and recovery of tax revenues respecting the general principles of tax fairness and to take efficient measures in cases of fraud, evasion or abuse."[265]

6. The midterm evaluation of the 2020 strategy: Europe slows down (yet again)

In 2015, European strategies underwent a new midterm evaluation. At that time, the available data showed the following progress made towards reaching the 2020 targets:

EU-LEVEL EUROPE 2020 TARGETS	LATEST DATA
Increasing the employment rate of the population aged 20-64 to at least 75%	68.4% (2013)
Increasing investment in R&D to 3% of GDP	2.02% (2013)
Reducing greenhouse gas emissions by at least 20% compared to 1990 levels	17.9% reduction (2012)
Increasing the share of renewable energy in final energy consumption to 20%	14.1% (2012)
Moving towards a 20% increase in energy efficiency (measured in terms of primary energy consumption and final energy consumption)	Primary energy consumption: 11.9% increase in energy efficiency (2013) Final energy consumption: 12.8% increase in energy efficiency (2013)
Reducing the rate of early leavers from education and training to less than 10%	12.0% (2013)
Increasing the share of the population aged 30-34 having completed tertiary education to at least 40%	36.9% (2013)
Lifting at least 20 million people out of the risk of poverty and social exclusion (equivalent to a target of 96.6 million)	121.6 million people at risk of poverty or social exclusion (2013)

Midway towards the 2020 deadline, achievements were, yet again, insufficient:[266]

> **"Halfway to the 2020 deadline, the delivery of the jobs and growth objectives is mixed, notably due to the impact of the crisis**. The legacy of the crisis is still particularly acute, in particular on labour markets with unemployment remaining very high at EU level and

[264] *Id.*
[265] *Id.*
[266] See **(2015) COM 468 Final**, "*Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Action Plan on Building a Capital Markets Union*", at 24: "The 2015 World Bank Doing Business Report ranks countries on the strength of their insolvency frameworks on a scale of 0-16. The EU simple average is 11.6, which is 5% below the OECD average for high income countries (12.2). Some Member States score below 8.

situations varying significantly across Member States. Among the main sources of concern, youth unemployment rates remain elevated in several Member States and long-term unemployment has been increasing. On the social front, the crisis has led to increased exposure to poverty and social exclusion and rising inequalities. The situation is particularly difficult in certain Member States where there have been increases in severe material deprivation and in the share of jobless households. At the height of the crisis, the need to get public spending under control limited expenditure in research and development in a number of Member States. Now that the focus is gradually shifting from the emergencies of the crisis to building solid foundations for jobs and growth, it is important for Member States to prioritise growth-enhancing expenditure such as investment in research and development. A number of long-term trends also continue to affect growth, for example demographic developments, globalisation and competition from international partners, the challenge of productivity and digitalisation as well as pressure on resources and environmental concerns.

The crisis has also affected progress towards the Europe 2020 headline targets. The crisis has had a clear negative impact on employment and levels of poverty and has constrained progress towards some of the other targets, with the exception of its effect on the reduction of greenhouse gas emissions. Despite the crisis there have been more positive structural trends, for instance in education levels, building a more sustainable energy mix and the reduction in the carbon intensity of the economy. As a consequence, globally, the EU is on course to meet or closely approach its targets on education, climate and energy. This is not the case regarding employment, research and development and poverty reduction where the impact of the crisis has been most acutely felt. In all areas, efforts need to be sustained to consolidate progress and make further advances.

The Europe 2020 targets are political commitments. The political nature of the targets is inherent in the strategy and reflects the primary role that national governments should play in the strategy, in line with the principle of subsidiarity. However, for most of the areas, national targets are not sufficiently ambitious to cumulatively reach the EU-level ambition. For instance, if all the Member States reached their individual national targets, the aggregated investment in research and development at EU level would amount to 2.6% of GDP by 2020, which is below the 3% target set by the EU. These varying degrees of commitment are also reflected in the variable degree of policy response and ambition across the EU.

Part of the mixed progress on the Europe 2020 targets can also be attributed to the time lag with which structural reforms produce their full impact on the economies. Although the pace and quality of structural reforms have varied from one Member State to another, most Member States have embarked on important structural reforms in their labour markets, to make them more resilient in the future, in product and services markets to improve their functioning and foster an efficient allocation of resources, and in public administrations to enhance their efficiency. Yet, these reforms take time to bear fruit and become visible, which makes their swift and thorough implementation crucial."[267]

Despite apparent progress and the illusion of having made it out of the swamp, the Union still struggled in several areas, such as the fight against poverty (which will have a relevant impact on further bankruptcy reforms). At a time of such deep economic crisis, it was a true challenge to reduce figures that counted millions of people at risk of poverty or social exclusion.

Difficulties were also found in reviving the common market.[268] The barriers that had been spotted in previous years continued weakening the effects of European actions. Notwithstanding all the attempts that

[267] **(2015) COM 100 Final**, "*Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Result of the public consultation on the Europe 2020 strategy for smart, sustainable and inclusive growth*", at 2-3.

[268] **(2015) COM 468 Final**, "*Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Action Plan on Building a Capital Markets Union*".

were made, in fact, the Member States still struggled in adopting the suggested policies uniformly, widening the gaps among themselves (and at international level) instead of reducing them:[269]

> **"Growing divergences across and often within Member States have hampered progress towards the Europe 2020 targets**. The crisis has led to a growing gap between the best and least well performing Member States, instead of the desired convergence of our economies. There has also been a widening gap between regions inside and across Member States. As an example, in 2013, the gap between the highest and the lowest performance as regards the employment rate of the population aged 20-64 was 26.9 percentage points, with employment rates varying from 52.9% in Greece to 79.8% in Sweden. This can be compared to the situation in 2000, where 22.7 percentage points separated the lowest from the highest performance, with employment rates going from 55.3% in Bulgaria to 78.0% in Denmark."[270]

Nevertheless, despite the (usual) delay in meeting the preset targets, the final choice was (just as it happened in 2004) to stick to the 2020 strategy, which was "reset" to compensate for the goals that had been missed in an attempt to bring the Union closer to matching the original roadmap:

> ***"3.1 The scope and the objectives of the Europe 2020 strategy are still relevant***
> **There is an overwhelming support for an EU strategy in favour of jobs and growth**. A large majority of the respondents (86%) consider that Europe needs a comprehensive and overarching medium-term strategy for jobs and growth for the coming years, while only a few of them (14%) have mixed or negative views. The latter, mainly individual citizens, consider either that the EU should focus on the implementation of existing instruments; or that social, economic and environmental development is more important than growth *per se*; or that decision-makers should put aside the idea of infinite growth. The vast majority of participants associate the strategy with their sphere of action and appreciate its overarching capacity. The relevance of the triptych "smart, sustainable and inclusive growth" is welcomed.
> **The Europe 2020 strategy addresses today's and tomorrow's challenges**. The contributions to the public consultation show a strong co-relation between the areas identified by the participants as priorities and those encompassed by the Europe 2020 strategy.
> ***3.2 The current five headline targets are relevant and mutually reinforcing***
> **Respondents very largely welcome the targets as a useful instrument for the delivery of the strategy**. Most (87%) consider the targets as a useful tool in the implementation and monitoring of the Europe 2020 strategy, since they act as benchmarks that help focus attention on a number of key areas. Some contributions (10%) indicate avenues for improvement while acknowledging that targets are a valuable instrument. A number of contributions emphasise the importance of avoiding too many targets and thus of keeping a focused approach. The targets are seen as unuseful by only a few of the respondents (3%). Moreover, some respondents highlight the importance of complementing any quantitative assessment of progress towards the targets with a qualitative analysis. The importance of a qualitative analysis and evaluation is shared by the Commission and is notably carried out in the context of the European Semester.
> **There is strong support for keeping the current five headline targets unchanged**. A large majority of respondents (78%) consider the current targets are sufficient. Some respondents propose to add new targets whereas others question the relevance of the target related to tertiary education, and underline the importance of adapting skills to labour market needs in order to avoid mismatches. It is important to recall that the targets are not meant to reflect the totality of the EU's policies or ambitions – they are

[269] *Id.;* **(2015) COM 183 Final**, "*Commission staff working document - Economic Analysis - Accompanying the document - Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Action Plan on Building a Capital Markets Union*".
[270] *Id.,* at 2.

representative measurements of the type of changes advocated by the Europe 2020 strategy. Some of the targets suggested by contributors such as indicative targets for resource efficiency and industry's share of GDP are already streamlined into other EU policies. Finally, no clear hierarchy between the targets emerges from the public consultation. Approximately half of the respondents take the position that the targets are equally important and interdependent, that they are mutually reinforcing and that altogether they contribute to jobs and growth.

3.3 The flagship initiatives have served their purpose

The flagship initiatives have generally served their purpose and action in their respective areas needs to be pursued through other forms. Overall, participants see the purpose of the flagship initiatives as improving the EU's performance to reach the Europe 2020 targets. Yet, a significant number of participants (32%), including governments and representative organisations, delivered a mixed assessment: flagship initiatives were seen to have delivered their purpose by giving an impetus to a range of priority actions. However, their added value has been overshadowed by a lack of awareness and overlapping policy actions, in turn making them redundant. Some respondents indicate that the flagship initiatives are disconnected from their respective broader policy areas and others perceive a blurring due to overlaps and a lack of prioritisation of the flagship initiatives. Therefore, respondents argue that they should now be replaced by more coherently organised and overarching policy programmes.

Relevant steps were made to incentivize investments, especially at a cross-border level. The European market, in fact, was suffocating after fifteen years (or more) of difficulties and had to acquire new resources. Actions in this area and for the creation of jobs were promoted, within official documents, with the usual optimism:

"The Commission's top priority is to strengthen Europe's economy and stimulate investment to create jobs. The EUR 315 billion investment plan, up and running less than a year after the Commission took office, will help to kick start that process. To strengthen investment for the long term, we need stronger capital markets. These would provide new sources of funding for business, help increase options for savers and make the economy more resilient. That is why President Juncker set out as one of his key priorities, the need to build a true single market for capital – a Capital Markets Union for all 28 Member States."[271]

Countless obstacles were still to be removed:

"Despite progress in recent decades to develop a single market for capital, there are still many obstacles that stand in the way of cross-border investment. These range from obstacles that have origins in national law, such as insolvency, tax and securities law, to obstacles arising from a fragmented market infrastructure."[272]

"Creditors may hesitate to offer more cross-border credits because they do not have sufficient knowledge about the applicable personal insolvency regimes in other Member States (where these regimes exist). Whilst the CMU Action Plan takes some steps towards more convergence in certain areas of business insolvency regimes across all 28 Member States, such as on early restructuring and enhanced effectiveness of administration of cross-border business insolvency proceedings, there are still substantial divergences in relation to personal insolvency regimes across the EU. This creates additional risk for firms wishing to enter a cross-border business relationship with customers, particularly in relation to provision of credit – if lenders are unable to assess and quantify the outcome of insolvency proceedings and repossession laws, they will not feel confident lending to

[271] **(2015) COM 468 Final**, "*Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Action Plan on Building a Capital Markets Union*", at 3.
[272] *Id.,* at 6.

> individuals. Member States' laws and practices on business failure and insolvency and on personal over-indebtedness are currently the subject of two studies due for completion in 2016."[273]

European legal frameworks *had* to reach higher levels of uniformity[274] as soon as possible. By doing so, in fact, they would ensure higher levels of predictability and transparency, allowing investors to feel safe in planning their moves across the whole territory of the Union. Moreover, forum shopping would be reduced:

> "Ineffective and divergent insolvency regimes represent an investment deterrent. Disparate insolvency regimes in the EU generates unpredictability for EU cross-border investments. This was confirmed by the responses to the Green Paper on the Capital Markets Union. When making investment decisions, investors look at their rights and expected losses in the event of financial difficulties. If before making an investment it is not possible to predict clearly what will happen with the investment throughout its lifecycle, it is also not possible to identify, quantify and manage risks which can affect."[275]

> "This will impact the readiness of investors to invest in particular markets. The insufficient clarity and predictability in case of insolvency deter, in particular, corporate higher-risk segments (such as mezzanine and high-yield debt). Differences in insolvency frameworks particularly impede the flow of capital across the EU. In the context of 28 divergent insolvency regimes in the EU, investors are facing high costs in assessing the risks associated with the potential bankruptcy of the company in which they invest. Companies in financial difficulty which do not have effective early restructuring possibilities in their home country have an incentive to relocate to Member States with more effective systems." [276]

> "Convergence of insolvency and restructuring proceedings would facilitate greater legal certainty for cross-border investors and encourage the timely restructuring of viable companies in financial distress. Consultation respondents broadly agreed that both the inefficiency and divergence of insolvency laws make it harder for investors to assess credit risk, particularly in cross-border investments."[277]

> "There is a need for greater convergence in insolvency law and restructuring proceedings across Member States, as identified in the Commission's Action Plan on Building a Capital Markets Union of 30 September 2015. Inefficiency and divergence of insolvency laws make it harder to assess and manage credit risk. The Commission will consider bringing forward proposals enhancing legal certainty and encouraging the timely restructuring of borrowers in financial distress, which is particularly relevant for the success of strategies to address the problem of non-performing loans (NPLs) in some Member States. In the context of the European semester the Commission will also call for increased attention from Member States to settle NPLs, including by upgrading insolvency regimes towards best practices."[278]

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[273] **(2015) COM 630 Final**, "*Green Paper – On retail financial services – Better products, more choice, and greater opportunities for consumers and businesses*", at 6.
[274] *Id.*
[275] **(2015) COM 183 Final**, "*Commission staff working document - Economic Analysis - Accompanying the document - Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Action Plan on Building a Capital Markets Union*", at 72.
[276] *Id.,* at 72-3.
[277] *Id.,* at 72-3.
[278] **(2015) COM 183 Final**, "*Commission staff working document - Economic Analysis - Accompanying the document - Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Action Plan on Building a Capital Markets Union*", at 72-77. See also **(2015) COM 587 Final**, "*Communication from the Commission to the European Parliament, the Council, the European*

"A large number of market participants and investors noted that the diversity of regimes across the EU negatively impacts confidence in cross-border investment. However, there was less agreement on how to solve this problem. While a minority of respondents proposed to leave the identified problem unresolved, other respondents were in favor of a solution. Yet, there were divergent views on the form of the solution, ranging from a wide scope harmonization of substantive insolvency framework via a targeted high-level principles approximation to a creation of a dedicated 29th EU insolvency regime which would exist in parallel to the national insolvency regimes. Some respondents also indicated preference for a full harmonization of insolvency laws. 60 Respondents pointed to the ambitious nature of full harmonization, indicating rather a preference for developing a common set of minimum standards and general principles. Some respondents noted that non-binding measures have not been able to spur action on the side of Member States towards at least functional convergence of their insolvency frameworks. Certain respondents indicated that an EU action was not necessary or achievable. At the same time a number of them admitted that national insolvency frameworks as such and the divergences among them were posing a problem. The reasons given for abstention from Commission action were mainly the complexity of the matter and subsidiarity concerns." [279]

Insolvency systems remained a key area in need of urgent harmonization. Nevertheless, despite fifteen years of attempts, studies and reforms, the relevant barriers that were spotted in the previous years were far from removed:

"The effects of bankruptcy also deter people from entrepreneurial activity. The fear of the social stigma, legal consequences and the inability to pay off debts is stronger in Europe than in many other parts of the world, for example because of much longer debt discharge periods. This is a significant disincentive for entrepreneurs to start up a business. Entrepreneurs need to know that they will have a second chance. Building on existing work, the Commission will support bona fide entrepreneurs and put forward a legislative proposal on business insolvency, including early restructuring and second chance, to ensure that Member States provide a regulatory environment that is able to accommodate failure without discouraging entrepreneurs from trying new ideas."[280]

Overall we could say that the Union appeared to be stuck in *déjà vu*. Despite the genuine efforts to make a better start in the second ten-year strategy, history appeared to repeat itself – from the negative data collected in the mid-midterm evaluation, to the failure to meet the targets of the assessment of 2015. An impasse prevented the Union from moving forward successfully as it planned.

As we will discuss in depth in the next chapters, such an impasse heavily affected the refoundation of European insolvency frameworks. In 2015, as many as six key areas mentioned in the Commission's Recommendation of 2014 were still to be developed[281]:

Central Bank, the European Economic and Social Committee and the Committee of the Regions - Towards the completion of the Banking Union", at 10.

[279] **(2015) COM 183 Final**, "*Commission staff working document - Economic Analysis - Accompanying the document - Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Action Plan on Building a Capital Markets Union*", at 72-77.

[280] **(2015) COM 550 Final**, "*Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Upgrading the Single Market: more opportunities for people and business*", at 7.

[281] **(2014) 1500 COMMISSION RECOMMENDATION Final**, "*Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency*". See also: **(2015) COM 183 Final**, "*Commission staff working document - Economic Analysis - Accompanying the document - Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Action Plan on Building a Capital Markets Union*", at 72-77; **(2015) COM 184 Final**, "*Commission staff working document - Feedback Statement on the Green Paper 'Building a Capital Markets Union' - Accompanying the document Communication from*

> "(i) The possibility to file early with the objective of avoiding insolvency: The later a business initiates restructuring proceedings, the higher the costs of restructuring and the lower the management powers and success rate.
> (ii) The position of the debtor: In order to encourage debtors to address their financial difficulties at an early stage, they should be left in principle in control of the day-to-day operation of their business. This would also ensure that the least disruption to the activity of the enterprise.
> (iii) The possibility of a stay on individual enforcement actions: During negotiations on a restructuring plan, the debtor should be able to apply to a court for suspension of individual enforcement actions which could otherwise jeopardize the success of the restructuring process.
> (iv) Adoption of the restructuring plans by creditors: Restructuring plans should be adopted by creditors representing the majority stipulated under national law.
> (v) The protection for new finance granted in restructuring procedures: Encouraging new financing is necessary to ensure the success of a restructuring plan.
> (vi) The involvement of courts when third party rights could be affected: While the Recommendation encourages some limits to the extent of court involvement, certain steps in a restructuring process require court involvement, notably when the rights of dissenting creditors are affected."

Stigma, the length of proceedings, the lack of uniformity among local regulations, and the difficulties met within the societies in accepting re-starters all remain relevant barriers across the Union even today, at the end of the second ten-year plan. They still prevent the field of insolvency laws from being a fully operative and effective tool in supporting businesses and entrepreneurialism as it was optimistically predicted by several of the studies and documents which we have discussed.

Europe, nevertheless, keeps trying. A particularly remarkable initiative which was developed recently includes a proposal for the Directive to develop relevant aspects of bankruptcy frameworks. This approach is innovative. We will discuss the importance of this action in greater details in Chapters II and III. For now, we will limit ourselves to a brief overview of the contents of the official document published by the Union.

7. A brief overview on more recent updates

We will not discuss recent updates in depth. It would be difficult to assess the impact of factors such as the Brexit or the continuing effects of the crisis from 2016 on. At the same time, some of the developments connected to the process of refounding insolvency frameworks are relevant and worthy of mention. As discussed in the previous sections, toward the end of the second ten-year plan the scenario remained critical:

> "Despite ongoing efforts to improve European insolvency and restructuring procedures, important differences persist across Member States. World Bank indicators suggest that resolving an insolvency can take between less than one year in Ireland, Belgium and

the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Action Plan on Building a Capital Markets Union":
"The main suggestions aimed at harmonization of requirements for opening insolvency proceedings, including a common definition of default and avoidance actions, restructuring of companies, stay on individual creditor claims and definition of a common discharge period. Other frequently quoted proposals for action suggested ring-fencing of a client's securities in the case of insolvency of the financial intermediary and harmonization of ranking of creditors' claims. The issue of personal insolvency and the application of existing insolvency rules also at individual level were raised too, in particular by consumer representatives. Overall, respondents indicated a number of specific issues within the area of insolvency which in their view should be harmonized at EU level, such as preventive restructuring proceedings, out-of-court and hybrid restructuring procedures, second chance for entrepreneurs, regulation of qualifications, tasks and rights of insolvency practitioners, liability of directors and shadow directors, introduction of a time cap on insolvency procedures, establishment of an EU register with information on insolvencies and a harmonized form for petition claims", at 59.

> Finland and more than three years in Bulgaria, Romania, Greece and the Slovak Republic. The recovery rate varies between 30% in Croatia and Romania and 90% in Belgium and Finland. A study commissioned by the European Parliament had shown that disparities between national insolvency laws can create obstacles, competitive disadvantages and difficulties for companies with cross-border activities or ownership within the EU. Unlike the US where bankruptcy is regulated at the federal level, in the EU insolvency proceedings are regulated at national level. In the absence of EU action, the discrepancies between the Member States'' insolvency legislations are likely to continue to create costs for cross-bordercreditors, incentives for forum-shopping and obstacles to the re-organisation of crossborder groups of companies."[282]
>
> "Reform processes in the Member States undertaken since the adoption of the Recommendation. According to the responses received, a few Member States have undertaken reforms which, in some cases, resulted in legislation implementing the Commission's Recommendation (legislation was passed in SI introducing a preventive restructuring procedure, ES, HU and RO have improved their personal insolvency regime, HR in both personal and corporate restructuring regimes, new PL is also due to pass legislation soon in the area of corporate restructuring). Such legislation in most cases implements only partially the Commission Recommendation: for example, SI has implemented a preventive restructuring procedure which is limited to debtors which are medium and large companies, but excludes from its scope small enterprises, and to financial creditors only; ES has implemented a personal insolvency procedure, but did not follow the Commission's recommendation on limiting the discharge period for honest debtors to three years, instead limiting it to five years.
> In NL a reform process which aims at improving the existing preventive restructuring procedures which does not seem to function properly is still on-going, in LT improvements to the personal insolvency laws are being discussed, while in others Member States consideration is still being given to whether any specific action is necessary following the adoption of the Commission Recommendation (for example in Sweden a special committee was appointed to look at the need to adapt national legislation in the light of the Recommendation and the results are expected in October 2016; in the UK a public consultation has recently been carried out)." [283]

Several steps were taken to improve and harmonize the European insolvency scenario. An important action was designed to improve the approach to the reform process. In 2016, a specific proposal for a Directive was drafted to increase coordination among substantive elements of reorganization[284] frameworks.[285] It is important to note how, up to this proposal, the Union took action mainly through the enactment of regulations[286] and by developing comparative studies on the topic of bankruptcy.

As we will discuss in greater detail in Chapter III, European insolvency regulations were deployed to increase levels of uniformity at cross-border level from the town-down. Binding statutes, in fact, appeared

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[282] **(2015) COM 183 Final**, "*Commission staff working document - Economic Analysis - Accompanying the document - Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Action Plan on Building a Capital Markets Union*", at 74.

[283] Directorate-General Justice & Consumers of the European Commission, "*Evaluation of the Implementation of the Commission Recommendation of 12.3.2014 on a new approach to business failure and insolvency*", (2015), at 2.

[284] **Carpus Carcea Mihaela, Ciriaci Daria, Cuerpo Caballero Carlos, Lorenzani Dimitri, Pontuch Peter**, "*European Commission - Directorate-General for Economic and Financial Affairs - The Economic Impact of Rescue and Recovery Framework: Fostering a culture of early restructuring*", (2015), at 1.

[285] **(2016) COM 723 Final**, "*Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU*". See also the more recent amendments published on the 21st of August at
http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A8-2018-0269+0+DOC+XML+V0//EN

[286] See
https://ec.europa.eu/info/policies/justice-and-fundamental-rights/civil-justice/civil-and-commercial-law/insolvency-proceedings_en

to be a preferable tool to bind Member States and push local actions in the direction which was decided by the general strategies. The use of this tool, though, presented some weaknesses.

Ironically, in fact, EU regulations in this field did not fully achieve their goals. They did indeed provide great support to organize cross-border cases, but mostly from a procedural point of view. The relevant discrepancies among local frameworks, in fact, impeded the application of a common model of substantive bankruptcy rules on Member States (as we will see, regulations refrain, for example, from even defining basic concepts such as "insolvency").

The opportunity for the enactment of directives in this key area was, therefore, discussed and proposed.

Directives are a less binding tool. They provide Member States with a common goal but allow them to choose the path to follow to reach it. It appeared that the Union, having processed the information connected to 15 years of attempts (and failures) in reaching the preset targets, was ready to improve its strategies and try new paths.

The proposal of 2016, in particular, focused on several relevant topics which could not reach the necessary levels of improvement through previous actions, in an attempt to reduce the significant barriers to the free flow of capital still stemming from lack of harmonization among the local frameworks of the Member States: [287]

- **Restructuring and insolvency** – the modern approach to insolvency matters designed to protect businesses from unnecessary liquidations (hence avoiding job losses) and reach greater levels of competition within the market. The focus was placed on providing early warning procedures and developing stays on the enforcement of individual actions;
- **Second chances** – the development of common second-chance policies became vital for business and non-business debtors to ensure that honest bankrupts could get back on their feet and support growth within the economy and society;

At the same time, the EU continued to develop relevant studies. An extremely meaningful one was published in 2016 by the University of Leeds[288] to compare substantive laws throughout the EU (adding as external comparators the US and the Norwegian models). The study addressed several key topics such as:

- directors' liabilities and disqualification;
- the role of insolvency practitioners;
- avoidance and adjustment actions;
- the process to rank claims and order priorities;
- procedural issues related to insolvency proceedings;
- the Commission's Recommendation to a new approach to business failure and insolvency;
- second chances for entrepreneurs;
- consumer over-indebtedness.

The Leeds study also discussed the Recommendationof 2014 on a new approach to business failure and the tools for structuring efficient and effective systems that address the needs of over-indebted natural persons.

The topic of the insolvency of natural persons had already been approached by European institutions in the early nineties[289]; but it has gained great relevance in the past few years.[290] [291] The European Council had, in fact, declared over-indebtedness a major concern of the EU already in 2001:

[287] **(2016) COM 723 Final**, "*Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU*", at 5.

[288] **McCormack Gerard, Keay Andrew, Brown Sarah, Dahlgreen Judith**, "*University of Leeds - Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States' relevant provisions and practices*", European Commission, Directorate-General for Justice and Consumers Tender No. Just/2014/JCOO/PR/CIVI/0075.

[289] A study on the topic was already published in 1994: **Nik Huls**: "*Over-indebtedness of Consumers in the EC Member States: Facts and Search of Solutions*", Kluwer Editions Juridiques Belgique, Centre de Droit de la Consollmation, Diegem, Louvain-la-Neuve (1994).

> "Credit is a driving force for economic growth and the welfare of consumers, it also constitutes a risk for credit providers and a threat for additional cost and insolvency for a growing number of consumers;
> Over-indebtedness is in the majority of cases due to increasing uncertainty regarding the occurrence and predictability of variations in income;
> Ten European Union Member States currently have specific legislation concerning the collective settlement of debts governing the social, legal and economic treatment of over indebted consumers, whereas ordinary debt collection procedures continue to apply in other Member States…
> A certain harmonization of preventive measures concerning the rules on information for debtors, the responsibility of credit-providers, compensation and costs if contracts are not fulfilled and the role of credit intermediaries or agencies (should be considered)…"[292]

Yet, actions by individual members on this topic came, not so surprisingly, in a very uncoordinated fashion[293]. As we will discuss in Chapter II, only a few Member States took early action in this area; more have developed specific policies in recent years.

The consequences of over-indebtedness at a systemic level acquired greater relevance for the Union due to the impact of the subprime crisis:

> "Over-indebtedness of natural persons is a major economic and social problem. 11.4% of European citizens are permanently in arrears with payments, often for utility bills, this is mostly due to unfavorable macroeconomic conditions in the context of the financial and economic crisis (e.g. unemployment) combined with personal circumstances (e.g. divorce, illness)."[294]

> "Consumer over-indebtedness is a matter of great economic and social concern and is closely related to the reduction of debt overhang. Furthermore, it is often not possible to draw a clear distinction between the consumer and business debts of an entrepreneur. A second chance regime for entrepreneurs would not be effective if the entrepreneur had to go through separate procedures, with different access conditions and discharge periods, to discharge his business personal debts and his non-business personal debts. For these reasons, although this Directive does not include binding rules on consumer over-indebtedness, Member States should be able to also apply the discharge provisions to consumers."[295]

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[290] **(2016) COM 723 Final**, "*Proposal for a Directive of the European Parliament and of the Council on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency and Discharge Procedures and Amending Directive 2012/30/EU*".

[291] **COM(2015) 468 Final**, "*COMMISSION STAFF WORKING DOCUMENT Economic Analysis Accompanying the document Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Action Plan on Building a Capital Markets Union*", at 72-77; see also **SWD(2015) 184 Final**, "COMMISSION STAFF WORKING DOCUMENT Feedback Statement on the Green Paper "Building a Capital Markets Union" Accompanying the document Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Action Plan on Building a Capital Markets Union", at 59-60.

[292] **Reinfer Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga**, "*Consumer Over-indebtedness and Consumer Law in the European Union*", final report presented by the institute for financial services e.V. Erasmus Univerity Rotterdam / School of Law, University of Helsinki / Helsinky Collegium for Advanced Studies to the Commission of the European Communities, Health and Cosumer Protection Directorate –General, (2003), at 22.

[293] **(2015) COM 630 Final**, GREEN PAPER on retail financial services Better products, more choice, and greater opportunities for consumers and businesses.

[294] **(2016) COM 723 final**, "*Proposal for a Directive of the European Parliament and of the Council on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency and Discharge Procedures and Amending Directive 2012/30/EU*", at 4.

[295] See point 15 of the draft of the preamble of 2016. *Id*., at 27. See also the following amendment:

Entrepreneurs and business debtors were not the only ones affected by the crisis and in need of concrete support:

> "Entrepreneurs are not the only ones affected. Although consumers have largely the same treatment under national insolvency laws, this is not the case in all Member States. This results in increased costs for Member State's social security schemes and economic consequences such as reduced consumption, labour activity and foregone growth opportunities." [296]

Although often, the origin of non-business debts was deeply related to business ones:

> "Individual entrepreneurs' personal and business debts are often intertwined: entrepreneurs take personal loans to start and run their business, for example because they guarantee their business loan with their personal assets such as a car, while natural persons use consumer credits to buy assets for their professional activity. Under the proposal, both types of debt can be consolidated, where applicable, where incurred by individuals in their entrepreneurial activity."[297]

The proposal for the Directive on insolvency frameworks did address the need to develop policies to support consumers that faced problems of over indebtedness, structuring local frameworks to grant them an opportunity to restart[298]:

> "Restructuring, insolvency and second chance are highly regulated at national level and are linked to other areas of law such as company law, employment law, tax law and state aid law. Furthermore, restructuring, insolvency and second chance are treated differently in the Member States not only due to different historical and economic developments, but also due to different approaches to protecting social values, such as workers' rights or the right to property. Minimum standards are therefore the most appropriate means to ensure a coherent framework in all Member States while also enabling Member States to go beyond the Directive's provisions. For example, Member States may further encourage new and interim financing in restructuring procedures by giving it priority ranking above pre-restructuring claims in subsequent liquidation procedures. Member States may also enhance second chance frameworks by extending its personal scope to cover all natural persons, including consumers. Member States may also improve the treatment of workers when at the stage of adoption of restructuring plans, by requiring that workers are placed in a class of their own, separate from other creditors."[299]

> "The European Parliament supported harmonisation of certain aspects of restructuring and put emphasis on ensuring a second chance to all natural persons."[300]

Given the growing relevance of this area within the field of European insolvency laws, we will expand our discussion to relevant topics regarding the insolvency of non-business debtors in the next chapters.

"(15a) In order to achieve greater clarity, the Member States and the Commission should conduct a study in order to identify the key indicators of personal over-indebtedness. In light of the results of that study, the Member States and the Commission should adopt measures establishing a system of early warning tools for the over-indebtedness of consumers." at
http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A8-2018-0269+0+DOC+XML+V0//EN

[296] **(2016) COM 723 final**, "*Proposal for a Directive of the European Parliament and of the Council on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency and Discharge Procedures and Amending Directive 2012/30/EU*", at 4.

[297] *Id.,* at 14.

[298] *Id.,* at 15.

[299] *Id.,* at 16.

[300] *Id.,* at 17.

8. Analysis of Chapter I

8.1 European strategies and theimpasse

In this Chapter we have accomplished the first steps in our journey.

The numerous official documents we have analyzed have allowed us to draw a captivating overview of the great difficulties that were faced by the Union in the beginning of the new millennium, from the setting of the ambitious da Feira Goals till today.

There was a struggle to adapt preset strategies to the many unforeseen circumstances that were faced and to find effective remedies. Several important goals were missed at every checkpoint. Despite the continuous attempts that were made to improve, the path remained more winding than expected.

Members lost cohesion and struggled to orchestrate effective, common responses.

Before continuing our discussion, we will briefly recap the lynchpins of the European strategies. We will do so by using more extracts on the following key aspects:

1. The struggle to compete as a Union within the globalized market and the struggle toward exploiting Europe's full potential;
2. The bet on SMEs;
3. The process of increasing levels of entrepreneurship;
4. The actions taken to reduce the barriers that afflict SMEs.

This process, although apparently tedious, has been chosen to recap the most relevant elements in the discussion of this first chapter.

8.1.1 The struggle to compete as a Union within the globalized market and the race toward exploiting Europe's full potential

> "European enterprises are under-capitalised in comparison with their counterparts in the US partly because national tax systems in the European Union. discriminate in favour of debt financing and against equity financing. This discourages enterprises from building up their own equity base and reinvesting the retained profits in their business. SMEs are particularly affected, since they have fewer financing options than large enterprises." [301]

> "According to a German study, the average time spent by businesses on administrative work amounts to over 700 man hours a year. A business with up to 9 employees devotes 62 hours per employee to administrative formalities. For a larger company, however, this figure is much lower at *112* hours. The same study stated that the relative cost of administrative burdens per employee is more than 20 times higher in smaller enterprises than in larger ones (see Graph 6). Administrative complexity is particularly important in the areas of labour, environmental and tax legislation. In the UK, for example, a study estimates that the smallest enterprises pay 2% of their turnover in VAT compliance costs whereas for larger enterprises the .cost is negligible. This effectively amounts to a 2% surcharge or penalty on smaller enterprises (see Graph 7) negatively affecting their competitiveness. In the area of VAT, SMEs face additional difficulties and costs in intra-Community trade, mainly because of the complications of the transitional VAT system with its numerous special schemes."[302]

> "Slow, complex procedures when registering a business hamper and delay business start-ups. The total annual cost of administrative formalities which businesses in Europe have to comply is estimated to be […] up to 3% of total GDP."[303]

> "Such excessive compliance costs not only discourage new business creation but also recruitment, entrepreneurship and innovation as well. Slow and costly administrative

[301] "A" , at 6.
[302] *Id.*, at 3.
[303] "E", at 4.

procedures which start-ups must go through in some Member States to obtain the necessary authorizations are a further disincentive. [304]

"European SMEs' **full potential** for growth and employment creation **is not being properly realised**. On average 50% of SMEs in the EU fail within the first five years of start-up, a significant attrition rate with corresponding job losses. In addition, 30,000 enterprises and 300,000 jobs are threatened every year simply because SMEs fail to overcome the difficulties involved in the transfer of ownership."[305]

8.1.2 The bet on SMEs:

"There is now widespread recognition within the EU that small and medium-sized enterprises (SMEs) are the **key sector for generating employment opportunities and growth in the European Union**. The Community and Member States at national, regional and local level, already try to unlock the potential of SMEs through an array of policy measures and support schemes, but many of these initiatives are narrowly targeted and too disparate to be easily accessible by most SMEs. The challenge is to improve their transparency, **ensure better coordination** between them, increase their uptake, so as to render them all more effective. But there is perhaps a bigger challenge: to make the life of the European entrepreneur simpler in every respect, less burdened with costly, unnecessary bureaucracy, so as to really encourage entrepreneurship, creativity and innovation throughout the Union."[306]

"Moreover, the SME-dominated services sector has been a major source of jobs in recent years and continues to offer significant employment potential. Because of their flexibility and capacity to swiftly adapt to the evolution and specialisation of market demands, SMEs are a major instrument for promoting the competitiveness of European industry and its capacity to penetrate into third country markets. Especially important is the role SMEs play in less favoured regions and rural areas where they often represent the backbone of the local economy. At the same time, the growing trend towards contracting out of activities and downsizing of operations by large firms represents both a challenge and an opportunity for SMEs. The rapidly changing technological environment and the globalisation of the markets impacts on competitive conditions and creates new opportunities for SMEs. They have therefore a key role to play for increasing economic and social cohesion in the Union."[307]

"The available evidence suggests that growth and job creation in SMEs has been inhibited by basic market and policy imperfections or failures which have not yet been adequately addressed. There is now an urgent need to develop remedial measures."[308]

"It is the Commission's view that, although SME policy now ranks higher than ever on the political agenda, much more can be achieved by a fresh approach focusing on a number of priority issues."[309]

8.1.3 The process of increasing levels of entrepreneurship

"The importance of encouraging **entrepreneurship** at all levels must now be given full recognition by policy makers throughout the Union. The primary goal must be to recreate and stimulate a truly entrepreneurial culture, based on values such as self-reliance, risk-taking and a sense of personal commitment. This refocused effort is required above all to create more jobs across all sectors of the European Union's economy. This requires action

[304] “A”, at 4.
[305] “A”, at 2.
[306] *Id*., at 1.
[307] “B”, at 3.
[308] “A”, at 3.
[309] “A”, at 2.

to change attitudes, starting from the educational and training systems and covering the relationship between the entrepreneur and public administrations, financial institutions and large businesses. But to create a more open and stable business environment for SMEs will require a very significant effort by all concerned. Furthermore, boosting SME competitiveness, both internationally and domestically, will also require a sustained policy effort over a number of years."[310]

"Fostering a culture of enterprise requires a two-fold strategy. On the one hand it involves measures to encourage individuals to become an entrepreneur and to equip them with the necessary skills to make their business successful, including reforms in training and education systems, cultural changes and measures to remove obstacles to business startups. On the other hand, encouraging entrepreneurship also implies creating a business environment which is conducive to start-ups, growth and successful transfers of businesses. This includes radical administrative simplification and improving the regulatory and financial environment, as well as access to Community programmes such as for RTD and the Structural Funds. In order to create a strong and vibrant business community we have to start by developing a spirit of enterprise and risk-taking. We must overcome a number of prejudices in society and our education systems and the institutional environment. It is not conducive to harnessing entrepreneurial zeal and demonstrates a lack of understanding of entrepreneurial culture. Furthermore, entrepreneurship is a vital part of the socioeconomic fabric of each Member State but it is not treated yet by our society as a Profession in its own right. There is an increasing need for effective education and training. Those preparing to start-up a business need special training for the management of a business and access to continuous training for the improvement of the skills required in an ever faster changing business environment. This covers both the industrial sector and services. For the services in particular, the new services sector is the most promising in job creation.
Would-be entrepreneurs may also be discouraged from starting a business or becoming self-employed as this entails a loss in their social security provisions. It also involves a certain risk of bankruptcy against which may not be protected. In Europe a serious social stigma is attached to bankruptcy. In the USA bankruptcy laws allow entrepreneurs who fail to start again relatively quickly and failure is considered to be part of a learning process. In Europe those who go bankrupt tend to be considered as “losers”. They face great difficulty in obtaining finance for a new venture."[311]

8.1.4 The actions taken to reduce the barriers that afflict SMEs[312]

"All Member States have recently strengthened their policies for SMEs and there is now a **considerable degree of convergence between these policies**. The objective of many of these measures is to both preserve jobs by supporting existing SMEs and create new jobs by supporting business start-ups and the development of firms with high growth or employment potential." [313]

"When proposing new legislation, the legislator should have full knowledge of the impact the regulation will have on businesses in terms of compliance costs and administrative burdens. Business-impact assessments and cost-benefit analyses, where appropriate, should be carried out in close cooperation with the business community. In doing so, the legislator should give special attention to the compliance requirements for SMEs. If SMEs can comply with the regulation at a reasonable cost, then so too can large firms, whereas the reverse is not necessarily true. This 'think small first' principle should act as a litmus test."[314]

[310] “A”, at 15.
[311] “E”, at 3.
[312] See also “C”.
[313] “A”, at 2.
[314] “D”, at 30.

8.2 The impasse preventing European progress

The above-mentioned quotes have been selected for they are both interesting and useful.

They do not just recap salient points of the topics that we explored in this first Chapter, but also show a tendency, which we already observed in the different pages of our analysis, to repeat steps and approaches. Each is often presented as a key step for the future and a short term priority, but when they are not achieved, as they often are, they enter into a loop.

All the extracts we have just listed, which provide a fair and adequate picture of the first two decades of development of European strategies, in fact, are taken from documents published before the setting of the da Feira Goals.

The table below shows the date of publication of each document used in the previous pages.

A	CSE (1995) COM 2087[315]
B	(1996) COM 96 [316]
C	(1997) COM 610[317]
D	(1997) Off Journal 145/30[318]
E	(1998) COM 222[319]

A relevant element that has characterized our discussion is, in fact, the one of *déjà vu*. We have observed several repetitions within the steps taken, and within the strategies deployed, in the past years. Europe has seemed to struggle to reset its plans and to move forward. Such difficulties have been linked to years of ferocious economic crisis, but also to a general incapacity in achieving the necessary coordination and cooperation needed to reach the targets that were set.

A general impasse, therefore, seems to have affected several areas of the recent European strategies.

Aside from the general impasse, we have also observed a specific impasses within the process of refounding European insolvency regulations. Much has been done in the past years, in fact, to structure efficient and effective reforms in this field of law, both at the local and cross-border level. The modifications that the Union attempted to achieve have been of such relevance that we have defined it as a true "refoundation" of the matrix of European insolvency law.

The EU has focused on aspects such as:

- the eradication of the stigma of failure, hence modifying the approach to bankruptcy itself;
- incentivizing the voluntary commencement of cases and encouraging trust in the insolvency system;
- incentivizing reorganizations and quick discharges;
- making a meaningful second chance available to honest entrepreneurs;
- creating modern insolvency frameworks to also support non-business debtors.

Yet, as we have discussed, several targets have been missed also in these areas. Such outcome seems to be caused by systemic factors, such as years of economic difficulties, but also to more specific ones

[315] **(1995) CSE 2087**, "*Small and medium-sized enterprises – a dynamic source of employment, growth and competitiveness in the European Union – Repot presented by the European Commission for the Madrid European Council*".

[316] **(1996) COM 98 Final**, "*Maximising European SMEs' full potential for employment growth and competitiveness – Proposal for a COUNCIL DECISION on a Third Multiannual Programme for Small and Medium-sized Enterprises (SMEs) in the European Union (1997-2000) – presented by the Commission)".*

[317] **(1997) COM 610 Final**, "*Report from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions – on the coordination of activities to assist small and medium-sized enterprises (SMEs) and the craft sector 1997*".

[318] **(1997) European Commission**, "*Commission Recommendation of 22 April 1997 on improving and simplifying the business environment for business start-ups*", in Official Journal of the European Communities, N. L 145/29.

[319] **(1998) COM 222 Final**, European Commission, "*Fostering entrepreneurship in Europe: priorities for the future – Communication from the Commission to the Council*".

which are rooted in the way the process of reform was structured. These elements will be investigated in the next chapters.

9 Conclusion

Our discussion in Chapter I has shown how the European Union set ambitious goals for the new millennium and boldly went towards achieving them. The improvement of insolvency regulations at the local and cross-border level became a priority in supporting the development of the master plan. Several unforeseen circumstances, though, acted as barriers and delayed progress both within the general strategies and within the process of refounding European insolvency frameworks.

Years of deep economic crisis and an increase in competition within the globalized market prevented the Union and the Member States from achieving the preset targets and from becoming the most competitive knowledge-based society of the world. In the second decade of the new millennium, they actually had to worry about not losing excessive ground on all their competitors – both old ones, such as the US, and new ones in Asia. The refoundation of European insolvency frameworks was delayed due to the same, general factors but also due to more specific, bankruptcy-related elements.

Two main barriers seemed to prevent the European insolvency scenario from making the intended progress: the lack of uniformity among local frameworks (which had also effects at a cross-border level) and the effects of the stigma of failure.

In the next chapters, we will try to gain a better understanding of such barriers and of the European insolvency scenario in general. In Chapters II and III, in particular, we will discuss best practices endorsed by influential international organizations which are deemed to work best in structuring models (at a local and at cross-border level) which would be fit to compete effectively and efficiently in the modern, globalized economy. Through the analysis of these chapters, we will attempt to understand if weaknesses are to be found in the formula adopted by the EU to structure the process of refoundation; thanks to our discussion we will spot a relevant cause of the current impasse which impedes European progress, a riddle that needs to be solved.

We will begin Chapter II by focusing on examining those best practices which are deemed to be more effective and efficient within local insolvency frameworks for business and non-business debtors.

CHAPTER II.
BEST PRACTICES FOR MODERN LOCAL INSOLVENCY FRAMEWORKS

1. Introduction

In Chapter I, we discussed the development of Europe's master plan for the new millennium starting from the setting of the da Feira goals. We analyzed the structuring of several actions deployed within different interconnected fields and their outcome up to recent years. In particular, we have examined strategies designed to build social and economic progress and prosperity and the need for a process of refoundation of European insolvency frameworks.

Modifying local and cross-border insolvency frameworks became a necessary step to achieve the ambitious targets that were set by the Union at the beginning of the millennium and to support its struggle during several years of economic difficulties.

Europe could not grow in competitiveness without making reforms and without effectively coordinating the efforts of its members. Actions were commenced to improve the quantity and quality of its entrepreneurs and, consequently, to deploy new approaches in the field of insolvency laws: to remove the stigma of failure and to provide harmonious, effective, and efficient tools to support what we may term a "rescue mentality".

Shaping and applying uniformly these new approaches, though, proved to be a true challenge.

Despite several attempts, the Union and the Member States struggled to coordinate their actions and to meet the requirements set by the checkpoints; an impasse appeared to affect the whole master plan and the process of refoundation. In the next pages we will examine relevant elements of such an impasse in the field of insolvency laws.

We could divide the next chapters of this book into two main parts.

In Chapters II and III, we will discuss best practices in modern insolvency frameworks; we will attempt to spot those principles that make local and cross-border systems more effective and efficient today within the globalized economy. In Chapters IV, V, and VI, we will analyze the structure of a selection of relevant rules from several historic and contempory insolvency frameworks which shaped or are impacting the structure of the modern European insolvency scenario. In the next two chapters, therefore, we will try to understand what structure is considered to work best for a modern local and cross-border model and why; while in the following three chapters we will examine the roots of the current status quo and how specific rules developed themselves and why.

Our discussion will ultimately allow us to better understand the impasse, which we may define as the factors that have prevented the Union from making necessary progress up to now: are they connected with the new principles that are being implemented (are they unreasonable or wrong), or is it that the European scenario is just unable to structure them correctly? If so, what changes need to be made, should this whole process be abandoned, or should it be developed differently?

In Chapter II, we will focus on the elements of effectiveness and efficiency in modern, local insolvency systems.

We will analyze such factors from the point of view of business and non-business debtors. We will develop this topic, basing our research on documents released by influential international organizations and, in particular, by the World Bank. In the past few years, the World Bank has explored the field of bankruptcy laws in depth and has published relevant studies to support international models in how to make countries more competitive within the globalized economy.

This chapter will be divided into two main sections. The first one will focus on business debtors, the second on non-business one (natural persons or consumers).. This last topic is less frequently discussed

within the European scenario, yet it deserves focus. As discussed in Chapter I, in fact, both of these aspects have to be carefully studied, developed, and balanced within the modern European insolvency scenario.

2. The World Bank's principles for effective insolvency and creditor/debtor regimes

The elaboration of the "principles for effective insolvency and creditor/debtor regimes" (the ICR Principles[320] [321]) started in the late nineties as a response to the financial crisis that afflicted emerging markets in those years.[322] The World Bank and partner organizations seized the opportunity to create a list of benchmarks and standards for the evaluation of the degree of effectiveness of domestic enforcement and insolvency systems[323] through the creation, in 1999, of an ad hoc committee[324] which formed a task force and working groups that involved experts from seventy-five countries.[325] Five regional conferences and numerous roundtables were held; the different documents drafted that year were placed online for public consultation and then merged into a list of thirty-five Principles[326] which was approved and published by the World Bank's Board of Directors in 2001[327] [328]:

	Legal Framework for Creditor Rights
1	Compatible Enforcement Systems
2	Enforcement of Secured Rights
3	Security Interest Legislation
4	Recording and Registration of Secured Rights
5	Enforcement of Secured Rights
	Legal Framework for Insolvency
6	Key Objectives and Policies
7	Director and Officer Liability
8	Liquidation and Rehabilitation
9	Commencement: Applicability and Accessibility
10	Commencement: Moratoriums and Suspension of Proceedings
11	Governance: Management
12	Governance: Creditors and the Creditors Committee
13	Administration: Collection, Preservation , Disposition of Property
14	Administration: Treatment of Contractual Obligations
15	Administration: Fraudulent or Preferential transactions

[320] See http://www.worldbank.org/en/topic/financialsector/brief/the-world-bank-principles-for-effective-insolvency-and-creditor-rights. Last visited on November 02, 2019.

[321] 2001; 2005; 2011; 2015.

[322] **Leroy Anne-Marie, Grandolini Gloria M.**, "*Principles for effective insolvency and creditor and debtor regimes (English)*", Washington, D.C.; World Bank Group, (2016), at 1.

[323] *Id.*, at ii.

[324] "The ad hoc committee that served as an advisory panel comprised representatives from the African Development Bank; Asian Development Bank, International Finance Corporation, International Monetary Fund, Organization for Economic Co-operation and Development, United Nations Commission on International Trade Law, INSOL International and the International Bar Association (Committee J). In addition over 70 leading experts from countries around the word participated in the Task Force and Working Groups." *Id.*, at 1 footnote 1.

[325] *Id.*, at 1.

[326] http://documents.worldbank.org/curated/en/424141468762589301/Introduction-executive-summary-and-principles

[327] **Leroy Anne-Marie, Grandolini Gloria M.**, "*Principles for effective insolvency and creditor and debtor regimes (English)*", Washington, D.C.; World Bank Group, (2016), at 1.

[328] In this part, the tables show the outline of the key topics discussed by each Principle.

16	Claims Resolution: Treatment of Stakeholder Rights and Priorities
	Features Pertaining to Corporate Rehabilitation
17	Design Features of Rehabilitation Statutes
18	Administration: Stabilizing and Sustaining Business Operations
19	Information: Access and Disclosure
20	Plan: Formulation, Consideration and Voting
21	Plan: Approval of Plan
22	Plan: Implementation and Amendment
23	Plan: Discharge and Binding Effects
24	International Considerations
	Informal Corporate Workouts and Restructuring
25	Enabling Legislative Framework
26	Informal Workout Procedures
	Implementation of the Insolvency System (Institutional & Regulatory Frameworks)
27	Role of Courts
28	Performance Standards of the Court; Qualification and Training of Judges
29	Court Organization
30	Transparency and Accountability
32	Judicial Decision Making and Enforcement
32	Integrity of the Court
33	Integrity of Participants
34	Role of Regulatory or Supervisory Bodies
35	Competence and Integrity of Insolvency Administrators

The list of 2001 was placed under continuous review in the following years so that the Principles could be refined and updated, reflecting the evolution of best practices and account for the lessons learned in the field, which included the difficult scenario of the financial crisis of 2008[329]. Aside from being debated in numerous seminars that involved hundreds of experts and judges counting dozens of nationalities, the Principles also found practical application through the assessment of twenty-four countries in all regions of the world.[330] Such a process of in-depth study, review, and consultation led to subsequent improvements to the original list; revised drafts were approved and published in 2005, 2011, and 2015.[331]

[329] *Id.,* at ii; 1-2: "In 2003, the World Bank convened the Global Forum on Insolvency Risk Management (FIRM) to discuss the experience with and lessons from the application of the Principles in the assessment program. The forum convened over 200 experts from 31 countries to discuss the lessons from this application and to discuss further refinements to the Principles themselves. During 2003 and 2004, the Bank also convened three working group sessions of the Global Judges Forum, involving judges from approximately 70 countries who assisted the Bank in its review of the institutional framework principles and developed more detailed recommendations for strengthening court practices for commercial enforcement and insolvency proceedings. Other regional for a have also provided a means for sharing experience and obtaining feedback in areas addressed by the Principles, including the Forum on Asian Insolvency Reform (FAIR) from 2002 to 2004 (organized by OECD and co-sponsored with the Bank and the Asian Development Bank), and the Forum on Insolvency in Latin America (FILA) in 2004, organized by the Bank."

[330] *Id.*, at 1-2. See also the World Bank, "Principles for effective insolvency and creditor/debtor rights systems", (2015), at 1 – 2, stressing that: "The revised *principles* contained in this document have benefited from wide consultation and, more importantly, from the practical experience of using them in the context of the Bank's assessment and operational work."

[331] **The World Bank**, "*Principles for effective insolvency and creditor/debtor rights systems*", (2015).

The additions and improvements made in 2005 were not radical in modifying the concepts of the original list, but rather the structure and organization of the Principles. Since that year, the Principles have been divided into four sections:

- **PART A** – "**Legal Framework for Creditor Rights**" – addressing the implementation and organization of effective credit and enforcement systems, including a discussion of the laws governing secured credit[332];
- **PART B** – "**Risk Management and Corporate Workout**" – addressing relevant topics such as credit information systems; director's and officer's liabilities (upon making decisions detrimental to creditors); and the opportunity for the creation of effective systems of corporate workouts[333];
- **PART C** – "**Legal Framework for Insolvency**" – listing and discussing the relevant best practices for the creation of effective business insolvency regulations, including both liquidations and reorganizations[334] (this is the part on which our discussion will be mostly focused);
- **PART D** – "**Implementation: Institutional & Regulatory Frameworks**" – discussing the issues faced in the implementation of an effective (transparent, efficient, honest, and trustable) institutional and regulatory framework to support the insolvency system.[335]

The most relevant changes, at this time, involved Principles 6 to 24, which were originally subdivided into two different sections ("Legal Framework for Corporate Insolvency" and "Features Pertaining to Corporate Rehabilitations"), and which were merged into Part C in 2005. The new section addressed both business liquidations and reorganizations (formerly "corporate rehabilitations"); Principles 6 to 16 became Principles C1 to C13, while Principles 17 to 24 were mostly merged into Principle C14. Former Principles 25 and 26 were included in Part " and, therefore, addressed at an earlier stage of the discussion, right after the development of effective enforcement and credit systems. The structural modifications of 2005 proved to be efficient. The model did not suffer further radical changes; the updates made in the drafts of 2011 and 2015 were, in fact, mostly concerned with the addition of new Principles and the revision of the best practices in the ones that were already present.

The revised model of 2005 led to a better organization in the discussion of several relevant topics, and the individual enumeration of each Part allowed for easier modifications in the following years. The draft started from the implementation of effective enforcement systems; then it offered solutions to more complex situations through informal workouts and full in-court insolvency procedures. Lastly, it addressed all those issues connected to the implementation of an efficient and transparent court system.

The modified list of 2005[336] read as follows:

	PART A. Legal Framework for Creditor Rights
A1	Key Elements
A2	Security (Immovable Property)
A3	Security (Movable Property)
A4	Registry Systems
A5	Commercial Enforcement Systems
	Part B. Risk Management and Corporate Workout
B1	Credit Information Systems
B2	Director and Officer Accountability
B3	Enabling Legislative Framework

[332] **Leroy Anne-Marie, Grandolini Gloria M**., "*Principles for effective insolvency and creditor and debtor regimes (English)*", Washington, D.C.; World Bank Group, (2016), at 5-6.
[333] *Id.,* at 6-7.
[334] *Id.,* at 7-8.
[335] *Id.,* at 8-9.
[336] http://documents.worldbank.org/curated/en/191201468315535668/The-World-Bank-principles-for-effective-insolvency-and-creditor-rights-systems

B4	Informal Workout Procedures
B5	Regulation of Workout and Risk Management Practices
	Part C. Legal Framework for Insolvency
C1	Key Objective and Policies
C2	**Due Process:** Notification and Information
C3	**Commencement** Eligibility
C4	Applicability and Accessibility
C5	Provisional Measures and Effects of Commencement
C6	**Governance** Management
C7	Creditors and the Creditors Committee
C8	**Administration** Collection, Preservation, Administration and Disposition of Assets
C9	Stabilizing and Sustaining Business Operations
C10	Treatment of Contractual Obligations
C11	Avoidable Transactions
C12	**Claims and Claims Resolution Procedures** Treatment of Stakeholder Rights and Priorities
C13	Claims Resolution Procedures
C14	**Reorganization Proceedings** Plan Formulation and Consideration Voting and Approval of Plan Implementation and Amendment Discharge and Binding Effects Plan Revocation and Case Closure
C15	International Considerations
	Part D. Implementation: Institutional & Regulatory Frameworks
D1	**Institutional Considerations** Role of Courts
D2	Judicial Selection, Qualification, Training and Performance
D3	Court Organization
D4	Transparency and Accountability
D5	Judicial Decision Making and Enforcement of Orders
D6	Integrity of the System
D7	**Regulatory Considerations** Role of Regulatory or Supervisory Bodies
D8	Competence and Integrity of Insolvency Representatives

The improvements of 2011 led to the introduction of two more principles in section C, incorporating updates made by the "UNCITRAL Legislative Guide to Insolvency Law – Part Three: Treatment of Enterprise Groups in Insolvency"[337] that addressed the specific issues of national and international groups of enterprises facing financial difficulties:

[337] http://www.worldbank.org/en/topic/financialsector/brief/the-world-bank-principles-for-effective-insolvency-and-creditor-rights

C16	Insolvency of Domestic Enterprise Groups
C17	Insolvency of International Enterprise Groups

The revisions of 2015[338] concerned mostly parts A and B. The modifications led to a higher degree of detail in the description of the principles regarding the relationship between costs and flow of credit, of effective enforcement systems, and of the duties and liabilities of directors in the period approaching insolvency.

	Part A. Creditor/Debtor Rights
A1	Key Elements
A2	Security (Real Property)
A3	Security (Movable Property)
A4	Registry for Property and Security Rights over Immovable Assets
A5	Registry for Security Rights over Movable Assets
A6	Enforcement of Secured Debt
A7	Enforcement of Security Rights over Immovable Assets
A8	Enforcement of Security Rights over Movable Assets
	Part B. Risk Management and Corporate Workout
B1	Credit Information Systems
B2	Director ‘s Obligations in the Period Approaching Insolvency
B3	Enabling Legislative Framework
B4	Informal Workout Procedures
B5	Regulation of Workout and Risk Management Practices

The overall result of this continuous process of discussion, modification, and improvement up to today is the following list of thirty-eight Principles effective as of 2015:

	PART A. Creditor/Debtor Rights
A1	Key Elements
A2	Security (Real Property)
A3	Security (Movable Property)
A4	Registry for Property and Security Rights over Immovable Assets
A5	Registry for Security Rights over Movable Assets
A6	Enforcement of Secured Debt
A7	Enforcement of Security Rights over Immovable Assets
A8	Enforcement of Security Rights over Movable Assets
	Part B. Risk Management and Corporate Workout
B1	Credit Information Systems
B2	Director ‘s Obligations in the Period Approaching Insolvency
B3	Enabling Legislative Framework
B4	Informal Workout Procedures
B5	Regulation of Workout and Risk Management Practices

[338]http://documents.worldbank.org/curated/en/518861467086038847/Principles-for-effective-insolvency-and-creditor-and-debtor-regimes

	Part C. Legal Framework for Insolvency
C1	Key Objective and Policies
C2	**Due Process:** Notification and Information
C3	**Commencement** Eligibility
C4	Applicability and Accessibility
C5	Provisional Measures and Effects of Commencement
C6	**Governance** Management
C7	Creditors and the Creditors Committee
C8	**Administration** Collection, Preservation, Administration and Disposition of Assets
C9	Stabilizing and Sustaining Business Operations
C10	Treatment of Contractual Obligations
C11	Avoidable Transactions
C12	**Claims and Claims Resolution Procedures** Treatment of Stakeholder Rights and Priorities
C13	Claims Resolution Procedures
C14	**Reorganization Proceedings** Plan Formulation and Consideration Voting and Approval of Plan Implementation and Amendment Discharge and Binding Effects Plan Revocation and Case Closure
C15	International Considerations
C 16	Insolvency of Domestic Enterprise Groups
C17	Insolvency of International Enterprise Groups
	Part D. Implementation: Institutional & Regulatory Frameworks
D1	**Institutional Considerations** Role of Courts
D2	Judicial Selection, Qualification, Training and Performance
D3	Court Organization
D4	Transparency and Accountability
D5	Judicial Decision Making and Enforcement of Orders
D6	Integrity of the System
D7	**Regulatory Considerations** Role of Regulatory or Supervisory Bodies
D8	Competence and Integrity of Insolvency Representatives

By the schedule followed until now, further updates are to be expected soon. Such new improvements will probably be relevant since the field of bankruptcy laws is experiencing an intense process of transformation at the international level, as we observed in the previous chapter discussing the path followed by the European Union.

2.1 Discussion of the Principles: flexible building blocks for effective and efficient insolvency systems

The World Bank's Principles have been designed as a broad-spectrum assessment tool for gathering best practices that have been widely recognized and accepted internationally[339] to assist countries in their efforts to:

a) evaluate core aspects of their commercial law systems;
b) bring necessary improvements;
c) promote and support commerce and economic growth.[340]

They address the following key elements in an attempt to achieve high degrees of efficiency and effectiveness[341]:

- compatible credit and enforcement systems;
- collateral systems;
- enforcement systems;
- credit information systems;
- corporate workout systems;
- insolvency law systems;
- institutional and regulatory frameworks,

In order to promote sound investment climates, the Principles attempt to raise the levels of:

- **Coordination** – insolvency frameworks should be coordinated with the general legal framework of the societies in which they are enacted;
- **Transparency and accountability** – rules and procedures should be clear. Basic information such as financial statements, operating statistics, and detailed cash flows should be disclosed and made available within the system. Accounting and auditing standards should be compatible with international best practices so that creditors can assess risks and monitor a debtor's financial viability[342];
- **Responsible corporate governance** – a corporation's board of directors should be responsible, accountable, and independent for all decisions, subject to best practices on corporate governance[343];
- **Predictability** – the capacity to accurately predict the costs, outcome, and the possibility of eventual defaults is fundamental to encourage investments.[344]

The proposed list has been drafted to be flexible and adapt to the different systems in which it may be applied.[345] If, in fact, each principle distills those good practices that are widely recognized and embraced in modern international insolvency settings, it does not mean that all of them should (or could) find contemporaneous application within a single scenario. Acting as independent building blocks, they can be molded to create the structure that best fits a society and its specific legal environment, bringing improvements in those areas that show deficiencies.[346]

The 2015 version of the Principles is subdivided into four parts, A-D, following the 2005 system. The original list of 2001 still works today, though. Most principles have remained valid pillars despite their new

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[339] **The World Bank**, "*Principles for effective insolvency and creditor/debtor rights systems*", (2015), at 3.

[340] **The World Bank**, "*World Bank Principles for Effective Creditor/Debtor Regimes, Revised 20 Jan 2011*", at 2. http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/ICRPrinciples-Jan2011%5bFINAL%5d.pdf

[341] **Leroy Anne-Marie, Grandolini Gloria M**., "*Principles for effective insolvency and creditor and debtor regimes (English)*", Washington, D.C. : World Bank Group, (2016), at 5-8.

[342] *Id.,* at 8.

[343] *Id.*

[344] *Id.,* at 10.

[345] **World Bank insolvency initiative, Institutional Advisory Panel, Task Force on Insolvency and Creditor Rights, Working Group Members and Contributors**, "*Effective insolvency principles: principles and guidelines*", (World Bank consultation draft), October (2002), at 6.

[346] **Leroy Anne-Marie, Grandolini Gloria M**., "*Principles for effective insolvency and creditor and debtor regimes (English)*", Washington, D.C.; World Bank Group, (2016), at 4.

numeration or placement within the framework. Our brief discussion of the different parts will often look back at the original list and to other relevant international documents such as the UNCITRAL Legislative Guides on Insolvency Law. The Guides share the purpose of establishing efficient and effective legal frameworks to address the financial difficulties of debtors[347] and make a useful reference tool for our research on this topic.

We will briefly discuss relevant aspects of A, B, and D. We will spend more time on Part C, which discusses insolvency frameworks in greater detail. The best practices we will meet in this section will serve as a useful reference tool for analyzing the systems we will meet in the next chapters.

2.2.1 Part A: Creditor/Debtor rights

Part A is concerned with the rights of debtors and creditors within the enacted credit system and with the creation of effective enforcement models. It is not surprising that a discussion of effective and efficient insolvency regimes is rooted in enforcement systems and credit products. In highly efficient frameworks insolvency and enforcement systems should, in fact, be like different faces on a die: they should be synchronized and designed to work harmoniously[348].

Credit is the lifeblood of modern commerce[349] and a key driver of economic activity, innovation and growth.[350] The ability to own and freely transfer one's rights in movable or immovable property are one of the pillars of a credit economy. Such abilities, though, are heavily deterred by a legal framework that does not transparently determine the rights among different parties and priorities among claims.[351]

A modern and successful credit-based economy should, therefore, facilitate broad access to a variety of credit products at affordable rates, while also deploying well tailored enforcement and insolvency systems to provide an effective legal framework to solve disputes.[352] Although the improvements of 2005 reorganized the original 35 principles, approaches to this key area remained congruent over the years. Part A, in its 2015 version, represents the evolution of Principles 1 to 5 enclosed in the original list of 2001.

[A] Predictable and transparent credit systems

Access to credit is considered a key factor in promoting development and growth in our markets.[353] Structuring a framework supporting and incentivizing an efficient interaction between debtors and creditors, though, presents numerous challenges. While in unsecured lending a certain degree of risk is inevitable, most systems need to provide a variety of tools to acquire a secured interest in property (collateral) to incentivize investors.

The international best practices embodied in the Principles support the creation of secured interests, voluntarily by agreement or automatically by operation of law, in the widest possible variety of possessory and non-possessory, movable and immovable[354], tangible and intangible, future and present assets and interests.[355]

An effective credit system should consist, therefore, of clear, predictabl,e and transparent:

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[347] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 4.

[348] **Leroy Anne-Marie, Grandolini Gloria M**., "*Principles for effective insolvency and creditor and debtor regimes (English)*", Washington, D.C.; World Bank Group, (2016), at 6.

[349] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 62.

[350] **Leroy Anne-Marie, Grandolini Gloria M**., "*Principles for effective insolvency and creditor and debtor regimes (English)*", Washington, D.C.; World Bank Group, (2016), at ii.

[351] **The World Bank**, "*Principles for effective insolvency and creditor/debtor rights systems*", (2015), at 2-4.

[352] **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry**, "A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group", The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010), at 9.

[353] **Leroy Anne-Marie, Grandolini Gloria M**., "*Principles for effective insolvency and creditor and debtor regimes (English)*", Washington, D.C.; World Bank Group, (2016). See also the discussion on this topic in Chapter I.

[354] Principle "A4" specifically refers to immovable assets.

[355] Draft of 2015 Principles "A2" and "A3".

a) rules concerning the creation of security interests and of efficient and possibly inexpensive methods to provide notice and publicize their existence to all interested parties.[356]
   Transparency relies on the availability of all the necessary and relevant information to make decisions. An efficient system of public registries should be implemented to inform lenders about their perspective capacity to recover their investments and about the physical location and use of the collateral. Principles A4 and A5 describe the characteristics, respectively, of such registries for property and of security rights over immovable and movable assets. To make them useful, access to the information contained in the registries should be as inexpensive as possible so that parties can take full advantage of credit opportunities, reducing risks.
   One relevant issue on this point, though, is the other side of the coin connected to the availability of information. As already mentioned in Chapter I, and as we will have a chance to discuss in greater depth in Chapter IV, the diffusion of information on debtors can become a key element in spreading stigma within society;
b) systems determining the ranking of rights, setting eventual priorities among the different claims of the creditors or of the parties involved.
   Priority rules become vital whenever certain assets owned by the debtor are not sufficient to repay outstanding debts, and, therefore, choices have to be made as to which creditors will get what.
   Exceptions to a standard set of rules on ranking may be necessary to protect the system's efficiency, or to safeguard certain specific interests that hold great social value (common examples include rules concerning the payment of the cost of enforcement actions or insolvency proceedings, or the prioritization of unpaid taxes or wages). In any case, such exceptions should be as limited as possible to protect the interests acquired under other statutes before the debtor goes into financial default (such as contract law), in order to maintain transparency and predictability within the system.[357]

[B] Effective enforcement systems

For an infinite variety of reasons, things in life often don't work the way were planned. The energies spent into evaluating each operation *ex ante* do not guarantee that a debt will be repaid as agreed (or at all).

Principles A6[358], A7, and A8 discuss the characteristics of effective systems for the enforcement of secured and unsecured rights over immovable and movable assets. Ranking credit rights and allowing the obtainment of securities in a variety of collateral are key improvements, as they create an effective system to record and make information reliable and available; but they are not sufficient measures to prevent, or cure, the issues arising from frauds or insolvencies. An effective credit system cannot disregard the enactment of tools to ensure the recovery of credits in case of default.

Enforcement systems, therefore, are important for:

> "A creditor's ability to take possession of a debtor's property and to sell it to satisfy the debt is the simplest, most effective means of ensuring prompt payment. It is far more effective than the threat of an insolvency proceeding, which often requires a level of proof and a prospect of procedural delay that in all but extreme cases make it not credible to debtors as leverage for payment."[359]

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[356] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 20.
[357] *Id.*, at 20-21.
[358] Endnote 2 states that: "Enforcement under this principle "A6" aims primarily at the treatment with respect to proceedings to recover against corporate debtors. Where enforcement proceedings involve individuals, reasonable and clearly defined exemptions may need to be adopted to allow individuals to retain household goods and those assets indispensable to the debtor's profession or job as well as the subsistence of the debtor and his family".
[359] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 4.

An effective enforcement system can be defined as a transparent set of mechanisms or procedures pushing debtors to comply with their obligations in a timely manner, while providing efficient alternatives upon performance failure.[360]

Such alternatives range from legal forms of self-help repossession (or other out-of-court systems) to full in-court proceedings, culminating in the use of public force to coerce performance. A debtor who is unable, or unwilling, to pay, despite the incentives provided within the legal framework, will automatically be pushed towards the enacted insolvency model, which will provide mechanisms for reorganization or liquidation.

As general guidelines, the Principles state that an effective enforcement framework, regardless of its structure, should be:

- **Transparent and predictable** - transparency and predictability contribute to strengthening the lending system[361], while conversely uncertainty leads to a steady growth in costs and perhaps even credit tightening.[362] A well-structured and predictable enforcement system reduces the risks of default. It discourages non-compliance, contains the costs of defaults, and incentivizes parties to agree on a common solution, minimizing the need to access more expensive and cumbersome in-court proceedings.
- **Swift and inexpensive** - the system should provide swift and, if possible, inexpensive options to cure defaults, avoiding excessive delays and uncertainty in the distribution of proceeds. It has already been mentioned how the quick enforcement of claims is deemed to have a positive effect on investments in general. It also supports the system, preventing collaterals from losing value.

Balancing all these factors effectively is a great challenge.

Aside from taking into consideration the valuable theories embodied within international best practices, enforcement formulas have to adapt to different local contexts and to the principles and policies of the societies they are enacted within. The actual effectiveness of a model depends also on its capacity to respond to specific needs and difficulties, which vary depending on a wide range of structural, social, and human factors.[363] As an example on this point, it can be mentioned that not all systems allow forms of self-help repossession, an effective and efficient tool but one which can also lead to conflicts and sad consequences.

The differences existing among societies have led to the enactment in the international scenario of a variety of effective and efficient in-court and out-of-court frameworks. All such tools can prove successful, despite holding some general weaknesses. If, in fact, in-court proceedings are usually costly and necessitate more time to bring results, out-of-court tools are less expensive but bring lower levels of predictability.

Attempts to find a valid middle ground have led to the enactment of a variety of alternatives in the form of summary judgments; slimmer in-court proceedings that seek to join the benefits of supervision while attempting to achieve swifter recoveries.

These solutions are often not interchangeable among different countries; reaching high levels of harmonization therefore remains a challenge.

2.2.2 Part B: Risk management and corporate workouts

Part B connects the dots, addressing the rights of debtors and creditors and the implementation of effective enforcement systems with a discussion of the intricacies of formal insolvency models. The Principles contained in this section cover three main topics:

1- Credit information systems;
2- Directors' obligations in the period approaching insolvency;
3- Corporate workouts.

The first two points require a national legislature to balance important, conflicting interests, which we have partially discussed already. The implementation of effective information systems, although deemed a

[360] *Id.,* at 13; 18-19.
[361] *Id.,* at 16.
[362] **Leroy Anne-Marie, Grandolini Gloria M**., "*Principles for effective insolvency and creditor and debtor regimes (English)*", Washington, D.C. : World Bank Group, (2016), at 6.
[363] *Id*., at 2.

necessary feature of a modern credit-based society[364], causes great issues connected to the protection of a debtor's privacy rights; while holding directors liable for their decisions upon approaching insolvency can affect their judgment in ways that are adverse to the interests of stakeholders and of the economy at large.

Lastly, Part B discusses the structuring of successful frameworks for consensual arrangements and informal workouts. Such a formula could prove particularly effective in solving debtor/creditor conflicts, since it could allow merging the positive benefits of in- and out-of-court enforcement and insolvency systems, creating a new, light, swift, and less expensive framework.[365] The difficulties that arise, though, in the implementation in practice of such solution are great.

[A] The creation of effective credit information systems

The 2015 executive summary of the key elements included in the Principles extensively discusses the relevance of credit information systems[366]:

> "A modern credit-based economy requires access to complete, accurate information concerning borrower's payment histories. This process should take place in a legal environment that provides the framework for the creation and operation of effective credit information systems. Permissible uses of information from credit information systems should be clearly circumscribed, especially regarding information about individuals. Legal controls on the type of information collected and distributed by credit information systems may often be used to advance public policies, including anti-discrimination laws. Privacy concerns should be addressed through notice of the existence of such systems, notice of when information from such system is used to make adverse decisions, and access by data subjects to stored credit information with the ability to dispute and have corrected inaccurate or incomplete information. An effective enforcement and supervision mechanism should be in place that provides efficient, inexpensive, transparent and predictable methods for resolving disputes concerning the operation of credit information systems with proportionate sections that encourage compliance but are not so stringent as to discourage the operation of such systems."[367]

While it is undeniable that credit systems, and therefore credit economies, rely heavily on a debtor's payment history to operate effectively, it is also true that it is often difficult to draw a line between information that should disclosed to incentivize lending, and unnecessary or harmful violations of a borrower's privacy.

According to Principle B1, the legal framework should support the cooperation between parties to the lending agreement. Lenders should be protected in their investments from frauds; at the same time, the system should ensure that the available information is accurate and complete, safeguarding the transparency and predictability of the market:

> "B1.1 Legal framework. The legal environment should not impede and, ideally should provide the framework for, the creation and operation of effective credit information systems. Libel and similar laws have the potential of constraining good faith reporting by credit information systems. While the accuracy of information reported is an important value, credit information systems should be afforded legal protection sufficient to

[364] *Id., at* 17.

[365] Including some Principles that had found a different allocation in the first draft of 2001 such as the ones regarding "Informal Corporate Workouts and Restructurings" which constituted former Principles 25 and 26 (in 2001 the two section were placed in a separate section entitled "Informal corporate workouts and restructuring").

[366] See **The World Bank**, "*Creditor rights and insolvency ROSC assessment methodology – based on the World bank principles for effective creditor rights and insolvency systems (revised January 2011) and UNCITRAL Legislative Guide on Insolvency Law – revised draft*", (2011), at 10.
http://siteresources.worldbank.org/INTGILD/Resources/ICR_ROSC_AssessmentMethodology_Jan2011.pdf

[367] **Leroy Anne-Marie, Grandolini Gloria M.**, "*Principles for effective insolvency and creditor and debtor regimes (English)*", Washington, D.C.; World Bank Group, (2016); at 6-7.

encourage their activities without eliminating incentives to maintain high levels of accuracy.

B1.4 Privacy. Subjects of information in credit information systems should be made aware of the existence of such systems and, in particular, should be notified when information from such systems is used to make adverse decisions about them. Subjects of information in credit information systems should be able to access information maintained in the credit information service about them. Subjects of information in credit information systems should be able to dispute inaccurate or incomplete information and mechanisms should exist to have such disputes investigated and have errors corrected."[368]

[B] Director's obligations in the period approaching insolvency

Principle B2 concerns the intricate matter of a director's liabilities upon approaching insolvency.[369]

This is a very relevant topic connected with several aspects of insolvency frameworks or, in general, the conflicts between debtors and creditors. It regards the capacity of a debtor to make decisions upon approaching insolvency and impacts key aspects of bankruptcy, such as:

- the capacity of creditors to commence cases at an early stage (involuntary liquidations are not the preferred option to cure insolvency cases and financial defaults under modern best practices)
- bankruptcy crimes or crimes in general (which are not discussed by the Principles).

On this topic, the Principles state that – although it is true that doing business requires timely action, courage, entrepreneurialism, and a certain degree of recklessness – it is also true that these qualities must necessarily be balanced by honesty and objectivity. Otherwise, the final outcome may be disastrous for the business, stakeholders, the market, and society at large. In an effective and efficient framework, directors should not be shielded from liabilities for making decisions detrimental to creditors when the business was approaching (or already in) insolvency. The Principles, therefore, encourage debtors to take risks responsibly.

Principle B2.1 specifically states that:

"The law should require that when they know or ought reasonably to know that insolvency of the enterprise is imminent or unavoidable, directors should have due regard to the interests of creditors and other stakeholders, and should take reasonable steps either to avoid insolvency, or where insolvency is unavoidable, to minimize its extent."

The Principles also address the issue of wrongful trading: the act of actively managing an insolvent business and aggravating its default, which should be prevented and sanctioned. In case of breaches, insolvency representatives should have primary standing to pursue a cause of action.[370] At the same time, though, the Principles recognize that insolvency is not always evident[371]; the fear of incurring sanctions may have detrimental effects, weakening decision-making processes and causing great harm to business operations at a time in which there may be no real risk. Finding an effective balance among all these components is not easy; it is a task that has kept scholars and lawmakers busy up to now and it does not appear that the Principles have managed to find a clear line of conduct to suggest up to now.

[C] Consensual out-of-court arrangements: informal workouts and restructuring

Principles B3, B4 and B5 (former Principles 25 and 26 of the 2001 list) encourage consensual arrangements, hybrid proceedings that stand in the middle between credit collection through enforcement

[368] See **The World Bank**, "*Creditor rights and insolvency ROSC assessment methodology – based on the World bank principles for effective creditor rights and insolvency systems (revised January 2011) and UNCITRAL Legislative Guide on Insolvency Law – revised draft*", (2011), at 10.
http://siteresources.worldbank.org/INTGILD/Resources/ICR_ROSC_AssessmentMethodology_Jan2011.pdf

[369] Principle 7 in 2001.

[370] Principle B2.3.

[371] Despite what is stated in Principle B2.1.

systems and the deployment of a full in-court insolvency proceeding, thus providing the major benefits of both models.[372]

A collective, consensual agreement between a debtor and his creditors would defeat one of the main weaknesses of enforcement systems, which work best in solving individual, debtor-to-creditor controversies. When multiple creditors adopt them simultaneously, they often lead to expensive and disorganized races, abusive behaviors, and an unbalanced final distribution of proceeds.

At the same time, such a hybrid option may also grant a reduction of:

a) expenses, compared to the ones necessary to commence and manage a full formal insolvency proceeding;

b) administrative formalities;

c) the duration of the process to collect claims.

Conversely, a number of weaknesses make this option, often, impracticable:

- First of all, insolvency is generally characterized by great conflicts. Creditors are usually not willing to make agreements with their debtors or reciprocal concessions;
- Second, it would be hard to make the information necessary to reach a satisfactory agreement equally available to all parties. Fear, mistrust, and suspicion of tricks and fraud would become a heavy burden, undermining any attempt to reach an agreement;
- Third, it is hard to imagine a procedure promoted by a debtor that would not advantage him in some manner. Creditors usually prove to be extremely indolent in proceedings and in most cases they do not sympathize with debtors. They show a tendency to be more favorable to a standard liquidation, unless an alternative provides them with specific benefits;
- Fourth, it would be difficult to ensure that all creditors are part of the proceeding and to make sure that all are paid what they are owed, hence ensuring some kind of a fresh start.

Informal workouts may, therefore, become an extremely efficient solution to debtor/creditor(s) issues in those legislative frameworks that are capable of: increasing trust among parties; encouraging participation in the process through the promotion of a code of conduct; discouraging frauds; and providing incentives (e.g. tax deductions) and relief to encourage the closure of binding agreements.[373]

Achieving such an enlightened balance in practice, though, is a great challenge. The guide to the Principles of 2001 discussed this topic, stating that:

> "Corporate workouts and restructuring should be supported by an enabling environment that encourages participants to engage in consensual arrangements designed to restore an enterprise to financial viability. An enabling environment includes laws and procedures that require disclosure of or ensure access to timely, reliable and accurate financial information on the distressed enterprise; encourage lending to, investment in or recapitalization of viable financially distressed enterprises; support a broad range of restructuring activities, such as debt write offs, rescheduling, restructuring and debt-equity conversion; and provide favorable or neutral tax treatment for restructurings. Because informal workouts take place in the "shadow of the law", consensual resolution requires reliable fallback options through existing legal mechanisms for individual enforcement and debt collection or through collective insolvency procedures. As such, the most conductive environment for informal workouts is having effective insolvency and enforcement regimes as reflected in the foregoing sections."[374]

This approach may be, therefore, impractical today, but studies should continue looking for a way to make it operative.

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[372] See **The World Bank**, "*Creditor rights and insolvency ROSC assessment methodology – based on the World bank principles for effective creditor rights and insolvency systems (revised January 2011) and UNCITRAL Legislative Guide on Insolvency Law – revised draft*", (2011), at 15-17.
http://siteresources.worldbank.org/INTGILD/Resources/ICR_ROSC_AssessmentMethodology_Jan2011.pdf

[373] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 53-4.

[374] *Id.,* at 53.

For now we are bound to continue our discussion, focusing on those best practices that increase the levels of effectiveness and efficiency within full, local insolvency frameworks. Despite their weaknesses, these practices remain, for now, the best tool that can deployed to solve conflicts between a debtor and numerous creditors.

2.2.3 Part C: Legal frameworks for business insolvency

Part C discusses the building blocks for the creation of a modern, effective, and efficient insolvency system.

The section addresses both liquidation and reorganization proceedings. It is founded on the work of the G-22[375] working group of 1998, which listed the following points as key objectives necessary an insolvency system formula to be fruitful:

- Maximize the value of a firm's assets by providing an option to reorganize;
- Strike a careful balance between reorganizations and liquidations;
- Provide for equitable treatment of similarly-situated creditors (including similarly-situated foreign and domestic creditors);
- Provide for the timely, efficient, and impartial resolution of insolvency cases;
- Prevent the premature dismemberment of the debtor's assets by individual creditors seeking to obtain quick judgments;
- Provide a procedure that is transparent and contains incentives for gathering and dispensing information;
- Reorganize existing creditor's rights and respect the priority of claims with a predictable and pre-established process;
- Establish a framework for cross-border insolvency with recognition of foreign proceedings.

The World Bank in 2001 presented the following list of "Key Objectives and Policies"[376], which were very similar:

- Integrate with a country's broader legal and commercial systems:

Integration. An insolvency system must be complementary and compatible with the legal system of the society in which it is rooted. To be properly implemented, an insolvency system's procedural and substantive rules must match the capacity of the relevant courts or agencies (judicial, professional, institutional, regulatory, administrative). As much as possible, a country's insolvency system should reflect the society's social and economic goals. Finally, the system must be continuously monitored to ensure that it is being implemented in accordance with the policies and purposes for its design.

- Maximize the value of a firm's assets, including by providing an option to reorganize:

Maximizing asset values. Maximizing asset values is a crucial objective of the insolvency process. Administrators and other stakeholders should have strong incentives to achieve higher values, because more value means that creditors will receive higher distributions and refuse the burden of insolvency. This is not an easy task given that creditors tend to act in their own self-interest. In some cases where creditors have bargained for superior rights, such as secured or *in rem* creditors, there may be a legitimate reason to treat them differently. As a general rule, maximizing value may require that before its sale the business is operated as a complete productive unit or merely to preserve the highest value of its assets. A number of design considerations emanate from this objective, including the need to protect the business and assets against actions by individual creditors, the balance to be struck between rapid liquidations and efforts to rehabilitate the business, the amount of investment that should be made to preserve or raise value and the implications for other stakeholders, the discretion that can be exercised by qualified administrators and the extent to which creditors should be allowed to monitor the process. Some of the design features pertain to the efficiency of procedures and the institutions that implement them.

- Strike a careful balance between liquidation and reorganization:

Rehabilitation policy. The modern trend supporting rehabilitation or rescue is an extension of the goal to maximize value. It is predicated on the idea that the value of the whole is greater than the value of the parts. Put differently, an

[375] **G-22**, "*Report of the Working Group on International Financial Crisis*" (1998), found at: http://www.imf.org/external/np/g22/ifcrep.pdf at 16, 44-45.

[376] See Principle "6" of the list of 2001. See also: The World Bank, "Principles and Guidelines for effective insolvency and creditor right systems", (2001), at 24-6.

> enterprise is more valuable as a going concern than if it is liquidated. This approach also reflects other objectives, such as preserving jobs. It is achieved by imposing a moratorium at the outset of an insolvency proceeding to prevent creditors from engaging in collection efforts or exercising enforcement remedies that dismember the enterprise for the benefit of a few. As discussed below, the moratorium should be brief to stabilize the business and determine if there is a decent likelihood of rehabilitation. The moratorium gives the debtor or the administrator a neutral forum in which to negotiate a consensual business solution, which can result in a higher dividend to creditors by salvaging an enterprise as a going concern rather than realizing value through liquidation, which is often much lower.

- Provide for the equitable treatment of similarly situated creditors, including similarly situated foreign and domestic creditors:

> Equitable distribution. The principle of equitable distribution is based on the notion that in a collective proceeding, creditors with similar legal rights should be treated the same. The equity policy permeates many provisions of an insolvency law, including the automatic stay, the moratorium on payments of claims created prior to the bankruptcy, provisions to set aside claims and recapture property or value, classification and voting procedures in a rehabilitation, and distribution mechanisms. At the outset an injunction prevents the "free for all" system of individual enforcement and replaces it with one that balances the interests of creditors, the debtor and the government. Another way of expressing the equity policy is the principle of pari passu treatment for creditors, which espouses that creditors should be paid on a ratable basis and in the relative priority of their claims and interests from the proceeds of the liquidated estate.12 Put differently, creditors on an equal legal footing should be treated equally, receiving a distribution on their claim proportionate to aggregate claims of the same kind. In reality, the pari passu principle and equity policy are modified by social choices on claim priorities.

- Prevent the premature dismemberment of a debtor's assets by individual creditors seeking quick judgments;
- Provide for the timely, efficient, and impartial resolution of insolvencies:

> Timely, efficient and impartial resolution. The objectives of timely and efficient administration support the objective of maximizing asset values, while impartiality supports the principle of equitable distribution. If the insolvency process is to have meaning, it must be fair and impartial. It must also result in genuine value if it is to provide meaningful benefit to creditors. Value reflects a number of factors, such as the ability to dispose of the business or assets promptly at fair market values, the costs incurred by creditors in realizing the asset value and the timing of distributions to creditors of value realized. If administrators or liquidators are not equipped to handle insolvency cases, they may not realize the highest value or may squander the remaining value in a hopeless search for the ideal buyer. If the institutions that render decisions are inefficient and overburdened, they may be unable to provide prompt responses on applications filed or other matters affecting the disposition of assets. The entire process must be examined at every stage to ensure maximum efficiency without sacrificing flexibility. This generally requires establishing clear but reasonable deadlines for most matters that occur within a proceeding. It may also mean providing time limits that assure secured or other creditors predictable outcomes by a certain time.

- Provide a transparent procedure that contains incentives for gathering and dispensing information;
- Recognize existing creditor rights and respect the priority of claims with a predictable and pre-established process:

> Predictability, transparency and accountability. Effective insolvency systems include rules that are reasonably predictable, transparent and hold all parties duly accountable throughout the process. There is no substitute for a clear law. A predictable law promotes stability in commercial transactions, fosters lending and investment at lower risk premiums, and promotes consensual resolutions of disputes between a debtor and its creditors by establishing a backdrop against which parties can assess their relative rights. In the same way, transparent rules and procedures promote fairness and integrity in the system and create an informed and communicative environment by which greater levels of cooperation can be achieved. Disclosure of information is crucial to an accurate evaluation of the prospects for the business and to assess the rights and priorities of creditors, but the enterprise must be assured that confidential information will be properly protected. Finally, a system that holds all participants in the process accountable reinforces predictability and promotes fairness.

- Establish a framework of cross-border insolvencies, with recognition of foreign proceedings.

The relevance of the "Key Objectives" presented by the World Bank was confirmed in 2005 by the publication of the UNCITRAL Legislative Guide on Insolvency Law, which presented a substantially similar list consisting of the following points:

1. Provision of certainty in the market to promote economic stability and growth:

> Insolvency laws and institutions are critical to enabling States to achieve the benefits and avoid the pitfalls of integration of national financial systems with the international financial system. Those laws and institutions should promote restructuring of viable business and efficient closure and transfer of assets of failed businesses, facilitate the

provision of finance for start-up and reorganization of businesses and enable assessment of credit risk, both domestically and internationally. The following key objectives of an insolvency law should be implemented with a view to enhancing certainty in the market and promoting economic stability and growth.

2. Maximization of the value of the assets present within an estate:

Participants in insolvency proceedings should have strong incentives to achieve maximum value for assets, as this will facilitate higher distributions to creditors as a whole and reduce the burden of insolvency. The achievement of this goal is often furthered by achieving a balance of the risks allocated between the parties involved in insolvency proceedings. The manner in which avoidance provisions treat prior transactions, for example, can ensure that creditors are treated equitably and enhance the value of the debtor's assets by recovering value for the benefit of all creditors. At the same time, the treatment afforded those transactions can undermine the predictability of contractual relations that is critical to investment decisions, creating a tension between the different objectives of an insolvency regime. Similarly, a balance has to be struck between rapid liquidation and longer-term efforts to reorganize the business that may generate more value for creditors, between the need for new investment to preserve or improve the value of assets and the implications and cost of that new investment on existing stakeholders, and between the different roles allocated to the different stakeholders, in particular the discretion that can be exercised by the insolvency representative and the extent to which creditors can monitor the exercise of that discretion to safeguard the proceedings and ensure the maximization of value.

3. Striking a balance between liquidations and reorganizations:

The first key objective of maximization of value is closely linked to the balance to be achieved in the insolvency law between liquidation and reorganization. An insolvency law needs to balance the advantages of near-term debt collection through liquidation (often the preference of secured creditors) against preserving the value of the debtor's business through reorganization (often the preference of unsecured creditors and the debtor). Achieving that balance may have implications for other social policy considerations, such as encouraging the development of an entrepreneurial class and protecting employment. Insolvency law should include the possibility of reorganization of the debtor as an alternative to liquidation, where creditors would not involuntarily receive less than in liquidation and the value of the debtor to society and to creditors may be maximized by allowing it to continue. This is predicated on the basic economic theory that greater value may be obtained from keeping the essential components of a business together, rather than breaking them up and disposing of them in fragments. To ensure that insolvency proceedings are not abused by either creditors or the debtor and that the procedure most appropriate to resolution of the debtor's financial difficulty is available, an insolvency law should also provide for conversion between the different types of proceedings in appropriate circumstances.

4. Ensuring the equitable treatment of similarly-situated creditors:

The objective of equitable treatment is based on the notion that, in collective proceedings, creditors with similar legal rights should be treated fairly, receiving a distribution on their claim in accordance with their relative ranking and interests. This key objective recognizes that all creditors do not need to be treated identically, but in a manner that reflects the different bargains they have struck with the debtor. This is less relevant as a defining factor where there is no specific debt contract with the debtor, such as in the case of damage claimants (e.g. for environmental damage) and tax authorities. Even though the principle of equitable treatment may be modified by social policy on priorities and give way to the prerogatives pertaining to holders of claims or interests that arise, for example, by operation of law, it retains its significance by ensuring that the priority accorded to the claims of a similar class affects all members of the class in the same manner. The policy of equitable treatment permeates many aspects of an insolvency law, including the application of the stay or suspension, provisions to set aside acts and transactions and recapture value for the insolvency estate, classification of claims, voting procedures in reorganization and distribution mechanisms. An insolvency law should address problems of fraud and favouritism that may arise in cases of financial distress by providing, for example, that acts and transactions detrimental to equitable treatment of creditors can be avoided.

5. Including provisions for the timely, efficient, and impartial resolution of insolvency:

Insolvency should be addressed and resolved in an orderly, quick and efficient manner, with a view to avoiding undue disruption to the business activities of the debtor and to minimizing the cost of the proceedings. Achieving timely and efficient administration will support the objective of maximizing asset value, while impartiality supports the goal of equitable treatment. The entire process needs to be carefully considered to ensure maximum efficiency without sacrificing flexibility. At the same time, it should be focused on the goal of liquidating non-viable and inefficient businesses and the survival of efficient, potentially viable businesses.

Quick and orderly resolution of a debtor's financial difficulties can be facilitated by an insolvency law that provides easy access to insolvency proceedings by reference to clear and objective criteria, provides a convenient means of identifying, collecting, preserving and recovering assets and rights that should be applied towards payment of the debts and liabilities of the debtor, facilitates participation of the debtor and its creditors with the least possible delay

and expense, provides an appropriate structure for supervision and administration of proceedings (including both professionals and the institutions involved) and provides, as an end result, effective resolution of the debtor's financial obligations and liabilities.

6. Preservation of the insolvency estate to allow equitable distribution to creditors:

An insolvency law should preserve the estate and prevent premature dismemberment of the debtor's assets by individual creditor actions to collect individual debts. Such activity often reduces the total value of the pool of assets available to settle all claims against the debtor and may preclude reorganization or the sale of the business as a going concern. A stay of creditor action provides a breathing space for debtors, enabling a proper examination of its financial situation and facilitating both maximization of the value of the estate and equitable treatment of creditors. Some mechanism may be required to ensure that the stay does not affect the rights of secured creditors.

7. Ensuring a transparent and predictable insolvency law that contains incentives for gathering and dispensing information:

An insolvency law should be transparent and predictable. This will enable potential lenders and creditors to understand how insolvency proceedings operate and to assess the risk associated with their position as a creditor in the event of insolvency. This will promote stability in commercial relations and foster lending and investment at lower risk premiums. Transparency and predictability will also enable creditors to clarify priorities, prevent disputes by providing a backdrop against which relative rights and risks can be assessed and help define the limits of any discretion. Unpredictable application of the insolvency law has the potential to undermine not only the confidence of all participants in insolvency proceedings, but also their willingness to make credit and other investment decisions prior to insolvency. As far as possible, an insolvency law should clearly indicate all provisions of other laws that may affect the conduct of the insolvency proceedings (e.g. labour law; commercial and contract law; tax law; laws affecting foreign exchange, netting and set-off and debt for equity swaps; and even family and matrimonial law).

An insolvency law should ensure that adequate information is available in respect of the debtor's situation, providing incentives to encourage the debtor to reveal its positions and, where appropriate, sanctions for failure to do so. The availability of this information will enable those responsible for administering and supervising insolvency proceedings (courts or administrative agencies, the insolvency representative) and creditors to assess the financial situation of the debtor and determine the most appropriate solution.

8. Recognition of existing creditor's rights and establishment of clear rules for ranking of priority claims:

Recognition and enforcement in insolvency proceedings of the differing rights that creditors had with respect to the debtor and its assets before the commencement of insolvency proceedings will create certainty in the market and facilitate the provision of credit, in particular with respect to the rights and priorities of secured creditors. Clear rules for the ranking of priorities of both existing and post-commencement creditor claims are important to provide predictability to lenders, and to ensure consistent application of the rules, confidence in the proceedings and that all participants are able to adopt appropriate measures to manage risk. To the greatest extent possible, those priorities should be based upon commercial bargains and not reflect social and political concerns that have the potential to distort the outcome of insolvency. According priority to claims that are not based on commercial bargains therefore should be minimized.

9. Establishment of a framework for cross-border insolvency:

To promote coordination between jurisdictions and facilitate the provision of assistance in the administration of insolvency proceedings originating in a foreign country, insolvency laws should provide rules on cross-border insolvency, including the recognition of foreign proceedings, by adopting the UNCITRAL Model Law on Cross-Border Insolvency (see annex III).

The World Bank's list of objectives and policies, which ultimately formed the basis of Principle C1, was updated and expanded through different drafts to account for the recent progress and the evolution of research in the field of insolvency laws. The last published version, in 2015, reads as follows:

- Integrate with a country's broader legal and commercial systems;
- Maximize the value of a firm's assets, including by providing an option to reorganize;
- Provide for the efficient liquidation of both nonviable businesses and those where liquidation is likely to produce a greater return to creditors and the reorganization of viable businesses;
- Strike a careful balance between liquidation and reorganization, allowing for easy conversion of proceedings from one procedure to another;
- Provide for equitable treatment of similarly situated creditors, including similarly situated foreign and domestic creditors;

- Provide for timely, efficient and impartial resolution of insolvencies;
- Prevent the improper use of the insolvency system;
- Prevent the premature dismemberment of a debtor's assets by individual creditors seeking quick judgments;
- Provide a transparent procedure that contains, and consistently applies, clear risk allocation rules and incentives for gathering and dispensing information;
- Recognize existing creditor rights and respect the priority claims with a predictable and established process;
- Establish a framework for cross-border insolvencies, with recognition of foreign proceedings.

Before we commence the discussion of the individual Principles, it is interesting to point out that the above listed key objectives and policies include those targets that efficient and effective insolvency frameworks should attempt to reach to compete in modern markets. Since the lists we have examined build on each other and present several similar traits, it seems that there is a common understanding in the international scenario on the elements that should characterize such a model.

Individual rules, though, can vary greatly among local settings and societies. The UNCITRAL Legislative Guide on Insolvency Law[377] makes an interesting comment on this point, underlining the "uniqueness" of insolvency formulas and that there may be several ways to be effective and efficient:

> "When a debtor is unable to pay its debts and other liabilities as they become due, most legal systems provide a legal mechanism to address the collective satisfaction of the outstanding claims from assets (whether tangible or intangible) of the debtor. A range of interests needs to be accommodated by that legal mechanism: those of the parties affected by the proceedings including the debtor, the owners and management of the debtor, the creditors who may be secured to varying degrees (including tax agencies and other government creditors), employees, guarantors of debt and suppliers of goods and services, as well as the legal, commercial and social institutions and practices that are relevant to the design of the insolvency law and required for its operation. Generally, the mechanism must strike a balance not only between the different interests of these stakeholders, but also between these interests and the relevant social, political and other policy considerations that have an impact on the economic and legal goals of insolvency proceedings. To the extent that it is excluded from the scope of such legal mechanisms, a debtor and its creditors will not be subject to the discipline of the mechanism, nor will they enjoy the protections provided by the mechanism."[378]
>
> "Although country approaches vary, there is broad agreement that effective and efficient insolvency regimes should aim to achieve the key objectives identified below in a balanced manner. Whatever design is chosen for an insolvency law that will meet these key objectives, the insolvency law must be complementary to, and compatible with, the legal and social values of the society in which it is based and which it must ultimately sustain. Although insolvency law generally forms a distinctive regime, it ought not to produce results that are fundamentally in conflict with the premises upon which laws other than

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[377] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 14-15. The UNICITRAL listed in the guide its own key objectives which were substantially congruent to those of the World Bank:

1. Provision of certainty in the market to promote economic stability and growth;
2. Maximization of value of assets;
3. Striking a balance between liquidation and reorganization;
4. Ensuring equitable treatment of similarly situated creditors;
5. Provision for timely, efficient and impartial resolution of insolvency;
6. Preservation of the insolvency estate to allow equitable distribution to creditors;
7. Ensuring a transparent and predictable insolvency law that contains incentives for gathering and dispensing information;
8. Recognition of existing creditor rights and establishment of clear rules for ranking of priority claims;
9. Establishment of a framework for cross-border insolvency.

[378] *Id*., at 9.

> the insolvency law are based. Where the insolvency law does seek to achieve a result that differs or fundamentally departs from that other law (e.g. with respect to treatment of contracts, avoidance of antecedent acts and transactions or treatment of the rights of secured creditors), it is highly desirable that that result be the product of careful consideration and conscious policy in that direction."[379]

> "Since an insolvency regime cannot fully protect the interests of all parties, some of the key policy choices to be made when designing an insolvency law relate to defining the broad goals of the law (rescuing businesses in financial difficulty, protecting employment, protecting the interests of creditors, encouraging the development of an entrepreneurial class) and achieving the desired balance between the specific objectives identified above. Insolvency laws achieve that balance by reapportioning the risks of insolvency in a way that suits a State's economic, social and political goals. As such, an insolvency law can have widespread effects in the broader economy."[380]

This part of our study alone, therefore, will not allow us to immediately solve the difficulties that we discussed in Chapter I. The process of refounding European insolvency frameworks attempts to structure models that can help the Union in reaching its demanding targets. The European Union does not just aim to find a successful uniform formula that can operate at the highest levels of effectiveness and efficiency at the local and cross-border level; it also has to find the correct way to implement it across its vast and heterogeneous territory.

European societies still present several differences which are difficult to bridge. The flexible building blocks provided by the World Bank cannot fulfill such a complex task alone, but they can provide a useful, neutral, and reliable roadmap. We will analyze the Principles and the key elements they embody, therefore, to examine how they match the path followed by the EU up to now and improvements that may be made in the Union's strategies.

[A] Principle C2. Due process: notification and information

Several relevant aspects of insolvency proceedings depend on the efficiency of the systems of notification and information that are adopted within a framework. A party in interest has a right to be heard and to seek relief on any issue in the insolvency proceedings that affect its rights, obligations and interests.[381]

An effective insolvency framework must protect the rights of those involved in the process, providing efficient notification systems and access to all information which may be relevant. Achieving such a result, though, remains a true challenge even in modern times, despite continuous technological improvements. Ensuring that a sufficient level of information is made available and that an effective and efficient interaction between all interested parties can occur is difficult, time consuming, and costly.

This is particularly true in reorganization proceedings, since creditors need to be "active" parties[382] involved in the process to make it fully operative; a reorganization proceeding, in fact, could not be truly successful without their participation in the voting process.

Several factors contribute to creating obstacles in making notifications and sharing information within the insolvency scenario:

- The great number of interest-holders involved in proceedings;
- Their distribution among jurisdictions (this point has become particularly relevant in recent times due to the dispersion of businesses across national borders within a globalized market[383]);

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[379] *Id.,* at 10.
[380] *Id.,* at 14.
[381] See **The World Bank**, "*Creditor rights and insolvency ROSC assessment methodology – based on the World bank principles for effective creditor rights and insolvency systems (revised January 2011) and UNCITRAL Legislative Guide on Insolvency Law – revised draft*", (2011), at 25.
http://siteresources.worldbank.org/INTGILD/Resources/ICR_ROSC_AssessmentMethodology_Jan2011.pdf
[382] Principle C2.2.
[383] Although, as we will discuss in Chapters III and IV, medieval bankruptcy systems had already started dealing with international bankruptcy issues centuries ago when markets where less globalized.

- The use of different software and of national (registered) e-mail providers;
- The use of different official forms and languages.

> *"(iv) Manner of giving notice*
> 69. In addition to the question of the time at which notice is to be given, an insolvency law may need to address, in order to ensure the effectiveness of the notice, the manner in which notice is given and the information to be included. The manner of giving the notice could address both the party required to give the notice (e.g. the court or the party making the application for commencement) and how the information can be made available, with the key consideration being delivery or publication in a form that is generally likely to come to the notice of parties in interest. For example, while known creditors may be notified individually (the effectiveness of this method will depend upon the state of the debtor's records), the need to inform unknown creditors has led legislators to adopt broad requirements, such as publication in an official government publication or a commercial or widely circulated newspaper. That newspaper may be regional, national or local (by reference to the location of the debtor's business), depending upon the circumstances of the case and what will prove to be most cost-effective. It may not always be necessary, for example, to require publication at considerable expense in a national newspaper when the debtor's business is based and conducted locally.
> 70. To avoid the notification procedure becoming unwieldy and requiring in each case an investigation into what will prove to be the most effective means of giving notice, the obligation should refer to standard forms, with some flexibility for local conditions. Other options for achieving effective notification may include various forms of electronic communication and use of relevant public registries."[384]

Difficulties are faced, therefore, not just in bringing information to those that should receive, it but also in making it understandable. Language barriers are not the only relevant element preventing the effective use of standardized international forms or registrars. The relevant differences existing among local frameworks and societies require high levels of understanding that go beyond a mere translation.[385]

Technology has brought some improvements at the local level, but issues remain. In Europe, for example, several national systems for registered e-mail have been activated; yet, they often are not compatible at a cross-border level. Notifications are often sent in the national language of the system only (see for example the Italian "PEC" system, which is used to file proofs of claims[386]). Dialogue between interested parties or the courts may, therefore, be problematic, and even if legal assistance is not imperative, communicative barriers may make it necessary.

It is also important to point out that inefficiencies in notification processes and delays in sharing information have negative effects on the total duration of proceedings and in the results of their administration.[387]

[B] Principles C3 and C4. Eligibility, applicability, and, accessibility

Principles C3 and C4 should be read in conjunction as a restatement of Principle 9 of the draft of 2001:

C3	**Eligibility** The insolvency proceeding should apply to all enterprises or corporate entities, including state-owned enterprises. Exceptions should be limited,	**Principle 9 (2001):** Commencement: Applicability and Accessibility A. The insolvency process should apply to all

[384] *Id.,* at 61.
[385] Moreover, the use of similar legal terms that have different connotations in the international scenario is the source of great misunderstandings. The differences in defining insolvency and the discordant consequences that may derive from it are a simple example.
[386] The system is designed to make it easier for claimants to file, starting a direct dialogue with insolvency administrators. Foreigners, though, would need to open an Italian registered e-mail account to benefit from it.
[387] See Principle C2, in particular C2.1.

	clearly defined, and should be dealt with through a separate law or through special provisions in the insolvency law.	enterprises or corporate entities except financial institutions and insurance corporations, which should be dealt with through a separate law or through special provision in the insolvency law. State-owned corporations should be subject to the same insolvency law as private corporations.
C4	**Applicability and Accessibility** **C4.1** Access to the system should be efficient and cost-effective. Both debtors and creditors should be entitled to apply for insolvency proceedings. **C4.2** Commencement criteria and presumptions about insolvency should be clearly defined in the law. The preferred test to commence an insolvency proceeding should be the debtor's inability to pay debts as they mature, although insolvency may also exist where the debtor's liabilities are measured on the basis of fair-market values. **C4.3** Debtors should have easy access to the insolvency system upon showing proof of basic criteria (insolvency or financial difficulty). **C4.4** Where the application for commencement of a proceeding is made by a creditor, the debtor should be entitled to prompt notice of the application, an opportunity to defend against the application, and a prompt decision by the court on the commencement of the case or dismissal of the creditor's application.	B. Debtors should have easy access to the insolvency system upon showing proof of basic criteria (insolvency or financial difficulty). A declaration to that effect may be provided by the debtor through its board of directors or management. Creditor access should be conditioned on showing proof of insolvency by presumption where there is clear evidence that the debtor failed to pay a matured debt (perhaps of a minimum amount). C. The preferred test for insolvency should be the debtor's inability to pay debts as they come due - known as the liquidity test. The filing of an application to commence a proceeding should automatically prohibit the debtor's transfer, sale or disposition of assets or parts of the business without court approval, except to the extent necessary to operate the business.

They address issues of eligibility, applicability, and accessibility in bankruptcy, encompassing several relevant topics that shape the very essence of an insolvency framework and provide key information on the societal principles of the particular nation in which a model is applied.

[1] Eligibility and applicability

The system that the World Bank deems more effective and efficient is:

- "Business oriented" – the Principles address the needs of business debtors exclusively;
- "Inclusive" – just few business debtors would be excluded from the structure presented by the Principles;
- "Debtor friendly" – the structure presented by the World Bank aims to support honest debtors facing financial difficulties instead of punishing and stigmatizing them.

All such characteristics, as we have observed in Chapter I, are targeted by modern European bankruptcy systems, which are also revising their rules on the eligibility of debtors include natural persons. Protecting consumers, in fact, has recently become a priority to support the integrity of international markets.

As we will discuss in the next part of this chapter, principles on this topic are not available, yet the continuous work to keep the list updated has led to the development of studies in this particular field of law. For now, we will just mention the comments made on this topic by the UNCITRAL Legislative Guide on Insolvency Law of 2005:

> "An important threshold issue in designing an insolvency law focused on debtors engaged in economic activities (whether or not they are conducted for profit) is determining and clearly defining which debtors will be subject to the law. To the extent that any debtor is excluded from the law, it will not enjoy the protections offered by the law, nor will it be subject to the discipline of the law. This argues in favour of an all-inclusive approach to the design of an insolvency law, with limited exceptions. The design of eligibility provisions for an insolvency law raises two basic questions. Firstly, whether the law should distinguish between debtors who are natural persons and debtors that are some form of limited liability enterprise or corporation or other legal person, each of which will raise not only different policy considerations, but also considerations concerning social and other

attitudes. Secondly, the types of debtor, if any, that should be excluded from the application of the law.

2. States adopt different approaches to defining the scope of application of their insolvency laws. Some insolvency laws apply to all debtors with certain specified exceptions, such as those discussed below. Other States distinguish between natural person debtors and juridical or legal person debtors and provide different insolvency laws for each. A further approach distinguishes between legal and natural persons on the basis of their engagement in economic (or consumer) activities. Some of these laws address the insolvency of "merchants", which are defined by reference to engagement in economic activities as an ordinary occupation, or companies incorporated in accordance with commercial laws and other entities that regularly undertake economic activities. Some laws also include different procedures based on levels of indebtedness and a number of States have developed special insolvency regimes for different sectors of the economy, in particular the agricultural sector.

(a) Natural persons engaged in economic activities

3. Policies applicable to individual or personal debt and insolvency often evidence cultural attitudes that are not as relevant to debtors engaged in economic activity. These may include, for example, attitudes toward the incurring of personal debt; the availability of relief for unmanageable debt; the social effect of bankruptcy on the status of individuals; the need for counselling and educational assistance with respect to individual debt; and the provision of a fresh start for debtors through a discharge (release of the debtor from liability for part or all of certain debts after the closure of the proceedings—see chap. VI, paras. 1-13). Policies applicable to insolvency in the commercial sector, in comparison, are generally restricted to economic and commercial considerations such as the important role that business plays in the economy; the need to preserve and encourage economic and entrepreneurial activity; and the need to encourage the provision of credit and protect creditors.

4. The interests of natural persons involved in economic activity (including, for example, partnerships of individuals and sole traders) differ from those of consumer debtors, at least in some aspects of their indebtedness, but it is often difficult to separate an individual's personal indebtedness from their business indebtedness for the purposes of determining how they should be treated in insolvency. Different tests may be developed to facilitate that determination, by focusing, for example, upon the nature of the activity being undertaken, the level of debt and the connection between the debt and the economic activity. Indicators of involvement in economic activity may include whether the business is registered as a trading or other business operation; whether it is a certain type of legal person under the commercial law; the nature of its regular activities; and information concerning turnover and assets and liabilities.

5. Many States include natural person debtors involved in economic activity within the scope of their commercial insolvency laws. The experience of other States suggests that although business activities conducted by natural persons form part of economic activity, those cases often are best dealt with under the regime for insolvency of natural persons because ultimately the proprietor of a personal business will conduct his or her activities through a structure that does not enjoy any limits on liability, leaving them personally liable, without limitation, for the debts of the business. These cases also raise difficult issues of discharge, including the length of time required to expire before the debtor can be discharged and the obligations that can be discharged or exempted from discharge. Debts that cannot be discharged often involve personal matters such as settlements in divorce proceedings or child support obligations.

6. An additional consideration is that the inclusion of natural persons in the commercial insolvency regime may have the potential, in some States, to act as a disincentive to use of the commercial regime because of the social attitude towards personal insolvency, irrespective of its nature. It is desirable that these concerns be considered in designing a law to address business-related insolvency, taking into account the manner in which economic activity is generally conducted in a particular State and the existence and effectiveness of insolvency laws dealing with natural persons. In many States, for example, economic activity is conducted almost exclusively by individuals and to exclude them from the insolvency law would significantly limit its operation and effectiveness. In others,

insolvency of natural persons engaged in economic activity is specifically addressed by the personal insolvency law and they are excluded from the commercial insolvency regime.
7. The *Legislative Guide* focuses upon the conduct of economic activities by both legal and natural persons, irrespective of the legal structure through which those activities are conducted and whether or not they are conducted for profit. It identifies those issues where additional or different provisions will be required if natural person debtors are included in the insolvency law."[388]

Bankruptcy is, therefore, changing. It is being redesigned as a tool to support greater numbers of debtors.

Some relevant groups of business debtors though, such as banks or insurance companies, remain excluded, for now, due to important policies.

[2] Groups of debtors that may be excluded from insolvency frameworks

Not all business debtors are concerned with bankruptcy.[389] The policies on this topic vary greatly among local settings depending on national needs. Some groups that have been traditionally excluded from basic insolvency framework, being dealt with instead through specific laws, can be categorized broadly as: a) banks, financial institutions, insurance companies; and b) state-owned (in contrast with private) enterprises.

Principle 9 of the list of 2001 stated that, to be effective, the insolvency process had to apply to all enterprises or corporate entities with the exception of banks[390], financial institutions, and insurance companies, which should be dealt with using different, more specific and better-tailored statutes. The 2001 guideline included a specific annex on the topic[391] describing the importance of setting special rules for banks:

> "What makes Banks different: in a market economy, banks are subject to special licensing, regulation and supervision rules known as prudential regulation. Banks are treated differently from other enterprises because a safe and sound banking system is indispensible for sustainable economic growth and because the nature of banking activities makes banks and the banking system vulnerable to the destructive panics caused by a sudden loss of public confidence. Market economies cannot function properly without an efficient banking system, which intermediates between public savings and investments and provides other essential financial services to the state and the public. For example a sound banking system is needed to conduct monetary policy and to operate payment and transfer systems." […] "in many countries the general insolvency law applies to banks, but in several countries the banking law includes special rules, administered by the bank regulator, for the restructuring and forced liquidation of banks. In most cases there is similarity between the broad policy objectives served by general insolvency law and those pursued by the restructuring and liquidation provisions of banking law. But there are some fundamental differences between the rehabilitation of nonbank enterprises."

Over the past fifteen years, new best practices were developed to deal with exclusions.

Section C3 in its 2015 version attempts to broaden access criteria, mandating that exceptions be "limited and clearly defined". On this topic the UNCITRAL Legislative Guide affirmed that:

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[388] *Id.,* at 38-40.

[389] See **The World Bank**, "*Creditor rights and insolvency ROSC assessment methodology – based on the World bank principles for effective creditor rights and insolvency systems (revised January 2011) and UNCITRAL Legislative Guide on Insolvency Law – revised draft*", (2011), at 27.
http://siteresources.worldbank.org/INTGILD/Resources/ICR_ROSC_AssessmentMethodology_Jan2011.pdf

[390] See on this topic **Marinic Matej, Vlahu Razvan**, "*The economics of bank bankruptcy law*", Springer, ISBN 978-3-642-21807-1, (2012).

[391] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), Annex I, at 63-72.

> "Although it may be desirable to extend the protections and discipline of an insolvency law to as wide a range of debtors as possible, separate treatment may be provided for certain entities of a specialized nature, such as banking and insurance institutions, utility companies and stock or commodity brokers Exceptions for these types of debtor are widely reflected in insolvency law and are generally justified on the basis of the detailed regulatory legal regime to which these businesses are often subjected outside the insolvency context To address the insolvency of such debtors, regulatory regimes can include provisions particular to the type of business being regulated or special rule can be included in the general insolvency law. The special consideration arising from the insolvency of such debtors and consumer insolvency are not specifically addressed in the *Legislative Guide*."[392]

After differentiating the treatment awarded to state-owned compared to private-owned enterprises, both the World Bank and the UNCITRAL agreed on the fact that exclusions should protect any sub-national governments, such as states, provinces, regions, and municipalities, and not those corporations that interact with the market:

> "8. An insolvency law can apply to all types of debtor engaged in economic activities, both private and state-owned, especially those state-owned enterprises which compete in the market place as distinct economic or business operations and otherwise have the same commercial and economic interests as privately-owned businesses. The discussion here is not intended to include States, subnational governments, municipalities and other similar types of organization or public authority, unless they are state-owned enterprises operating as commercial enterprises.
> 9. Government ownership of an enterprise may not, in and of itself, provide a sufficient basis for excluding the enterprise from the coverage of the insolvency law, although a number of States do adopt that approach. Where the State plays different roles with respect to the enterprise not only as owner, but also as lender and largest creditor, normal commercial incentives will not apply, compromise solutions may be difficult to achieve and there is clear ground for conflicts of interest to arise. Inclusion of these enterprises in the insolvency regime therefore has the advantages of subjecting them to the discipline of the regime, sending a clear signal that government financial support for such enterprises will not be unlimited and providing a procedure that has the potential to minimize conflicts of interest."[393]

> "The Principle also supports the view that state enterprises that compete in a market economy should be subject to the same regulatory, commercial and economic process as private corporations – including insolvency law. In cases where the treatment of state enterprises is part of a change in macroeconomic policy, independent legislation on state enterprises may be warranted. (Examples include massive privatization programs, as in transition economies.) But outside this context, there is no compelling reason for state enterprises to be exempt from the regular insolvency system or to be guided by separate rules. The disciplinary effects of the insolvency system provide a means for regulating state enterprises with weak corporate governance structures. Viable state enterprises should be placed under independent supervision acceptable to creditors, to avoid conflicts often inherent in state enterprise insolvency, where the state acts in multiple capacities (e.g., shareholder, management, and judicial arbiter)." [394]

[392] **UNCITRAL (United Nations Commission on International Trade Law),** "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 40-41.
[393] *Id.,* at 40.
[394] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 28-29.

The exclusion of certain groups of business entities from an insolvency framework, in fact, should not be conceived lightly[395], for it can cause great uncertainty and a lack of transparency within the system.

In general, the guide to the list of Principles of 2001 stated that if differences must exist:

> "The law should clearly identify the entities to which it applies – a threshold policy decision that can have enormous economic implications because entities left outside the process will not be entitled to the benefits or exposed to the discipline of the system."[396]

Policies may, in fact, broaden or limit the list of debtors that may be excluded from insolvency proceedings. As we will discuss in Chapter VI, for example, the Italian framework, a traditionally stigmatizing one, has been excluding small businesses to "protect" them from the harshness of its criminal rules. The European Union and the United States are studying how to design more specific systems focused on supporting small businesses through insolvency proceedings.

This is an evident example of how different policies within societies can impact the structure of local models.

[3] Access criteria

Much has changed in this area, which has traditionally been heavily stigmatized.

In early bankruptcy frameworks, voluntary cases were not allowed, or systems included harsh punishments which deterred debtors from taking early action. Today, the voluntary commencement of cases is perceived as the most effective and efficient form of commencing a case since it allows the debtor, who has greater knowledge about the condition of his finances, to take timely action before it is too late.

Modern frameworks should, therefore, structure tools to increase levels of trust so that debtors facing difficulties can feel free to look for help. At the same time, barriers and controls should ensure the liceity of involuntary petitions, hence preventing insolvency systems from becoming substitutes for enforcement ones.[397]

Important modifications were made over time to the Principles. While in 2001, Principle 9.B conditioned involuntary filings on showing insolvency as the clear evidence that the debtor failed to make the payment of matured debts, the modern draft only requires that: a) prompt notice of the application is given to the debtor together with an opportunity to defend himself, and b) a prompt decision on the matter by the competent court is ensured:

> "The standard to be met for commencement of insolvency proceedings is central to the design of an insolvency law. As the basis upon which insolvency proceedings can be commenced, this standard is instrumental to identifying the debtors that can be brought within the protective and disciplinary mechanism of the insolvency law and determining who may make an application for commencement, whether the debtor, creditors or other parties."[398]

Access to insolvency proceedings should be made quick, convenient, and if possible inexpensive.[399] [400] Time is always of the essence in the field of bankruptcy; waiting too long before commencing a case may cause irreparable harm[401] to the debtor, the creditors, and society.

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[395] See **The World Bank**, "*Creditor rights and insolvency ROSC assessment methodology – based on the World bank principles for effective creditor rights and insolvency systems (revised January 2011) and UNCITRAL Legislative Guide on Insolvency Law – revised draft*", (2011), at 27 http://siteresources.worldbank.org/INTGILD/Resources/ICR_ROSC_AssessmentMethodology_Jan2011.pdf

[396] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 28.

[397] *Id.*

[398] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 45.

[399] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 29.

[400] See Id., and also **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 45: "As a general principle it is desirable that the commencement standard be transparent and certain, facilitating access to insolvency proceedings

Insolvency is the commonly-applied criteria to determine when the commencement of an insolvency proceeding cannot be procrastinated on any longer. Providing frameworks with a common and clear insolvency test at the international level has been a task. Local statutes differ greatly on their interpretation of this relevant element[402]:

> "Laws differ on the specific standard that must be satisfied before insolvency proceedings can commence. A number of laws include alternative standards and distinguish between the standard applicable to commencement of liquidation and reorganization proceedings, as well as between applications by a debtor and a creditor or creditors."[403]

Two tests are commonly applied in the international environment:

a) the "liquidity test", under which insolvency is defined as the incapacity of the debtor to repay debts as they come due;
b) the "balance sheet test", by which a debtor is insolvent if its assets are worth less than the outstanding debts.

Overall, the first test is preferred and deemed more accurate.[404] The balance sheet test, in fact, causes issues of valuation; a simple example will show the difficulties that are met applying the basic form of this test: Under the balance sheet test, a business owning a one million dollar warehouse would not be insolvent if its debts amounted to a total of $700.000,00; but the truth is that such an "asset", the warehouse, may be totally illiquid and practically unsellable (a situation that has become more common after the 2008 crisis). The business may be unable to repay its debts despite theoretically owning greater value.

Such a debtor may, therefore, pass the balance sheet test but fail the liquidity one. He may therefore procrastinate filing a petition, deteriorating the business's finances and causing further damage to the creditors. Both formulas, though, are widely used, with several variations within the international framework.

The guidelines of 2015 did not impose the use of the liquidity test, but they attempted to limit the deficiencies of the balance sheet test. In the case of the application of the balance sheet test, in fact, the guidelines suggest to provide certainty to the value of the assets that are owned by the debtor through expert opinions to establish their fair market value.[405]

[C] Principle C5. Provisional measures and the effects of commencement

Principle C5[406] addresses a relevant topic, the granting of moratoriums and administrative stays prior to the commencement of an insolvency case. Such provisional measures are a sensitive matter in

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conveniently, cost-effectively and quickly to encourage financially distressed or insolvent businesses to voluntarily commence proceedings. It is also desirable that access be flexible in terms of the types of insolvency proceedings available (reorganization and liquidation), and the ease with which the proceedings most relevant to a particular debtor can be accessed, and that conversion between the different types of proceeding can be achieved. Restrictive access can deter both debtors and creditors from commencing proceedings, while the effects of delay can be harmful to the value of assets and the successful completion of insolvency proceedings, in particular in cases of reorganization. Ease of access needs to be balanced with proper and adequate safeguards to prevent improper use of proceedings. Examples of improper use may include application by a debtor that is not in financial difficulty in order to take advantage of the protections provided by the insolvency law, such as the automatic stay, or to avoid or delay payment to creditors and application by creditors who are competitors of the debtor, where the purpose of the application is to take advantage of insolvency proceedings to disrupt the debtor's business and thus gain a competitive edge."

[401] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 29.

[402] See Chapters I and III.

[403] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 45.

[404] The Guideline of 2001 at point C explicitly mentioned the liquidity test as the preferred test for insolvency, although the second test is also mentioned.

[405] Insolvency may also exist where the debtor's liabilities exceed the value of its assets, provided that the values of assets and liabilities are measured on the basis of the fair-market value.

[406] Formerly Principle 10 of the 2001 list.

proceedings, for they have a heavy impact on the already fragile balance between the interests of the debtor and the ones of his creditors and of other interest holders. They are, though, a necessary component of a modern insolvency framework.

Proceedings, in fact, could not operate successfully without a little breathing room, incentivizing the dialogue among all the parties and protecting the estate and the original status quo from modifications for the time necessary to:

- acquire control over the debtor's assets and organize them;
- learn about claims and organize them;
- plan the steps to be taken before distribution can occur.

Moreover, most reorganizations just could not take place without a moratorium ensuring that:

- the assets which are absolutely necessary for the business of the debtor remain available:

> "For reasons of principle , policy and pragmatism there must be some restraint on the debtor and creditors if a fair and orderly administration is to result and if fundamental objectives and policies of the insolvency law are to be upheld. Accordingly, the commencement of proceedings should have two main effects. First, it should impose a moratorium on the disposition of the debtor's asset (including repayment of debts that arose before the filing of the petition) except as authorized by the court. Second, it should enjoin actions by creditors to enforce claims against the enterprise's asset through the collection efforts, adjudication, execution or otherwise. Both effects inhibit the disposition or removal of assets in a way that would undermine the ability to maximize asset values, and both promote equitable distribution among creditors and encourage the rehabilitation of viable businesses."[407]

- the predisposition of the plans and voting operations can take place without distractions.

Three main aspects of moratoriums have to be balanced upon including them in a framework:

a. When moratoriums should come into force to protect the status quo;
b. How encompassing should they be;
c. How long should they last.

In the past fifteen years, the Principles have changed in response to progress made by insolvency systems. The differences between 2001 and 2015 can be seen by comparing the two versions of the Principles on this topic:

Principle 10 (2001): A. The commencement of bankruptcy should prohibit the unauthorized disposition of the debtor's asset and suspend actions by creditors to enforce their rights or remedies against the debtor or the debtor's assets. The injunctive relief (stay) should be as wide and all embracing as possible, extending to an interest in property used, occupied, or in the possession of the debtor. B. To maximize the value of asset recoveries, a stay on enforcement actions by secured creditors should be imposed for a limited periods in a liquidation proceeding to enable higher recovery of asset by sale of the entire business or its productive units, and in a rehabilitation proceeding where the collateral is needed for the rehabilitation.
C.5 Provisional Measures and Effects of Commencement C5.1 When an application has been filed, but before the court has rendered a decision, provisional relief or measures should be granted when necessary to protect the debtor's assets and the interests of stakeholders, subject to affording appropriate notice to affected parties. C5.2 The commencement of insolvency proceedings should prohibit the unauthorized disposition of the debtor's assets and suspend actions by creditors to enforce their rights or remedies against the debtor or the debtor's assets. The injunctive relief (stay) should be as wide and all-encompassing as possible, extending to an interest in assets used, occupied, or in the possession of the debtor.

[407] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 30-31.

C5.3 A stay of actions by secured creditors also should be imposed in liquidation proceedings to enable higher recovery of assets by sale of the entire business or its productive units, and in reorganization proceedings where the collateral is needed for the reorganization. The stay should be of limited, specified duration, strike a proper balance between creditor protection and insolvency proceeding objectives, and provide for relief from the stay by application to the court based on clearly established grounds when the insolvency proceeding objectives or the protection of the secured creditor's interests in its collateral are not achieved. Exceptions to the general rule on a stay of enforcement actions should be limited and clearly defined.

The new version of 2015 extends the application of provisional measures to gap periods. The Principle, therefore, protectsthe time between the filing of a petition and the eventual commencement of a case.[408]

It also addresses the issues of including excessive exceptions to the general rule within a framework. This is a recurrent issue in bankruptcy. Several aspects of insolvency models, in fact, provide tight rules together with infinite lists of exceptions. On this point, it is specified that exceptions should be as limited as possible to avoid damaging the operations of proceedings, an approach that can be applied to several similar situations in insolvency frameworks.

The third aspect, the one on the length of moratoriums, remains a topic of discussion. The Principle states that they should be of limited, specified duration, striking a proper balance between the goal of protecting the interests of creditors and the objectives of the proceeding. Yet opportunities for review should be available and creditors should always be allowed to obtain relief upon court decision.

An effective and efficient balance on all these points is hard to find in reality, though.

[D] Principles C6. and C7. Management; creditors and the Creditors' committee

Principles C6 and C7 (former Principles 11 and 12) address the relevant topic of the governance of cases from the points of view of the involvement of debtors and of the creditors.

The Principles state:

- In a liquidation, the management should be replaced and substituted with competent insolvency representatives acting in the interest of creditors.[409]

> "2. Once liquidation proceedings have commenced, the conservation of the estate requires comprehensive measures to protect the estate not only from the actions of creditors, but also from the debtor. For this reason, many insolvency laws divest the debtor of all rights to control assets and manage and operate the business in liquidation and appoint an insolvency representative to assume all responsibilities divested. In addition to the powers relating to use and disposal of assets, those responsibilities may include the right to initiate and defend legal actions on behalf of the estate and the right to receive all payments directed to the debtor. After commencement of the liquidation proceedings, any transaction involving assets of the estate, including transfer of those assets, that is not authorized by the insolvency representative, the court or creditors (depending on the requirements of the insolvency law) generally will be void (or under some laws subject to avoidance) and the assets transferred (or their value) subject to recovery for the benefit of the insolvency estate."[410]

- Different approaches may apply to reorganizations.[411] In some systems, administrators are directly put in charge; in others attempts are made to leave the old management in control to save expenses and capitalize on their knowledge of the business. In these cases, management is usually

[408] Id., at 31.
[409] See C6.1.
[410] **UNCITRAL (United Nations Commission on International Trade Law),** "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 161-2.
[411] The 2001 guide mentioned two: a) exclusive control of the proceeding by an impartial administrator; and b) supervision of management by an impartial administrator or supervisor. The list of 2015 includes three options, adding c) governance and responsibilities remain vested in the management.

kept under surveillance by a competent expert or administrator, who may be appointed with full administrative powers in case of fraud, incompetent behavior, or mismanagement[412]:

> "In reorganization proceedings, there is no agreed approach on the extent to which displacement of the debtor is the most appropriate course of action and, where some level of displacement does occur, on the ongoing role that the debtor may perform and the manner in which that role is balanced with the roles of other participants. That ongoing role may depend in large part upon the debtor acting in good faith during the reorganization proceedings; where it does not, its continuing role may be of questionable value. It may also depend upon the existence of a strong, independent governance regime that can address incompetent or self-serving behaviour. Sometimes the advantages of a continuing role may also depend upon whether the debtor commenced the proceedings or whether they were commenced on the application of creditors. In the latter case the debtor may be uncooperative or even hostile to an extent that makes its continued participation pointless. The decision on which approach to take may depend upon a number of factors, including local corporate culture; the role of banks; the existence and effectiveness of corporate governance regimes; the effectiveness of insolvency institutions; the level of supervision provided by, or required of, the courts; the effectiveness and accessibility of the courts; and the extent to which incentives to commence insolvency proceedings are determined to be of importance to the design of the insolvency regime."[413]

For centuries, the power and responsibility of managing an insolvent business during a bankruptcy proceeding has been awarded to competent external administrators. It is often difficult, in fact, to trust previous management which has already brought a business to its knees. Public officers have had to step in to guarantee the regularity of operations and the protection of the interests of the creditors and of society.[414] Little has changed with regard to liquidations.

There is great debate in the modern scenario when it comes to balancing interests in reorganizations. The automatic substitution of the management with administrators (just as it happens in liquidations) allows for a higher degree of fairness, but discourages voluntary filings and increases expenses. On the other hand, creditors often feel like they cannot trust the former management (which often shows low degrees of competency); such a fact may make them less cooperative, damaging a proceeding's chances of success.[415] Frameworks at the international level are attempting to find a successful middle ground to maximize the benefits of the different approaches.

Another key aspect of the administration of proceedings revolves around the role and involvement of creditors. Principle C7 addresses the issue of organizing efficient Creditors' committees which operate to monitor and bring support in the administration of insolvency proceedings. The Principles require statutes to enact clear and transparent rules to define the number of components and their roles and powers. An effective statute should also clearly determine the rules to becoming a member, avoiding conflicts.

Limitations on the appointment of secured creditors should be set. Secured creditors, in fact, often hold fully secured claims and bear little risks in a proceeding; their main interest therefore is to close the proceeding as soon as possible, to be paid their share or obtain the restitution of their assets. Such a privileged status is in contrast with the one of general unsecured creditors, the class that risks the most as it enjoys no protections and is often paid little or nothing of the value of the claims.

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[412] C6.2.

[413] **UNCITRAL (United Nations Commission on International Trade Law),** "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 162.

[414] **Vv.Aa.**, "*Effective insolvency systems principles and guidelines – World bank consultation draft – October 2000*", at 21.

[415] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 32. See also UNCITRAL (United Nations Commission on International Trade Law), "Legislative guide on insolvency law", United Nations, New York, ISBN 92-1-133736-4, (2005), at 162-4.

Committees make decisions directly, or ensure that relevant information is made available to all creditors and interested parties, so that interest holders may express their opinion on relevant matters (such as voting on plans in reorganizations).

Their role, therefore, may vary depending on the kind of proceeding. Balancing the levels of involvement of debtors and creditors in proceedings is yet another task. Improving current formulas could ensure a reduction in the costs of proceedings and higher chances of success.

[E] Principles C8 and C9. Creation of the estate and stabilization of business operations

Principle C8 (former Principle 13) addresses the fundamental issue of the effective and efficient identification, collection, preservation, and disposition of all property belonging to the debtor through the creation of an estate[416]:

> "Fundamental to insolvency proceedings is the need to identify, collect, preserve and dispose of the debtor's assets. Many insolvency systems place these assets under a special regime sometimes referred to as the insolvency estate, over which the insolvency representative will have specified powers, subject to certain exceptions."[417]

The estate is commonly formed at the moment of the commencement of the case to ensure that assets are protected and that proceedings can continue in an organized manner:

> "To provide certainty for the debtor and for creditors, the insolvency law should specify the date by reference to which the estate will be constituted. Some insolvency laws refer to the effective date of commencement of proceedings, while others refer to the date of the application for commencement or to an act of insolvency that forms the basis of the application. The significance of the difference between the dates relates to the treatment (and most importantly the protection) of the debtor's assets in the interim period between application and commencement. For that reason, some laws constitute the estate from the date of application. Other laws, for reasons of clarity and certainty, constitute the estate from the date of commencement, but also contain provisions that restrict the debtor's powers to dispose of property during the period after the application is made. The insolvency representative can reclaim assets disposed of in that period. A further consideration with respect to protection of assets between application and commencement is the relevance of avoidance provisions and the date from which the suspect period is calculated."[418]

The rules contained in local frameworks often differ on:

- The identification of the items that should be included or excluded from the estate;
- The steps to be taken to preserve and protect its integrity;
- The tools that may be used to maximize returns for the creditors (such as selling parts of the estate, or rules that allow participants in the proceedings to retain items of property to use them as necessary).

Principle C8.1 states that the estate should include "all" of a debtor's assets, including encumbered ones and those obtained after the commencement of the case. By definition the estate should therefore include all:

> "Immovable and movable, tangible and intangible, including premises, fixtures, stock, inventories and goods, works in progress, bank accounts and accounts receivables, books and records, securities and financial instruments, contract rights, intellectual property and other kinds of property interests."[419]

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[416] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 34.

[417] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 75.

[418] Id., at 81.

[419] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 35.

This is true even if they are in the use or possession of third parties; or rented, leased, or bound by licensing agreements. Similar assets acquired by the insolvency administrator after the commencement of a case are also included.[420]

In order to maximize the value of the estate, an insolvency administrator should, therefore, be given powers to:

- Commence all necessary actions to collect property, obtain its restitution, or determine the rights of the estate;
- Initiate the sale of any item (whether it may be of great interest and value or small personal items of little interest and value) through transparent, cost-effective procedures;
- Abandon those assets that are of no value or that would prove more costly to manage than the value that may be obtained from their sale.

At times, assets may, or should, be excluded from the estate. This is usually the case of goods of no market value or those that would cost more to maintain than the return that they may generate:

> "The insolvency law may exclude certain assets from the estate. Insolvency laws adopt different approaches to this issue. Assets excluded from the estate may include, for example, certain assets owned by a third party that are in the possession of the debtor when the proceedings commence, such as trust assets and assets subject to an arrangement (whether contractual or otherwise) that does not involve a transfer of title, but rather use of the assets and return to the owner once the purpose for which they were in the possession of the debtor has been fulfilled.3 They may also include assets subject, under some laws, to reclamation, such as goods supplied to the debtor before commencement, but not paid for and recoverable by the supplier (subject to identification and other applicable conditions)."[421]

The discussion on exclusions has risen to great relevance in the field of the insolvency of natural persons. This topic will be discussed in greater depth in the next pages and chapters. For now it will be sufficient to mention that recent policies have allowed an increase in the quantity, kind, and value of the items that may be retained by debtors that cooperate honestly with the bankruptcy system. The goal of the new policies is to prevent individuals in economic difficulties from remaining fully dispossessed, unable to obtain the wealth necessary to provide for themselves and their families, hence becoming a weight on society.

[F] Principle C10. Treatment of contractual obligations

Principle C10 (former Principle 14) addresses the relevant issue of pre-bankruptcy contractual obligations in an insolvency proceeding. We will not be able to discuss this area in depth due to its great complexity but we will try to provide a meaningful overview of the most prominent topics.

This Principle has been greatly expanded in the latest drafts of the World Bank's list:

Principle 14 Treatment of Contractual Obligations: The law should provide for the avoidance or cancellation of pre-bankruptcy fraudulent and preferential transactions completed when the enterprise was insolvent or that resulted in its insolvency. The suspect period prior to bankruptcy , during which payments are presumed to be preferential and may be set aside, should normally be short to avoid disrupting normal commercial and credit relations. The suspect period may be longer in the case of gifts or where the person receiving the transfer is closely related to the debtor or its owners.
C.10 Treatment of Contractual Obligations: C10.1 To achieve the objectives of insolvency proceedings, the system should allow interference with the performance of contracts where both parties have not fully performed their obligations. Interference may imply

[420] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 81.
[421] *Id.*, at 80.

continuation, rejection, or assignment of contracts.
C10.2 To gain the benefit of contracts that have value, the insolvency representative should have the option of performing and assuming the obligations under those contracts. Contract provisions that provide for termination of a contract upon either an application for commencement or the commencement of insolvency proceedings should be unenforceable subject to special exceptions.
C10.3 Where the contract constitutes a net burden to the estate, the insolvency representative should be entitled to reject or cancel the contract, subject to any consequences that may arise from rejection.
C10.4 Exceptions to the general rule of contract treatment in insolvency proceedings should be limited, clearly defined, and allowed only for compelling commercial, public, or social interests, such as in the following cases:
Upholding general setoff rights, subject to rules of avoidance;
Upholding (subject to a possible short stay for a defined period) termination, netting and close-out provisions contained in clearly defined types of financial contracts, where undue delay of such actions would, because of the type of counterparty or transaction, create risks to financial market stability;
Preventing the continuation and assignment of contracts for irreplaceable and personal services where the law would not require acceptance of performance by another party; and
Establishing special rules for treating employment contracts and collective bargaining agreements.

Counterparties to contracts are usually interested in obtaining the full performance they are owed, but the bankruptcy scenario alters objectives and leverage among parties. To achieve the goals of the proceeding, the administrator of a case is usually allowed broad powers to interfere with previous contracts so that value can be preserved for the distribution process. Some contracts, in fact, amount to a net burden for the estate and bring no actual benefits.

This is a particularly relevant factor in liquidations. Reorganizations, by allowing the debtor to remain in possession and the business to continue operations, may preserve their original interest in certain specific contracts. Insolvency administrators are often allowed to cherry-pick and select among the different contracts depending on the benefits deriving to the proceeding.[422]

On this topic, the UNCITRAL Guide of 2005 made the following comment:

> "120. Insolvency laws adopt different approaches to continuation and rejection of contracts. Under some laws, contracts are unaffected by the commencement of insolvency proceedings so that contractual obligations remain binding and the general rules of contract law will continue to apply unless an insolvency law expressly provides different rules, such as an express power to override automatic termination clauses or to reject a contract.
> 121. Other laws link continuation and rejection in a common procedure that requires the insolvency representative to take some positive action with respect to a contract, such as providing notice to the counterparty that the contract is to continue to be performed (and in some cases be adopted by the insolvency estate) or be rejected. Under laws that adopt this approach, the stay would apply to the counterparty's right to terminate, allowing the insolvency representative time to consider what action should be taken with respect to the contract. One disadvantage of the approach of requiring the insolvency representative to take positive action on all contracts is that in practice there may be many cases where no decision can be taken because the contract cannot be performed. To require an explicit choice to be made on every contract could also be excessively costly and cumbersome. A further difficulty associated with this approach relates to whether or not the insolvency representative is well informed of all contracts to which the debtor is a party and is therefore in a position to take action with respect to each one. The manner in which the law deals with contracts of which the insolvency representative is not aware, in particular in terms of default rules, is therefore important."[423]

[422] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 37.
[423] **UNCITRAL (United Nations Commission on International Trade Law),** "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 121.

The balance is shifted in favor of proceedings to increase the chances of recovery for creditors. At the time of contracting, in order to protect themselves from potentially catastrophic consequences, parties may attempt to make agreements to limit the effects of default and insolvency proceedings on their deals. Such clauses, though, are often made unenforceable by specific rules included in bankruptcy laws or trade laws:

> "114. Many contracts include a clause that defines events of default giving the counterparty an unconditional right, for example, of termination or acceleration of the contract (sometimes referred to as "ipso facto" clauses). These events of default commonly include the making of an application for commencement, or commencement, of insolvency proceedings; the appointment of an insolvency representative; the fact that the debtor satisfies the criteria for commencement of insolvency proceedings; and even indications that the debtor is in a weakened financial position. Some laws uphold the validity of these types of clause and where, for example, it is desirable that a contract continue to be performed after commencement of insolvency proceedings, this will only be possible if the counterparty does not elect, or can be persuaded not to elect, to exercise its rights of termination under the contract or if the insolvency law includes a mechanism that can be used to persuade the counterparty to allow the contract to continue. In the case of termination clauses, such a mechanism may include establishing a priority for payment for services provided after the commencement of proceedings (in some insolvency laws this may exist as a general provision, which typically treats costs incurred after the commencement of proceedings as a first priority).
> 115. The approach of upholding these types of clause may be supported by a number of factors, including the desirability of respecting commercial bargains; the need to prevent the debtor from selectively performing contracts that are profitable and rejecting others (an advantage that is not available to the counterparty); the effect on financial contract netting of not upholding an automatic termination provision; the belief that, since an insolvent business will generally be unable to pay, delaying the termination of contracts potentially only increases existing levels of debt; the need for creators of intellectual property to be able to control the use of that property; and the effect on the counterparty's business of termination of a contract, especially one with respect to an intangible.
> 116. Under a different approach, the insolvency law overrides those clauses, making them unenforceable. Where the clause provides, for example, for termination on the occurrence of the defined event, the contract can be continued over the objection of the counterparty. Although the approach of overriding such clauses can be regarded as interfering with general principles of contract law, such interference may be crucial to the success of the proceedings. In reorganization, for example, where the contract is a critical lease or involves the use of intellectual property embedded in a key product, continued performance of the contract may enhance the earnings potential of the business; reduce the bargaining power of an essential supplier; capture the value of the debtor's contracts for the benefit of all creditors; and assist in locking all creditors into a reorganization."[424]

Set-offs represent an exception which mitigates potential unfairness caused by the alteration of the status quo that comes as a consequence of the sudden, unexpected, and often unforeseeable deployment of the bankruptcy framework to protect a business.[425] In the case of mutual credits, statutes often allow, or require, that the credits are netted. A simplified example will help illustrate the problem:

> An Italian and a Swiss shipment company make deliveries within their national borders only. Sometimes Italian clients wish to make shipments to Switzerland and vice versa. The two companies decide to cooperate. Since the volume of business and the costs originating from packages going from Italy to Switzerland is similar to the one taking the opposite route, they decide not to pay each other

[424] *Id.,* at 122-3

[425] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 37-38. See also UNCITRAL (United Nations Commission on International Trade Law), "Legislative guide on insolvency law", United Nations, New York, ISBN 92-1-133736-4, (2005), at 155-6.

each single transaction but to keep an accounting, regularly offsetting debts and credits. The yearly value of international operations for both businesses is about 50.000 €.

In case the Italian company defaulted, the Swiss shipper would become an unsecured creditor in the Italian proceeding and the debtor of an equal amount. The problem is that, while the debt would have to be paid in full to the Italian proceeding, the claim would statistically recover less (much less) than 20% of its value over a number of years. Such situation would amount to a great loss which may cause a chain of further (even international) defaults.

Being allowed to set-off is a relevant advantage for it allows for the compensation of all matching debts and credits on a one-to-one ratio, leaving only an eventual deficiency to be accounted for under bankruptcy rules. Keeping the simplifications in our example, if the Swiss shipper had, at the time of the default of the Italian company, a credit of 49.000 € and a debt of 50.000 €, it would be able to compensate the entire value of its 49.000 credit, remaining indebted for the remaining one thousand. If the figures were to be inverted, debts and credits would still be compensated and the Swiss shipper would hold a 1.000 € unsecured claim in the Italian proceeding. In both examples, therefore, set-offs reduce the weight of insolvency and its potentially devastating consequences.

[G] Principle C11. Avoidable Transactions

Principle 15: Fraudulent or preferential transactions The law should provide for the avoidance or cancellation of pre-bankruptcy fraudulent and preferential transactions completed when the enterprise was insolvency or that resulted in its insolvency. The suspect period prior to bankruptcy, during which payments are presumed to be preferential and may be set aside, should normally be short to avoid disrupting normal commercial and credit relations. The suspect period may be longer in the case of gifts or where the person receiving the transfer is closely related to the debtor or its owners.
C11 Avoidable Transactions C11.1 After the commencement of an insolvency proceeding, transactions by the debtor that are not consistent with the debtor's ordinary course of business or engaged in as part of an approved administration should be avoided (cancelled), with narrow exceptions protecting parties who lacked notice. C11.2 Certain transactions prior to the application for or the date of commencement of the insolvency proceeding should be avoidable (cancelable), including fraudulent and preferential transfers made when the enterprise was insolvent or that rendered the enterprise insolvent. C11.3 The suspect period, during which payments are presumed to be preferential and may be set aside, should be reasonably short in respect to general creditors to avoid disrupting normal commercial and credit relations, but the period may be longer in the case of gifts or where the person receiving the transfer is closely related to the debtor or its owners.

This is a very intricate area of insolvency law. Part of its complexity derives from the countless policies that interact within it, causing a lack of uniformity among local systems. In this section, we will briefly address this topic discussing the elements that hold most relevance to our discussion; in the next chapters, we will examine how rules evolved from medieval systems up to the contemporary US and Italian models.

An effective and efficient insolvency framework requires clear and transparent rules on the topic of avoidable actions.

The timing of the commencement of the case and the contraction of insolvency or irreparable levels of default are very rarely concomitant. In the period between the second and the first the debtor may, voluntarily or involuntarily, commit a number of actions that alter the status quo and damage the interests of some of the relevant parties irreparably:

> "148. Insolvency proceedings (both liquidation and reorganization) may commence long after a debtor first becomes aware that such an outcome cannot be avoided. In that intervening period, there may be significant opportunities for the debtor to attempt to hide assets from creditors, incur artificial liabilities, make donations or gifts to relatives

> and friends or pay certain creditors to the exclusion of others. There may also be opportunities for creditors to initiate strategic action to place themselves in an advantageous position. The result of such activities, in terms of the eventual insolvency proceedings, generally disadvantages ordinary unsecured creditors who were not party to such actions and do not have the protection of a security interest."[426]

> "The law should provide for the avoidance or cancellation of pre-bankruptcy fraudulent and preferential transactions completed where the enterprise was insolvent or that resulted in its insolvency. The suspect period prior to bankruptcy, during which payments are presumed to be preferential and may be set aside, should normally be short to avoid disrupting normal commercial and credit relations. The suspect period may be longer in the case of gifts or where the person receiving the transfer is closely related to the debtor or its owners."[427]

Most systems allow avoiding actions to apply retroactively, identifying a "suspected period" in which the debtor is presumed to have been insolvent. Such a period usually ends, or starts, on the day of the commencement of the case (the time in which insolvency becomes, in most cases, evident):

> "150. Many insolvency laws include provisions that apply retroactively from a particular date (such as the date of application for, or commencement of, insolvency proceedings) for a specified period of time (often referred to as the "suspect" period) and are designed to overturn those past transactions to which the insolvent debtor was a party or which involved the debtor's assets where they have certain effects. These effects include reducing the net worth of the debtor (e.g. by gifting of its assets or transferring or selling assets for less than their fair commercial value); or upsetting the principle of equal sharing between creditors of the same rank (e.g. by payment of a debt to a particular unsecured creditor or granting a security interest to a creditor who is otherwise unsecured when other unsecured creditors remain unpaid and unsecured). Many non-insolvency laws also address these types of transaction as being detrimental to creditors outside insolvency. In some cases, the insolvency representative will be able to use those non-insolvency laws in addition to the provisions of the insolvency law."[428]

Moreover, frameworks attempt to find effective formulas to prevent debtors from making transactions that are not consistent with their financial capacities (such as making "gifts") or that are made with the sole purpose of damaging (all, or some of) the creditors. Thus is a relevant bankruptcy issue:

> "The insolvency estate generally will include any assets or their value recovered through avoidance proceedings where the transaction involving the assets was of the type subject to avoidance under an insolvency law. Such transactions may include transactions that resulted in preferential treatment to some creditors, were prejudicial to the insolvency estate or were entered into in an effort to defeat the collective rights of creditors."[429]

Despite the importance of including rules to avoid transactions and to protect the integrity of estates, it must be kept in mind that long avoidance terms decrease the levels of predictability in a system and, therefore, deter investments.[430]

[H] Principle C12. Treatment of stakeholder rights and priorities

Principles C12 and 13 address several relevant issues connected to claims. An effective and efficient framework must account for the scarcity of value in the estate and be aware of the impossibility of paying

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[426] *Id.,* at 135.
[427] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 39.
[428] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 135.
[429] *Id.,* 79.
[430] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 39.

all creditors what they are owed in full. Choices have to be made. Some will get higher shares compared to others based on local policies. Typical examples are the ones that privilege the payment of the wages of employees or of some taxes.

Other priorities originate from the very structure of bankruptcy systems. This is the case, for example, of the special status awarded in several models to the expenses of insolvency proceedings, which are often paid first. This approach is supported by obvious, practical reasons. If insolvency administrators or those working for the proceeding were not ensured their remuneration, the framework could not work.[431]

Proceedings have not always worked this way. As we will discuss in Chapter IV, for example, early bankruptcy systems would consider all creditors equal and would award equal shares (with very minor exceptions[432]).

Modern models, on the other hand, tend to divide claims among the following major groups: secured and unsecured. Among unsecured creditors, a distinction is made between "general unsecured" and creditors enjoying a priority. Local policies determine those classes of creditors that society deserves worthy of greater protections, which are paid first compared to the remaining general unsecured creditors.

Unsecured creditors are the ones at greater risk of collecting only a minimal fraction of the value of their claims. The general rule under modern best practices is that they are paid following the *pari passu* principle, based on the level of priority of their class. Obtaining collateral or a "priority" status is therefore often vital for creditors.

An effective insolvency system should preserve the priorities established by commercial or other applicable laws before the commencement of the case, hence protecting the legitimate expectations of creditors and enhancing the predictability and transparency of the local system.[433] Deviations from the general framework should, therefore, occur only if they are necessary to protect relevant interests within a society.

In order to protect the predictability and transparency of the system, therefore, the number of classes awarded a priority ranking should be kept to a minimum[434]:

> "53. There is, however, a limit on the extent to which these goals can be achieved. In addition to rankings based upon commercial and legal relationships between the debtor and its creditors, distribution policies also very often reflect choices that recognize important public interests (such as the protection of employment), the desirability of ensuring the orderly and effective conduct of the insolvency proceedings (providing priority for the remuneration of insolvency professionals and the expenses of the insolvency administration) and promoting the continuation of the business and its reorganization (by providing a priority for post-commencement finance). To the extent that these broader public interests compete with private interests, they may lead to a distortion of normal commercial incentives. Where public interests are given priority and equality of treatment based upon the ranking of claims is not observed, it is desirable that the policy reasons for establishing that priority be clearly stated in the insolvency law. In the absence of equality of treatment, this approach will at least provide an element of transparency and predictability in the area of claims, distribution and the establishment of creditor classes under a reorganization plan."[435]

The 2001 guide contained the following warning:

> "There is an observable tendency to increase the categories of debts enjoying such priority, for example by living this status to each new form of tax or duty or each additional employee entitlement. Indeed, in countries with a strong tradition of worker protection there is sometimes an acute tension between the provision of safeguards for

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[431] See "C12.1" list of 2015.

[432] See Chapter IV.

[433] The World Bank, "Principles and Guidelines for effective insolvency and creditor right systems", (2001), at 40.

[434] *Id.,* at 44.

[435] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 267.

> employees against the insolvency of their employers' insolvency and the need of the bankruptcy trustee to keep the business viable and, if possible, to restore profitability which may involve a sharp reduction in the workforce. In recent years there had been a reaction against the preferential status for unsecured debt and even against the concept of unsecured preferential claims as impeding the perceived objective of insolvency law – namely, to maximize returns for creditors as a whole.[…] Legislatures should resist the temptation to create a proliferation of priority classes based on a special interest rather than solidly endorsed and widely embraced social policies. All insolvency law reflect policy choices that prioritize some claims over others in the distribution scheme. While many such policies recognize important public interests compete, such as preserving the estate's revenue base or ensuring employee security, the broader public interests compete with private interests and may distort the normal commercial incentives. Insolvency laws should not serve as surrogate of social security systems environmental protection agencies and the like."[436]

Principle C12.2 restates the relevance of safeguarding the interests of secured parties in their collateral. Proceedings should allow distribution to this class of creditors to occur as promptly as possible and avoid the depreciation of the assets used in reorganizations.

[I] Principle C.13. Claims resolution procedures

An extremely interesting topic is discussed by Principle C13 (which, given recent updates, should probably be expanded under several relevant aspects in one of the next revisions). The Principle analyzes a complex and relevant component of insolvency proceeding: the process by which creditors participate through the filing and verification of their claims. When creditors find obstacles in communicating effectively and efficiently with the proceeding, it is a loss for the whole system.

> "Procedures for notifying creditors and permitting them to file claims should be cost effective, efficient, and timely. While there must be a rigorous system of examining claims to ensure validity and resolving disputes, the delays inherent in resolving claims should not be permitted to delay insolvency proceedings."

Processes vary greatly among models, so we will not discuss this Principle in depth. It is worth mentioning, though, some aspects which are in need of urgent developments. Procedures for the verification of claims are often complex and lengthy, especially in major cases which involve hundreds or thousands of creditors. Achieving greater levels of harmonization in this key area is important.

Mistakes in lodging claims can cost dearly. Missing a deadline or erring in communicating the priority status of a claim, or in filing all the necessary supporting documents, may cause a creditor to suffer losses. In order to reduce costs and duration, at the least in the phase of transmitting the (often copious) documentation, several systems have increased the use of digital tools. A local court's software or registered e-mail system, though, often is not easily accessible or intelligible, especially to foreigners.

Finding a successful formula to allow a multitude of international creditors to interact effectively and efficiently within proceedings is a task that requires immediate attention.

[J] Principle C14. Reorganization Proceedings

Reorganizations proceedings are not recent additions to insolvency scenarios. As we will discuss in Chapter IV, models to promote agreements between debtors and creditors and to reorganize the former group or allow them to continue with their businesses have been available in insolvency frameworks since the Middle Ages. With few exceptions, though, societies in the past centuries condemned insolvency harshly, and the idea of allowing debtors to discharge and to enjoy a fresh-start found great opposition. In order to limit the use of such a tool, governments often placed demanding entry requirements and burdens on debtors, which posed great disincentives to the commencement of such proceedings.[437]

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[436] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 44.
[437] See Chapter IV.

As discussed in Chapter I, though, the importance of reorganization proceedings has grown greatly in modern times. In the past years, they have become a pillar of the refoundation of European local and cross-border insolvency frameworks.[438] The most relevant goals pursued by the Union in incentivizing reorganizations over liquidations are:

- increasing the number of active and competitive SMEs in the market;
- protecting levels of employment;
- preventing the dispersion of resources in the market;
- incentivizing honesty within the market. Mistakes may happen and facing business difficulties should be a learning process, strengthening a debtor's capacities to compete and to avoid future mistakes.

Reorganization proceedings, though, should not benefit debtors only. To be effective, they should advance the interests of the creditors, who should be involved in the whole process. The end result of the proceeding, obtained through their efforts, should ultimately place them in a better position than the one they could have reached in a basic liquidation:

> "The purpose of reorganization is to maximize the possible eventual return to creditors, providing a better result than if the debtor were to be liquidated and to preserve viable businesses as a means of preserving jobs for employees and trade for suppliers. With different constituents involved in reorganization proceedings, each may have different views of how the various objectives can best be achieved. Some creditors, such as major customers or suppliers, may prefer continued business with the debtor to rapid repayment of their debt. Some creditors may favour taking an equity stake in the business, while others will not. Typically, therefore, there is a range of options from which to select in a given case. If an insolvency law adopts a prescriptive approach to the range of options available or to the choice to be made in a particular case, it is likely to be too constrictive. It is desirable that the law not restrict reorganization plans to those designed only to fully rehabilitate the debtor; prohibit debt from being written off; restrict the amount that must eventually be paid to creditors by specifying a minimum percentage; or prohibit exchange of debt for equity. A non-intrusive approach that does not prescribe such limitations is likely to provide sufficient flexibility to allow the most suitable of a range of possibilities to be chosen for a particular debtor."[439]

The new balance which is sought at international level is based on a key pillar: honesty. For a modern reorganization process to work effectively and efficiently (and for costs to be reduced), debtors and creditors must be diligent and cooperative. Frauds should be heavily sanctioned. Moreover, detailed information about each step of the process should be made widely available so as to ensure high levels of transparency (supporting as well the active and effective participation of all interested parties):

> "To be commercially and economically effective, the law should establish rehabilitation procedures that permit quick and easy access to the process, assure timely and efficient administration of the proceeding; afford sufficient protection for all those involved in the process, provide a structure that encourages fair negotiation of a commercial plan enable a suitable majority of creditors in favor of a plan or other course of action to bind all other creditors by the exercise of voting rights (subject to appropriate minority protections and the protection of class rights) and provide for judicial and or other supervision to ensure that the process is not subject to manipulation or abuse."[440]

Reorganizations also seek to incentivize debtors to commence proceedings at an early stage of their financial difficulties, preventing them from reaching irreparable levels of default and sparing them from

[438] "Recent years have witnessed the introduction of 'low entry' rehabilitation proceedings intended to rescue businesses or at the least enable them to wound down more sedately."

[439] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), 209-10.

[440] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 47.

insolvency and liquidation. Taking early action, though, requires trust in the system and incentives. Stigmatizing factors which are present within societies adversely affect the chances of success of reorganization frameworks.

[1] Access requirements

In Chapters IV and VI, we will discuss how models in the past have placed heavy burdens to limit access to reorganization proceedings (when available). The goal was to prevent abuses and ensure that debtors, who were heavily stigmatized, would not take undue advantage of society.[441] Today, the balance seems to have been inverted.

As discussed in Chapter I, modern frameworks attempt to incentivize the use of this tool to preserve value in modern markets. Models attempt, therefore, to grant easy access based on ample access criteria. Policies have evolved and led to extensive modifications: insolvency, for example, is not anymore a key factor in the commencement of cases. In order to support markets, frameworks today attempt to allow debtors to file (honestly) as soon as they deem it necessary or as soon as they find themselves facing financial difficulties.

[2] The making and approval of plans

Reorganizing necessitates a clear strategy and the cooperation of all the parties which are involved. Upon attempting to reorganize, therefore, debtors or interest holders are asked to file detailed plans, which serve as roadmaps, illustrating the benefits that would derive from the successful completion of the proceeding to all parties. Creditors are called to evaluate plans carefully, casting a reasoned vote on whether a proposal may be acceptable[442]:

> "A central element of those proceedings is the reorganization plan and insolvency laws generally address a number of issues in relation to the plan. These include the nature or form of the plan; when it is to be prepared; that is permitted to prepare a plan; its content; how it is to be approved by creditors; whether court confirmation is required; the effect of the plan and how it is to be implemented."[443]

The elements to be included in a plan may vary among statutes.[444]

A key and necessary factor to guarantee the success of the process of reorganizing a business is the deployment of tools to ensure full disclosure of all the information necessary to cast votes:

> "23. Creditors and other relevant parties in interest (such as equity holders), who may be required to vote on the plan, need to be able to assure themselves that what is proposed by the plan is feasible and not based, for example, on faulty assumptions and that implementation of the plan will not leave the debtor overburdened with debt. To facilitate that evaluation, creditors and other parties in interest need to be provided with information explaining what the plan proposes and the impact of those proposals on their rights and claims. For these purposes, the plan can be submitted to creditors and others together with a disclosure statement that provides a full disclosure of information that will enable all parties to properly evaluate the plan. That statement may be prepared by a qualified professional who can be expected to provide a credible and unbiased assessment of the measures proposed by the plan or by the party who proposes the plan, with or without professional advice. Where the insolvency representative is not involved in the proposal of a plan or preparation of the disclosure statement, it may be desirable to require it to comment on both instruments. Where creditors and other parties in interest do not agree with the professional evaluation or do not believe that the disclosed information is persuasive, their views could be taken into account in the course of

[441] See Chapter VI.

[442] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 48.

[443] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 209.

[444] *Id.,* at 215-6.

approval by allowing the plan as proposed to be amended or in the course of the confirmation process (if confirmation is required by the insolvency law).

24. A number of insolvency laws include provisions specifying the information that is to be provided to creditors and other interested parties to enable them to properly assess the plan, whether it is to be included in the plan itself or in a separate statement. A requirement to provide this information, supported by appropriate mechanisms for obtaining it, satisfies the key objective of transparency and can assist in ensuring creditor confidence in insolvency proceedings. It may need to be balanced, however, against confidentiality concerns arising from access to potentially sensitive financial and commercial information relating to the debtor, even where that information may ultimately enter the public domain through approval or confirmation of the plan by a court. This concern can be addressed in the law by including obligations to observe confidentiality that will apply to the debtor, creditors, the insolvency representative and other parties in interest. The requirement to provide information should not be misused by supplying information that is irrelevant to evaluation of the plan; the focus should be upon the information required in a particular case to evaluate the specific proposals contained in the plan.

25. It is desirable that an insolvency law specify the minimum information to be provided in a disclosure statement. This could include information relating to the financial situation of the debtor, including asset and liability and cash flow statements; non-financial information that might have an impact on the future performance of the debtor (e.g. the availability of a new patent); a summary of the plan; a comparison of the treatment afforded to creditors by the proposed plan and what they could be expected to receive in liquidation; the basis upon which the debtor's business would be able to keep trading and be successfully reorganized; information on voting mechanisms applicable to approval of the plan; and information showing that, having regard to the effect of the plan, adequate provision has been made for satisfaction of all obligations provided for in the plan and that the debtor is expected to have the cash flow to pay its debts as provided for in the plan."[445]

[3] The rights of creditors upon voting for a plan

Upon voting for a plan, creditors are usually awarded rights proportional to the value and class of their (unsecured) claims.[446]

Secured creditors do not usually vote unless they renounce their "privileged" status.[447] The reason is simple: they enjoy special protections that ensure high chances of repayment to their claims. Their main goal, therefore, often is to close a proceeding as soon as possible. They may be incentivized to prefer liquidations over reorganizations and their vote would be cast in in opposition to the vote of unsecured creditors, a class that has much at stake. Therefore, secured creditors are usually excluded from the voting process.

Approval of a plan usually requires a majority vote. Majorities may be counted based on the number of claimants, on the value of claims, or on the subdivision of creditors into classes if the framework allows it. Not all insolvency statutes provide for such an opportunity; those that do also provide the rules for their formation and organization:

"41. A number of insolvency laws do not provide for unsecured creditors to be divided into different classes and they vote together as a single group.

42. States that have established classes for secured and priority creditors often also provide for the division of ordinary unsecured creditors into different classes based upon their varying economic interests. The creation of such classes is designed to enhance the prospects of reorganization in at least three respects, by providing a useful means of identifying the varying economic interests of unsecured creditors; a framework for

[445] *Id.*, at 216-5.
[446] *Id.,* at 217.
[447] *Id.*, at 221.

> structuring the terms of the plan and ensuring that all creditors in a class receive the same treatment; and a means for the court to utilize the requisite majority support of one class to make the plan binding on dissenting classes. Since the creation of different classes has the potential to complicate the voting procedure, it may be desirable only where there are compelling reasons for special treatment of some ordinary unsecured creditors, such as where there is a large number of creditors that lack a common economic interest and the treatment they are to be to be offered under the plan differs. Criteria that may be relevant in determining commonality of interest may include the nature of the debts giving rise to the claims; and the remedies available to the creditors in the absence of the reorganization plan, including the extent to which the creditors could recover their claims by exercising those remedies. Where there is a small number of unsecured creditors or where their interests are similar, there may be no need for voting on approval of the plan to be conducted in different classes, thus simplifying the procedure."[448]

This is a relevant, much-discussed topic. Bankruptcies lead to great conflicts and frameworks must provide efficient formulas to:

- protect the rights of dissenting minorities;

- protect the creditor's vote from excessive interference by insiders and interested parties who may interfere fraudulently with the intent to guide the voting process towards a desired end result[449];

- balance the powers of the competent bankruptcy judges and courts in the process. The results of the voting process should be the expression of a successful mediation between the debtor and the creditors; awarding inordinate review powers to courts may constitute an excessive interference. The Principles, therefore, support a modern approach which tends to limit the court's impact in the process. It is deemed effective and efficient for bankruptcy courts to limit themselves to:

a) supervising the process;

b) verifying that parties comply with the necessary formalities;

c) verifying that the plan is accurate and feasible;

d) verifying that information has been made available to all voters;

e) ensuring that the rights of dissenting minorities are protected in the forms established by an enacted framework.

Most systems, in fact, deploy mechanisms to guarantee that a majority vote approving the plan may become binding over a dissenting minority to ensure the functioning of the framework. At the same time, minorities are protected by:

a) granting access to courts review;

b) ensuring that they will ultimately be paid an higher share compared to what they may obtain in a liquidation.

In those cases in which the reorganization process may prove ultimately unworkable, the system should provide for easy means of conversion to a liquidation:

> "72. A number of circumstances may arise in the course of a reorganization proceeding when it will be desirable for an insolvency law to allow the proceedings to be converted to liquidation. The principal grounds for conversion would be failure to propose or approve a reorganization plan; failure to approve proposed modifications that are required for implementation of the plan; failure to obtain confirmation (where confirmation by the court is required); a successful challenge to an approved or confirmed plan; a majority vote by a meeting of creditors to terminate reorganization proceedings; a material or substantial default by the debtor of its obligations under the plan; or failure of implementation for some other reason. Some of these circumstances will only be relevant to those systems where the court supervises implementation of the plan and retains jurisdiction over the debtor after approval.
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> 73. It may also be appropriate to consider conversion where it is determined that there is no reasonable likelihood of the business being successfully reorganized; where it is

[448] *Id.,* at 222.
[449] *Id.,* at 223.

> apparent that the debtor is misusing reorganization proceedings either by not cooperating with the insolvency representative or the court (e.g. withholding information) or otherwise acting in bad faith (e.g. making fraudulent transfers); where the business continues to incur losses during the reorganization period; or where administrative expenses are not paid. Some laws impose an obligation on the insolvency representative to terminate administration of the reorganization proceedings as soon as it is evident that reorganization will not be possible, in order to preserve value for creditors. Including provisions in an insolvency law for conversion to liquidation will provide predictability as to the ultimate resolution of the proceedings. If conversion to liquidation requires a new application for commencement to be made, rather than relying upon the original application as the basis for the converted proceedings, it may lead to further delay and diminution of value. Accordingly**,** consideration may need to be given to the procedural requirements for commencement and conduct of converted proceedings.
> 74. Where reorganization proceedings are converted to liquidation, an insolvency law will also need to consider the status of any actions taken by the insolvency representative prior to approval of the plan; the continued application of the stay, in particular to secured creditors if the insolvency law contains a time limit calculated by reference to commencement; the treatment of payments made in the course of the implementation of the plan prior to a conversion; and the treatment of creditor claims that have been compromised in the reorganization. Payments made in the course of the reorganization may need to be protected from the operation of avoidance provisions. Claims that have been compromised in the reorganization may be reinstated to full value in any subsequent liquidation or may be enforceable only as compromised. The issue of failure of implementation may also be addressed in the reorganization plan, which may specify the rights of creditors in that event. Such an approach simplifies the question of treatment of those claims and avoids potentially difficult issues of applicable law.
> 75. Where the insolvency law permits conversion, a related question is how conversion can be triggered—whether it should be automatic once certain conditions are fulfilled or require application to the court by the insolvency representative or other parties in interest. Because it is the party that, after the debtor or its management, has the greatest knowledge of the debtor's business, and often learns at an early stage of the proceedings whether or not the debtor's business is viable, the insolvency representative can play a key role in initiating conversion. In addition, it may be reasonable to allow creditors or other parties in interest to request the court to convert the proceedings. The court could also be given the power to convert on its own motion where certain conditions are met."[450]

[K] Principles C15, C16, and C17: international considerations and the insolvency of international groups of enterprises

Principles C16 and C17 show the excellent job made by the World Bank in continuously improving and integrating modern best practices within its Principles, a process that takes place in coordination with other relevant international institutions such as INSOL Europe and the UNCITRAL. In 2010 the United Nations Commission on International Trade Law published the "Legislative Guide on Insolvency Law – Part three: Treatment of enterprise groups in insolvency", a study on the local and international effects of the insolvency of groups of corporations:

> "The structure of many enterprise groups shows the dimension and potential complexity of the arrangements. They may involve many layers of different companies controlled to a greater or lesser extent by the level or levels above, in some cases involving hundreds if not thousands of different companies.
> A study based upon the 1979 accounts and reports of a number of large British-based multinationals, for example, had to be abandoned with respect to two of the largest groups, one with 1,200 and the other with 800 subsidiaries, because of the impossibility of completing the task. Researchers noted that few people inside the group could have had a clear understanding of the precise legal relationships between all group members and that

[450] *Id*., at 232-3.

> none of the groups studies appeared to have its own complete chart. Similarly, the group charts of several Hong Kong property groups, such as the Carrian group, which failed over 20 years ago, ran several pages, and a reader would have needed a good magnifying glass to identify the subsidiaries. The group chart of the Federal Mogul group, an automotive component supplier, when blown up to the point you can read the names of all the subsidiaries, covers a wall of a small office. The group chart of Collins & Aikman, another automotive group, is printed in a book, with sub-sub-groups having the complexity of structure of many domestic enterprise groups."[451]

We will not analyze these Principles in depth, as the next chapter will focus on international issues. It is important to mention, though, that the process of designing a modern local insolvency framework must take into account also cross-border aspects and the structure of globalized businesses. The number of cases with an international impact is growing rapidly due to the globalization of the market, and this trend will increase.

As we will discuss also in the next chapter, the implementation of effective and efficient cross-border insolvency frameworks and their coordination with local ones is one of the great tasks of modern insolvency law. It is key, therefore, in the absence of effective international models, that local frameworks take steps forward in including elements that can help solve international conflicts and support interested parties in a globalized scenario.

2.2.4 Section D: Implementation; institutional and regulatory frameworks

The topics discussed by the Principles contained in section D of the draft of 2015 are analogous to the ones included in the last section of the draft of 2001, which was entitled "Implementation of the insolvency system" (formerly Principles 27 to 35). They examine the structure of efficient, trustable, and honest insolvency systems and include aspects such as:

a) the organization of bankruptcy courts and other connected offices;
b) the independence, impartiality, training and overall performance of bankruptcy judges;
c) the competence and integrity of bankruptcy administrators and of the personnel working in bankruptcy courts.

Bankruptcy is an extremely intricate field of law. It presents several challenges not just for stake holders, but also for the people that work within it and make it operative.

To reach high levels of effectiveness and efficiency, the public must trust the system. Courts must count on specialized judges and clerks to scrupulously guard against frauds and fairly solve the numerous conflicts that arise in such an adversarial environment. Continuing education becomes key to ensuring that the high quality of the model is maintained over time despite modifications the framework may undergo.[452]

Courts and bankruptcy judges will be more active in liquidations compared to reorganizations.[453] The need to ensure the fairness of proceedings, though, is not lower in the second scenario. Quite the opposite. All the expert parties that take part in a reorganization must bring high levels of competence and honesty to ensure a successful end result.

Even though insolvency proceedings originate from financial defaults, estates may still hold assets of great value. The cumulative value of cases within an economy is of extraordinary significance, and transparency is a key element of effective management. The general public will not be able to trust a corrupt system.

A well organized and efficient structure also reduces the duration of proceedings, which can bring great benefits to all of the parties involved:

a) Debtors may return to productivity in a short time from their default;
b) Creditors may receive a quick payment of their claims;

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[451] **UNCITRAL (United Nations Commission on International Trade Law),** "*Legislative guide on insolvency law, Part Three; Treatment of enterprise groups in insolvency*", United Nations, New York, ISBN 978-92-1-133803-4, (2012), at 9-10.

[452] **UNCITRAL (United Nations Commission on International Trade Law),** "*Legislative guide on insolvency law, The Judicial perspective*", United Nations, New York, (2014), at 58.

[453] **The World Bank**, "*Principles and Guidelines for effective insolvency and creditor right systems*", (2001), at 57.

c) The legal system and society at large are not burdened with excessive, everlasting litigation;
d) The market is not drained of resources for more time than what is absolutely necessary.

3 The World Bank's report on the insolvency of natural persons[454]

Effective bankruptcy systems, today, must include tools to deal with the default of non-business debtors, consumers, and natural persons in general.[455]

If the insolvency of a single individual is potentially irrelevant within a market, the default of many can create problematic chain effects and lead to troublesome international repercussions. The mortgage crisis of the past few years was a clear manifestation of such a phenomenon-and led governments to react with the swift enactment of specific bankruptcy frameworks.

Over the past decades, such insolvency models were known mostly as a characterizing feature of the American bankruptcy system. The drafters of the American bankruptcy code took early action designing specific rules in this field and become, therefore, a model and the subject of specific studies by international organizations such as INSOL International.[456] The European Union also explored the field early in the nineties, due to the economic depression hitting the Community at the time:

> "Consumer over indebtedness has become a central legal policy issue among European Union Member States over the past decade. At the beginning of the 1990s, the European countries were hit by a deep economic depression. The consequences of this economic setback were aggravated by an increase in indebtedness in private households during the preceding decade. In addition to low income families, many middle class households ran into serious economic difficulties because of home mortgages, small business loans, personal guarantees of business and private loans, and consumer debt."[457]

But it was only with the raging of the subprime mortgage crisis that the Union and most Member States took more decisive action to tackle the problem.[458] The inclusion of the topic of "poverty and social exclusions" within the 2020 strategy was another incentive to focus more on consumer debts[459]:

> "Over-indebtedness of consumers has a European dimension. This is the reason why the European Commission started several initiatives to tackle the problem. First, the European

[454]http://documents.worldbank.org/curated/en/120771468153857674/World-Working-group-for-the-treatment-of-the-insolvency-of-natural-persons

[455] See in general on this topic: **Howells G., Ramsay I. M., Wilhelmsson T.**, "Handbook of research on international consumer law – second edition", Research handbooks in international law, Edward Elgar Cheltenham, ISBN 9781783568202, (2018); **Ramsay I.,** "Personal insolvency in the 21st century: a comparative analysis of the US and Europe", Bloomsbury Publishing PLC, London, (2017); **Cerini D.**, "*Sovraindebitamento e consumer bankruptcy: tra punizione e perdono*", Univ. Milano Bicocca-Fac. giurisprudenza, Volume 86 di Università degli studi di Milano-Bicocca, Facoltà di giurisprudenza, Giuffrè Editore, Milano, ISBN 9788814174520, (2012).

[456] **INSOL International, International Federation of insolvency professionals**, "Consumer Debt Report - Report of Findings and Recommendations", (2001). See also **Kilborn Jason J.**, "*Elaborating UNCITRAL's Legislative Guide on Insolvency Law: Principles for Natural Persons*", at 1-2.
http://www.uncitral.org/pdf/english/congress/Papers_for_Congress/131-KILBORN-UNCITRALs_Legislative_Guide_on_Insolvency_Law.pdf

[457] **Reifner Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga**, "*Consumer over-indebtedness and consumer law in the European Union*", Presented by the institute for financial services e.V., Erasmus University Rotterdam/School of law, University of Helsinki/Helsinki Collegium for Advanced Studies, to the Commission of the European Communities, Health and Consumer Protection Directorate-General, (2003), at 14; see also pages 22-23.

[458] The abovementioned European study wrote, on the status quo in 2003, that: "Several European countries introduced laws on judicial debt adjustment (consumer bankruptcy) during the 1990s. Such laws have been enacted, for example, in Austria (1993), Germany (1994; in force 1999), the Netherlands (1997), Belgium (1998), Luxembourg (2001) and four Scandinavian countries. England (1990) and France (1989) have also introduced laws to regulate and alleviate situations of over-indebtedness and similar legislation is on the way in Italy and Portugal. The study examines these laws in detail and gives a comparative account of the different regulations adopted."

[459] See https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/framework/europe-2020-strategy_en

> Union is working towards a harmonised market for financial services – it is intended that in such a harmonized market, financial service providers compete internationally and consumers can chose a wide variety of products from different service providers in different countries. Creditors, on the other hand, will have to get a complete picture of the indebtedness situation of a borrower to be able to adequately estimate the risk inherent in lending to this consumer, thus credit reporting systems will play an important role for integrated credit markets."[460]

In 2011, the World Bank's Task Force became involved in the study of this relatively new field within the ongoing process of refor, the "Principles and Guidelines for effective insolvency and creditor rights systems". Once the systemic significance of this phenomenon-was recognized, action was immediately taken:

> "[O]ne of the lessons from the recent financial crisis was the recognition of the problem of consumer insolvency as a systemic risk and the consequent need for the modernization of domestic laws and institutions to enable jurisdictions to deal effectively and efficiently with the risks of individual over indebtness. The importance of these issues to the international financial architecture that had been recognized in various ways by the G-20 and by the Financial Stability Board has today been reconfirmed and emphasized by this Task Force. It is important to recognize the diversity of policy perspectives, values, cultural preferences and legal traditions that shape the way jurisdictions may choose to deal with the problems of individual over-indebtedness. Yet recent events suggest that the expansion of access to finance, the extension of modern modes of financial intermediation, and the mobility and globalization of financial flows may have changed the character and scale of the risk of consumer insolvency in similar ways in many different economies. In response to these concerns, the World Bank, through the Legal Vice-Presidency, will organize an appropriate Working Group of the Insolvency Law Task Force to begin work on identifying the policies and general principles that underlie the diverse legal systems that have evolved for effectively managing the risks of consumer insolvency and individual over-indebtedness in the modern context. The World Bank will work with its international partners and use its convening power to bring together a representative group of internationally recognized experts in order to address these important issues."[461]

The Task Force created a Working Group to develop a study and analyze the key regulatory aspects on the treatment of the insolvency of natural persons and the differences in approaches among national frameworks, called the "World Bank's Working Group Report on the treatment of the insolvency of Natural Persons".[462]

The study differs in its structure from the more advanced ones on business insolvency and creditor rights systems which we examined in the previous pages. The natural person's report, in fact does not provide a list of principles yet. The document affirms that it would be premature to identify a single approach or, in general, best practices for a complex field of law at such an early stage of the research.

The Report still represents an interesting distillation of the relevant practices and theories on the topic and will be a useful guideline for our analysis of this field. The information we will collect will be useful in the next chapters whendiscussing and comparing the rules applied by the U.S. bankruptcy code and by other models such as the modern Italian one (which did not include specific rules until the recent reforms of 2012).

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[460] **EU Commission**, "*Towards a common operational European definition of over-indebtedness*", OEE Etudes, (2008), at 5.

[461] Concluding Remarks of the Task Force meeting by Vijav S. Tata (Chief Consel, LEGPS, World Bank). See http://siteresources.worldbank.org/EXTGILD/Resources/WB_TF_2011_Consumer_Insolvency.pdf

[462] **Vv. Aa., The World Bank,** "*Insolvency and Credito/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013).

Before analyzing the salient points of this document, it is useful to mention that it covers the treatment of over-indebtedness of natural persons exclusively; it does not analyze tools for the prevention of this growing phenomenon.

3.1 Differences among insolvency systems for natural persons and social welfare systems

A distinction must first be drawn between insolvency frameworks designed to support natural persons and those social welfare systems which are enacted in most legal frameworks.

This particular type of insolvency system attempts to assist debtors that face *temporary*, although often harsh and problematic, financial difficulties, by offering relief, mainly in the form of discharge and exemptions. Their ultimate goal is to avoid waste of energies and resources within the market, granting an effective and meaningful second chance to those honest debtors who are willing to cooperate and wish to take action to return to being productive members of society.

Social assistance frameworks, on the other hand, revolve purely around humanitarian purposes, supporting social solidarity and fighting poverty. They aim to redistribute income and to guarantee that a basic level of resources is made available to every member of a given society.[463] Social assistance frameworks typically offer support in the form of monetary subsidies and the basic necessities for life, such as medicine and shelter.

The difference among the two models is relevant, and can be summarized in the following statement: poverty cannot be solved through a single public proceeding; the practical problems connected to over-indebtedness, eventually, may.[464]

Definitions of over-indebtedness vary among systems, causing difficulties similar to the ones faced in providing a uniform definition of insolvency. In the European context, for example, relevant differences were present already among the few early systems enacted at the beginning of the millennium[465]:

> "**Denmark:** Debtors without assets who are caught in the deadlock of permanent indebtedness.
> **Finland:** Insolvency means other than temporary inability of the debtor to pay his debts as they become due. The following shall be taken into account when assessing the ability of the debtor to pay: 1) the funds from the liquidation of the assets of the debtor; 2) the income of the debtor and his earning potential, in view of his age, working capacity and other circumstances; 3) the necessary living expenses of the debtor; 4) the maintenance liability of the debtor; and 5) the other circumstances affecting the financial status of the debtor
> **France:** "The manifest impossibility for a debtor in good faith to meet his/her debts taken as a whole as they fall due and payable." Case law: individuals are overindebted if repayment of debts reduces their minimum income requirement (the amount which cannot be seized or the Revenue Minimum Insertion (income support level).
> **Sweden:** The Adjustment of Debts Act (1994:334) includes other than temporary inability of the debtor to repay his debts as they become due. An additional criterion is that there are special reasons for granting adjustment. Consideration is here given to the length and reason of indebtedness and to the efforts by the debtor, to the best of his ability, to reach."[466] [467]

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[463] *Id,.* at 11.

[464] *Id.,* at 12.

[465] See **Kilborn Jason J**., "*Elaborating UNCITRAL's Legislative Guide on Insolvency Law: Principles for Natural Persons*", at 4.
http://www.uncitral.org/pdf/english/congress/Papers_for_Congress/131-KILBORN-UNCITRALs_Legislative_Guide_on_Insolvency_Law.pdf

[466] **Reifner Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga**, "*Consumer over-indebtedness and consumer law in the European Union*", Presented by the institute for financial services e.V., Erasmus University Rotterdam/School of law, University of Helsinki/Helsinki Collegium for Advanced Studies, to the Commission of the European Communities, Health and Consumer Protection Directorate-General, (2003), table 3 at 19.

[467] See also the "update" made in 2008 in: **EU Commission**, "*Towards a common operational European definition of over-indebtedness*", OEE Etudes, (2008), at 34-36.

In an attempt to support the progress of the Union in providing organized, uniform, and coordinated actions to to address the consequences of over-indebtedness, a study published by the University of Leeds in 2016 applied the following generic definition:

> "In this Report, we refer to Consumer Over-indebtedness. This is defined in the Glossary as indication of an inability or difficulty in meeting payment obligations. By this we mean ongoing difficulties in relation to financial obligations that have become due, such as monthly payments for rent or household bills and other payments, such as loan or other credit installments."[468]

3.2 An introduction on the similarities and differences in goals and structures between insolvency systems for natural persons and for businesses debtors

People often assume that insolvency systems are connected to business debts, but modern lending systems and recent developments in our debt culture have made it necessary for insolvency frameworks to deal also with the financial difficulties of non-business debtors. The U.S. Bankruptcy Code was a pioneer in this field of insolvency law, which is now becoming a necessary component of all effective and efficient models.

The structure of frameworks addressing non-business debts resembles business ones under several aspects. Some relevant differences, though, apply to make them more effective in dealing with hoards of natural persons[469]:

> "Natural persons cannot simply grind to a halt; they must carry on existing as best they can, providing for their own and their dependents' basic survival needs."[470]

Although these particular insolvency systems should not be aimed, as we have just discussed, at providing pure social assistance, they still are animated by a higher degree of humanitarian purposes than business ones.

While, aside from our discussions on the needs of modern markets, it is mostly irrelevant in the business context if a debtor should "live" (be reorganized) or "die" (be liquidated) and decisions can be made mainly based on economic or other social factors, modern frameworks for the insolvency of natural persons are clearly oriented towards protecting debtors and supporting petitioners in obtaining a successful fresh start. Such an approach has slowly developed in the past decades due to changes in social policies and in the structure of the globalized market.[471]

The original assumption applied in bankruptcy settings was that it would be dishonorable for a person to contract unbearable levels of debts. If debtors did so, they would not benefit from any support. They would remain indebted until they found a way to cover all their debts, which often proved impossible due to the high levels of stigma which permeated societies and impeded them from obtaining an income.

A modern credit economy, though, prospers on lending, on providing a variety of credit products and on incentivizing recourse to them. By doing so, it puts heavy pressure on natural persons, who therefore find themselves to be in a weak position. By being under the continuous solicitation of lenders, many end up contracting more debts than they could ever afford to repay:

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[468] **McCormack Gerard, Keay Andrew, Brown Sarah, Dahlgreen Judith**, "*University of Leeds - Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States' relevant provisions and practices*", European Commission, Directorate-General for Justice and Consumers Tender No. Just/2014/JCOO/PR/CIVI/0075, at 306. See also EU Commission, "Towards a common operational European definition of over-indebtedness", OEE Etudes, (2008), at 7.

[469] See also **Kilborn Jason J**., "*Elaborating UNCITRAL's Legislative Guide on Insolvency Law: Principles for Natural Persons*", at 2.

[470] *Id.,* at 3

[471] **Vv. Aa., The World Bank**, "*Insolvency and Credito/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), at 18.

> "The idea of bankruptcy in the economy was – in economic terms – the elimination of the debtor from the market. Economic players who are not able to honour the basic assumption of contract law – that you have to have money and that nobody should be able to claim that he was not able to honour his debts – should leave the market place. Enterprise organised in accordance with the system of limited companies should cease to exist, in the way that death occurs under natural selection. Such concepts cannot be applied to consumers. While a legal person can stop participating in the market, consumers are bound to continue to buy goods and services and to sell their labour on the market. This is why the concept of economic exclusion or elimination and natural selection is not applicable to consumers. A traditional market view of bankruptcy for consumers is impossible. Abandoning the idea of a "debtor's death", the new U.S. American inspired philosophy of fresh start seemed to offer a solution through the "death of the debt"."[472]

Systems concerning non-business debtors have, therefore, developed some unique features to cure the social damages caused by the current structure of markets. Insolvency frameworks for natural persons typically provide:

- Discharge – they prevent honest debtors from being bound to their mistakes for life;
- More or less generous "exemption" statutes – they allow individuals to retain those assets which are deemed necessary (as we will discuss later, the definition of what may be necessary varies greatly among settings) to commence a second, hopefully successful, life;
- Education – models attempt to teach to debtors how to avoid further mistakes so that they can improve their performance.

Designing an effective and efficient insolvency framework to support natural persons is a difficult task. Balancing interests is as hard as in the business context, while stigma represents, if possible, an even greater obstacle:

> "Overindebtedness in most European countries is associated with failure and bankruptcy. The term bankruptcy has stigmatic connotations as it puts the blame on the debtor. Bankruptcy is degrading and can reduce one's self-esteem a feeling reinforced by the disapproval of others. The idea that insolvent people should be taught a lesson which they won't forget, does not fit with an economic approach towards overindebtedness. The penal approach towards debtors is not a good thing from a policy perspective because it leads to the exclusion of some categories of consumers. People that are deeply in debt should not be treated as sinners or criminals. The idea that a debtor should suffer for the rest of his life because he becomes overindebted, is not acceptable anymore in a credit society that promotes the take up of credit and positively values risk-taking in financial matters. Failure is as much a part of the market-process as is success. A certain amount of failure is taken into account by the creditors beforehand. Thus, for the creditor default is a routine part of the cost of granting credit. A society that accepts credit offered by the market should also accept overindebtedness as an inherent side effect. The fact that there are casualties shows that the market is working, because profit and loss are indissolubly linked with competitive market processes, and winners as well as losers are an outcome. Both categories should be seen as part of the financial system. Insolvent people should not be treated as guilty until proven innocent, especially when the real reasons for such consumers becoming overindebted are accepted. Today, people get into financial difficulty for numerous external causes, including unemployment, divorce or collapsing real estate prices (group 1). Apart from this, people can get into trouble through poor financial management, overestimation of their redemption possibilities, or too high a desire for material prosperity (group 2). It has also been suggested that many families run into difficulties because of Government policies aimed at pushing back the welfare state

[472] **Reifner Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga**, "*Consumer over-indebtedness and consumer law in the European Union*", Presented by the institute for financial services e.V., Erasmus University Rotterdam/School of law, University of Helsinki/Helsinki Collegium for Advanced Studies, to the Commission of the European Communities, Health and Consumer Protection Directorate-General, (2003), at 47.

> and social sector. In several European countries, a shift is indeed taking place in several areas from public to private financing, which has consequences in the private sector. Public attention is often concentrated on the consequences of those changes for the lowest income groups, but the contraction of the public sector affects middle and higher income groups as well."[473]

Discriminating against debtors, in fact, can nullify the beneficial effects sought through the proceeding. There can be no true fresh start in a community that looks at debtors as second class citizens. At the same time, though, providing excessive relief and protections, as we will discuss in the next pages, can make individuals reckless, a behavior which also harms markets and societies.

3.3 Benefits provided by developing effective and efficient insolvency frameworks for natural persons

Bankruptcy is a field dominated by animosity and conflicts.

Frameworks are designed to make choices among many antithetical interests in an attempt to achieve the best possible balance. The implementation of modern insolvency systems for natural persons aims to become a bridge, benefitting all the major players involved in a complex scenario.

In this section, we will discuss the benefits provided by models to creditors, debtors, and society at large.

3.3.1 Benefits for creditors

The benefits acquired by creditors through the enforcement of effective and efficient insolvency models that address the financial default of natural persons are often underestimated. This is understandable to a certain extent. The ultimate goal of a creditor is to recover the full value of a claim, a scenario that is often impossible to realize in bankruptcy.

Still, insolvency models for natural persons are designed to attempt to mitigate some of the main shortcomings of the application of enforcement systems, in particular:

a) the ineffectiveness of mechanisms to acquire information and find assets to seize, which leads to high costs and waste of further resources;

b) races between creditors which lead to inequitable distribution of resources

Single actions by creditors against their non-business debtors, in fact, often require costly, difficult, in-depth investigations to spot and seize the few assets that are eventually available. If the debtor owes to a multitude of creditors, many may have to add further losses suffered in recovery attempts to the value of their original claim. Just a few, if any, may manage to be repaid for their efforts.

An insolvency system designed for natural persons provides creditors with a fair, organized, and supervised framework. It demands that debtors behave honestly, disclosing all relevant information on their finances and handing over all of their assets, if they wish to obtain any benefit from the proceeding, such as an award of discharge.[474] Creditors are not guaranteed to recover the full value of their claims in this scenario either, but the framework does increase levels of transparency and predictability, hence reducing collection efforts and increasing the opportunities for the debtor and other interested parties to communicate.

Three major benefits presented to creditors, therefore, are:

- the reduction of the additional costs connected to (uncertain) recovery through enforcement systems;
- greater levels of transparency and predictability, which allow early action to be taken to protect the investment and limit "races" in case of default;
- a trustable, predictable framework which can become fertile ground for negotiations among all parties and, therefore, lead to better results and lower costs.

But there is more.

[473] *Id.,* at 68-69.

[474] **Vv. Aa., The World Bank**, "*Insolvency and Credito/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), 20-21.

Most cases involving natural persons, unfortunately, are "no asset" ones. The estate usually is poor compared to business bankruptcies, and exemptions often contribute to make the most valuable items unavailable for distribution. The structure of insolvency models for natural persons, though, allows the debtor to put more chips on the proceeding's table:

> "The preferred position among both commentators and established insolvency systems, however, is to avoid this kind of discrimination and provide the same relief to all debtors, regardless of their financial means. So-called "zero plans" have consistently represented a significant portion of all "payment plans" in insolvency cases for natural persons. It is not uncommon for payment plans in one-third, two-thirds, or even a greater proportion of all confirmed cases to be purely symbolic, paying only the fees of the insolvency representative, if even that. In one well-established system in particular, early resistance by courts to confirming "zero plans" was quickly overcome, and such plans came to represent an estimated 80% of all individual insolvency cases. In another system where resistance to "zero plans" did not subside on its own, judicial intervention at the highest levels resolved the matter in favor of debtors with insufficient income or assets to offer creditors any dividend. This country's constitutional court ruled that extending relief only to debtors who could pay some portion of their debt violated the equality principle in this state's Constitution. It is probably both more honest and more meaningful to refer to these arrangements as "debt adjustment" plans, rather than "payment" plans, or better yet something like "rehabilitation" plans, to focus on their real purpose."[475]

Natural persons often have the capacity to recover from difficult financial situations, making good use of the support offered by a fresh start.

These debtors, and those that already have stable incomes, are therefore often denied an easy way out through a quick liquidation; they are pushed towards reorganization proceedings, which demand more of them. In order to obtain a fresh start and discharge, in fact, debtors have to file a plan with a duration that commonly ranges between three and five years, and to contribute portions of their future earnings to repay previously incurred debts.

Future earnings often are the most valuable resource in possession of an individual. At the same time they are difficult to seize without the debtor's cooperation[476]:

> "Because most natural person debtors have little value in available assets, existing insolvency regimes most commonly require some contribution from debtors' future income in exchange for whatever benefit the system offers (usually a discharge of unpaid debt). Whatever the form and extent of relief offered, most systems envision an "earned start" for natural persons, rather than a simple fresh start with no contribution or exertion expected of debtors."[477]

The specific framework provided by an insolvency proceeding for natural persons, therefore, offers several benefits to creditors; most notably the capacity to bind debtors and their future earnings to pay a greater portion of the outstanding claims. At times, though, it is difficult for a creditor to see this as an opportunity, mainly due to the animosity often present in an insolvency scenario.

3.3.2 Benefits for the debtors and their families

Modern insolvency systems for natural persons benefit debtors greatly. From an historical point of view, the friendly, supportive approach they present debtors with is innovative. It moves radically away from traditional rules which stigmatized bankrupts heavily and ultimately banned them from society or left them to die in crowded jails.[478]

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[475] *Id.,* at 98.
[476] *Id.,* at 23.
[477] *Id.,* at 83.
[478] See Chapter IV and the discussion on imprisonment for debts in Chapter V.

Modern insolvency frameworks attempt to assist honest debtors providing them with the necessary tools to obtain a fresh start. Bankrupts, in fact, seldom are the dishonest criminals that they were believed to be in the past. Most defaults concern individuals that find themselves trapped by the lending mechanism provided within modern markets.

They suffer greatly due to their condition; high levels of debts cause elevate degrees of physical and psychological stress, which lead to the incapacity to produce wealth and to find effective solutions to the original problem. This is particularly true at times of great crisis, such as the ones we are living in today. Lack of employment opportunities and the high rates of business defaults have suddenly impoverished many.

The suffering deriving from such a condition can eventually lead to extreme consequences such as suicidal feelings, which can affect not just the debtor but also his or her family or dependents. Research shows that children that grow u[in such difficult situations are often socially excluded.[479] A single default, therefore, leads to a chain of negative consequences:

> "The social and psychological consequences of overindebtedness are often very far reaching. Repayment problems can have a destructive effect on family-life. Social and psychological disturbances can result, which can manifest in escapism or a complete withdrawal from societal life because of feelings of shame. Because the legal position of insolvent people is weak, they are vulnerable to threats and harassment from their creditors and debt collection agencies. The actual number of evictions, disconnections and so on is relatively low, but the expectation of their execution may be felt as a sword of Damocles. Despair and insecurity result because debtors do not have any prospect of building up a new life."[480]

Insolvency systems for natural persons are designed to cure such situations and to provide relief in exchange for honesty and cooperation. They mean to ensure that that debtors can return to being productive members of societies. The European study of 2003 expressed this goal clearly[481]:

> "This study advocates an approach involving the integration of overindebted consumers. They must be "recycled" into the financial system in such a way that they can participate again, and not be excluded from the market and society. A rehabilitative approach to debt settlement is good for the debtor and his family in the first place, but also for society as a whole. Putting the blame on the consumer and making him suffer for the rest of his life is a counter-effective response to the societal problem of overindebtedness, because it leads to the exclusion of citizens. The system should encourage all the parties concerned to look to the future rather than to the past. When integration is the first aim, policy is not centred on the past, nor preoccupied with the question of who is to blame for the fact that the financial position of the debtor has gone wrong. The focus is on the future, and on how the person can restore independent participation in economic life, rather than remain dependent on his creditors or social security, or even worse. Discharge of debts restores to the debtor some measure of confidence in his capacity to arrange his future as he wishes, free from the dead hand of the past. Without such confidence, the debtor may lose even that minimum of self-respect that is a condition for his taking an interest in himself and his own life, and not turn away from society. Because of the rehabilitation function of debt settlement, the debtor is encouraged to become an active member of society again, producing wealth rather than remaining non-productive. Discharge reflects an awareness that the productive resources of every individual are significant, and that by releasing the debtor from his past financial obligations, his renewed vigour will benefit

[479] *Id.,* at 25-26.

[480] **Reifner Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga**, "*Consumer over-indebtedness and consumer law in the European Union*", Presented by the institute for financial services e.V., Erasmus University Rotterdam/School of law, University of Helsinki/Helsinki Collegium for Advanced Studies, to the Commission of the European Communities, Health and Consumer Protection Directorate-General, (2003), at 69.

[481] Most pointedly, it even used the term "recycle", referring to the capacity – or the need – of the system to support debtors in their new attempts.

society as a whole as well as himself. Seen in this way, the study's approach contains utilitarian elements, and may be justified from a public policy standpoint. By being allowed to regain his position in society, the debtor contributes to the "common good" through being a productive member of society."[482]

Two ways out are offered to solve the societal problem presented by overindebtedness: liquidation proceedings and reorganizations.

Liquidations, as applied in the field of non-business bankruptcy, are swift and require low levels of involvement; the most burdensome step usually concerns the correct filing of a petition in good faith. Such proceedings are considered of residual importance. They should be limited to those individuals that have no steady employment and that have a low chance of earning future income. At the time of filing in such situations, if the debtor is found worthy, he will be swiftly discharged and surrender a portion (often limited) of his remaining assets.

Reorganizations, as discussed in the previous section, push individuals to pay a greater portion of their debts over a longer period of time. They therefore require higher levels of effort and commitment. As such, debtors often consider them a less preferred option compared to the quicker discharge offered by liquidations.

A proceeding that is correctly commenced following bankruptcy rules usually leads to the deployment of a stay which halts the individual actions of creditors.[483] The stay provides the debtor and the proceeding with the necessary breathing room to organize next steps. It alleviates the pressure of a difficult financial situation, giving some comfort and peace of mind.

Upon effectively and honestly cooperating with the proceeding, the debtor can be awarded a fresh start through exemptions, discharge, and protections from social discrimination.

- Discharge allows the debtor to pay only a portion of his or her pre-petition obligation, hence reducing the financial burdens which forced him or her to file for a public proceeding.
- Exemptions allow the debtor to keep certain assets which are considered absolutely vital. Hence, they allow petitioners to make full use of their "second chance" and they support debtors, their families, and the people that depend on them, preventing them from becoming a burden on the community.
- Protections against discrimination are sets of rules that are specifically designed to fight the negative effects of stigma, supporting the debtor's efforts in once again becoming a productive member of society. Such protections have a wide range; for example, they grant that debtors can have access to licenses that are necessary to being active members of their communities.

These three elements will be discussed in more depth in the next pages and chapters.

Modern insolvency models for natural persons support debtors greatly through different tools. They adopt approaches which are opposite from traditional business bankruptcy policies. They do not aim to stigmatize and punish bankrupts by imposing heavy civil and criminal burdens, but to support their honest attempts to return to being productive members of society.

3.3.3 Benefits for society at large

A national insolvency framework for natural persons does not aim to provide sporadic benefits for isolated debtors and their creditors; it is structured in an attempt to ameliorate the negative, systemic effects of unregulated distressed debt and incentivize responsible lending.[484]

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[482] **Reifner Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga**, "*Consumer over-indebtedness and consumer law in the European Union*", Presented by the institute for financial services e.V., Erasmus University Rotterdam/School of law, University of Helsinki/Helsinki Collegium for Advanced Studies, to the Commission of the European Communities, Health and Consumer Protection Directorate-General, (2003), at 70-71.
[483] *Id.,* at 179-180.
[484] *Id.,* at 100-150. See also **Vv. Aa., The World Bank**, "*Insolvency and Creditor/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), at 26-27.

The benefits that derive to economies and societies from the ample availability of credit are not free of charge. Individuals may end up unable to control their expenses and the weight of the loans they contract. It is difficult to be thrifty in the modern scenario.[485]

The simultaneous default of many has uncontrollable negative repercussions on the whole economy; it is an event that needs to be contained.

The systemic benefits provided by the enactment of modern insolvency systems for natural persons include:

a) **Reduction of the work load for courts and the connected costs**. Individual actions are expensive and may not produce positive results. Helping creditors to better understand the scenario they find themselves in and providing alternatives reduces the high volume of enforcement proceedings (and connected litigation) and may unlock a better end result.

b) **Encouragement of responsible lending**. A transparent, predictable system promotes responsible lending, reducing the availability of credit for those non-business debtors that are evidently unable to manage it. Lenders are in the best position to make decisions. In those situations in which individuals are pushed to seek debts beyond their capacities, they are asked to accept the loss.

c) **Maximization of the value of available assets in proceedings**. In an organized proceeding, the available assets are protected by a stay. They are gathered, valued, organized, and utilized to the extent allowed by law to ensure the payment of the highest portion of the outstanding debts. As discussed in the previous sections, insolvency systems for natural persons also allow, in certain circumstances, for portions of the debtor's future earnings to be available for distribution.

d) **Returns derived from supporting the honest debtor in having a full fresh start**. Educating and supporting citizens is expensive. However, in the past the imposition of harsh punishments, such as imprisonment for debts or disqualifications from managing businesses, caused both great burdens on public budgets and the loss of the debtor as a member of society. Those debtors that were imprisoned together with criminals were affected by the impossible conditions they were forced to live in. If they died in the process, society lost resources; if they managed to be released, they probably turned into criminals themselves.[486]

In a modern credit economy, the financial default of great numbers of honest individuals seems to be unavoidable. This is particularly true at a time of great difficulties, such as the ones faced by markets nowadays. An effective insolvency formula can help achieve a better balance and support the growth of both society and the market; on the other hand, as we are about to discuss, excessively increasing benefits for bankrupts may incentivize reckless behaviors and lead to lack of trust in the enacted framework.

3.4 Potentially negative consequences stemming from the enactment of insolvency frameworks for natural persons

Every coin has two sides.

Following a modern approach towards insolvency frameworks for natural persons may also lead to negative consequences. If the scales are weighed excessively in favor of debtors, it may incentivize fraud, abuse, and dishonest behavior in general. An overbroad safety net, in fact, may become an incentive for individuals to act irresponsibly. Debtors may even end up demanding protection in the form of an automatic fresh start, despite the damages they caused though their reckless behavior.[487]

Petitioners may also be tempted to abuse the friendly rules that compose the framework to get more benefits than they should be entitled to. Often times, debtors may hide assets to keep them from the liquidation process and from distribution to the creditors, hence hurting the levels of trust in the system.

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[485] **Tucker David M.**, "*The Decline of Thrift in America. Our Cultural Shift from Saving to Spending*", published by Praeger Publishers, New York, New York State, (1991).

[486] See Chapters IV and V.

[487] **INSOL International, International Federation of insolvency professionals**, "*Consumer Debt Report - Report of Findings and Recommendations*", (2001), at 40.

They may also forge claims, allowing insiders to collect assets and ultimately keep more than they would be allowed to. Or they may file multiple consecutive cases to take advantage of moratoriums and stays in an attempt to discourage their creditors from taking individual actions.

As we will discuss in Chapter IV, in the past, statutes used torture and civil and criminal punishments to prevent and limit abuses. Such tools are, of course, not congruent with the frameworks that international organizations are trying to build today. Nevertheless, new models need protections to operate successfully and to be trusted within the legal system, the market, and society.

In recent times, legislators have tried to find an effective formula to exclude dishonest petitioners from insolvency proceedings *tout court*, or prevent them from obtaining benefits they do not deserve. As we will see more in-depth when we analyze the American system in Chapter V, for example, dishonest debtors do not enjoy the benefits of discharge; moreover, in the case of multiple filings, the "automatic stay" does not shield assets or protect debtors.

Although it is impossible to prevent all frauds, crimes, and abuses, some expedients are a necessary component of a successful, modern insolvency system. Just as it is necessary to effectively support honest debtors, it is also important to discourage dishonest behaviors. If a correct balance is not found, models cannot produce the positive effects sought through their enactment.

3.5 Informal alternatives to full bankruptcy proceedings for natural persons[488]

A recent trend has developed in this area of bankruptcy law to promote informal workouts instead of full, formal bankruptcy proceedings. Such an option would be particularly beneficial when addressing the insolvency of most natural persons, due to the scarcity of assets usually available. Reducing costs and formalities while effectively supporting dialogue among parties may be key to implementing a less onerous and more efficient framework.

Other positive elements, aside from the purely economic one, support the validity of this approach. Through an out-of-court mediation among debtor and creditors:

- **Stigma can be limited**. Information on the default of the debtor would not have to become of public domain. Hence, the debtor would not suffer negative consequences within his community (personal consequences are particularly relevant when the debtor is a natural person and not a corporation).
- **Chances of success may be higher**. Cooperation among parties may lead to the drafting of flexible agreements based on the specific needs of the parties involved in the case. Such an approach could increase the chances of success of long-term plans especially.
- **A successive in-court proceeding may be efficiently prepared**. Not finding an agreement though the mediation process does not exclude the possibility of subsequently commencing a full in-court proceeding. The chance of making mistakes in the forms, or hidding assets to defraud creditors, would be greatly reduced after such a preliminary, voluntary attempt.

Benefits, though, may prove illusory.

Several elements undermine the effective capacity of parties to execute an informal agreement:

- **Single creditors demanding enforcement, or acting aggressively, may make negotiation practically impossible**. This is true even in cases in which the majority of creditors are proactive in the negotiation and just a few may be antagonizing it. Even a single dissenting creditor, in fact, may veto or irreparably harm a collective informal agreement.
- **A generalized lack of trust among stakeholders may harm dialogue and cooperation**. Fear of incurring frauds can be a powerful deterrent and the difficulty of locating assets in presence of uncooperative debtors can cause discouragement.
- **Difficulties in gathering creditors**. Bringing all creditors to the same table is a major challenge. Creditors are often unwilling to spend energies on a project that would benefit the debtor.

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[488] *Id.,* 45. **Reifner Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga**, "*Consumer over-indebtedness and consumer law in the European Union*", Presented by the institute for financial services e.V., Erasmus University Rotterdam/School of law, University of Helsinki/Helsinki Collegium for Advanced Studies, to the Commission of the European Communities, Health and Consumer Protection Directorate-General, (2003), at 170-1.

- **Difficulties in protecting exempt property.** A mediation may discourage debtors due to the difficulties they may encounter, outside of a more rigid framework, in protecting exempt items.

A good alternative may, therefore, be a mixed system, which should effectively provide:
- supervision by some kind of authority for a low cost;

> "Not all existing insolvency regimes for natural persons invoke the aid of an insolvency representative, however. In some countries, payment plans developed in the natural person insolvency system are regarded simply as contracts like any other. Debtors receive no guidance or supervision in making the required payments, and creditors bear the burden of monitoring these payments and enforcing the debtor's duty to perform via ordinary enforcement mechanisms. This approach might be explained in part by the fact that such payment plans arise only in cases involving mildly distressed debtors who remain fully solvent. Cases involving more distressed debtors generally result in global moratoria on collections and possibly a full discharge, with no ongoing payments under a rehabilitation plan. In one country in particular, however, even significantly distressed debtors are left on their own in collecting and distributing payments to creditors. One system has developed an admirable middle-ground approach of helping debtors to organize and process their payments, but leaving it to debtors themselves to make the appropriate deposits—leaving monitoring burdens on creditors. That system engages trustees to develop payment plans, but once the plan is confirmed, the insolvency representative's job is complete. To help debtors to manage the payments by themselves, the insolvency representative at the beginning of the insolvency procedure opens a dedicated bank account to which debtor-applicants immediately begin depositing their disposable income, thus immediately starting the five-year payment plan clock and reducing the total period during which debtors are forced to live on depressed resources. For plans that are ultimately approved, the insolvency representative generally forwards to the bank a list of creditors, their account numbers, and the percentages of the debtor's accumulated monthly deposits to be transferred to each creditor's account once each year electronically. Debtors are encouraged to make the required deposits and payments through automatic bank transfers, but debtors generally retain free disposition of their income and are responsible for making the monthly deposits themselves. Despite the debtor's freedom and creditor's lack of ability to monitor monthly deposits, this arrangement had functioned quite well in practice. The cooperation of banks in supporting this system and charging more reasonable processing fees was required, however, not to mention an advanced technological infrastructure."[489]

- a certain degree of protection from enforcement actions without incentivizing frauds;
- ways to gather all creditors and to ensure the disclosure of all the necessary information.

Such a framework should also ensure that:
- dissenting minorities would be bound to the general outcome or to the decisions of a qualified majority;
- discharge and exemptions are made available to those honest debtors that cooperate actively.

Due to all such difficulties, therefore, formal proceedings continue to be the most practical option to structure a fair insolvency framework.[490] Their high costs, though, in this "poor" area of bankruptcy law, are a relevant incentive to keep looking for workable alternatives.[491]

3.6 Key features of effective and efficient insolvency frameworks for natural persons

Most insolvency statutes drafted to address the issue of the default of consumers, or non-business debtors in general, are recent. Several countries started introducing such regulations from the nineties[492],

[489] *Id.,* at 100.
[490] **Vv. Aa., The World Bank**, "*Insolvency and Creditor/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), at 55.
[491] *Id.,* at 49.
[492] *Id.,* at 50.

with the United States representing the most notable exception. The American model, therefore, influenced most subsequent regulations.

The different international models, despite maintaining similarities in the struggle for efficiency, are not mere photocopies. The connection with local policies is extremely relevant in this field of bankruptcy law and affects both the contents and structure of the individual models. Some, for example, have opted for the creation of autonomous statutes addressing the issues connected to the insolvency of natural persons or consumers only. Others have made additions and modifications to the already-enacted businesses ones.[493] Some statutes have been defined as "insolvency" regulations; others continued using the term "bankruptcy."

Overall, as we have mentioned in previous sections, insolvency procedures for natural persons do not differ greatly from business ones in their basic structures. They are, though, more involved with humanitarian factors and, therefore, include some relevant and specific features, such as:

- education requirements for debtors;
- some peculiar characteristics of plans in rehabilitation proceedings;
- exemption statutes;
- discharge rules;
- non-discrimination rules protecting debtors at the end of a case.

We will briefly discuss some of the key traits of the specific elements of these frameworks as an introduction to the topics that we will encounter in the next chapters.

3.6.1 Educating Debtors

Education is a key feature of insolvency frameworks for natural persons and should be a cornerstone of bankruptcy models in general. As discussed in Chapter I, in fact, SMEs often suffer from lack of expert counseling due to their small size, which makes it difficult to sustain the costs of expert input. By the same principle, a great number of natural persons are often unprepared to resist the many solicitations of a credit-based economy and ultimately face financial difficulties.

Their mistakes are often not connected to those excessive or fraudulent behaviors that a more traditional approach to bankruptcy stigmatized and tried to eradicate; they are induced by inexperience and lack of expert advice. Education can become a key factor in the process for their rehabilitation. Awarding discharge and a fresh start, in fact, would be meaningless (and expensive) if debtors were not put in the position to learn from their experiences and to learn ways to avoid mistakes and further defaults[494]:

> "There seems to be a common understanding among the Member States that the debtor should regain control over his financial affairs during the consumer insolvency procedure. The underlying idea seems to be that since he has mismanaged his financial affairs before the insolvency he should change his habits in order not to do it again. Therefore, the procedure should have some educational features. Often, for example, the payment plan is seen as an educational tool, but the debtor is also considered to require specific counselling in financial and budget skills. Since the consumer insolvency procedure is in most Member States linked with or preceded by participation in debt counselling, there seems to be a fair chance for re-education (see subchapter II.D.3.a) below). There was a long tradition of debt counselling services in some Member States before any consumer insolvency proceedings were discussed. Most notably, debt advice has been organized through consumer advisors and social workers in Sweden, different consumer, welfare and social organizations, and even labour unions and churches in Germany and in connection with the municipal banks in the Netherlands. In most cases, it has been individual advice and counselling on budgeting, financial management and support in

[493] *Id.,* at 51.

[494] See **EU Commission**, "*Towards a common operational European definition of over-indebtedness*", OEE Etudes, (2008), 83-4.

> negotiations with creditors. Financial literacy education for groups or in educational institutions still seems to be at an initial and experimental stage."[495]

Imposing education requirements serves another relevant purpose: it forces debtors to put effort into the rehabilitation process.

This is necessary. As it has been mentioned in the previous sections, achieving a fresh start cannot be too easy. If debtors are offered relief without being challenged to make improvements with their lives they may incur reckless behaviors. Upon tailoring a proceeding concerning natural persons, the goal must not just be to ensure the debtor makes it successfully every step of the way till the end, but to do what is necessary to make it so that an "earned start" (instead of a mere "head start"[496]) can be achieved. On this point, it is interesting to read the analysis made by the European Study on overindebtedness of 2003, comparing approaches between the US and Member States:

> "In all Member States, which have a consumer insolvency law, the idea of a fresh start for debtors has been expressed in legislative bodies and in the general discussion about the law. The purpose is that a debtor can through the consumer insolvency procedure gain back the command of his economic affairs. After the legal process and the payment plan the debtor would be "rehabilitated", that is to be able to act in the economic life as anyone else. The concept of a fresh start as discussed has a different meaning from that which it has in the United States, where the concept originated. In American legal usage, the concept of fresh start refers to a right to be discharged from pre-bankruptcy debt in fairly quick and formal bankruptcy proceedings. This difference can be traced back to (business) bankruptcy law. As bankruptcy is acknowledged in the US Constitution (1789), discharge is historically an essential part of the American bankruptcy law. Likewise discharge belongs to the domain of bankruptcy law in other Anglo-Saxon countries as well even though it is not necessarily as clear cut a right as in the United States. For example, in England and Ireland bankruptcy proceedings have retained some of their repressive character, but nevertheless the debtor may be freed from liability for pre-bankruptcy debt after a certain number of years have passed. The historical context in Continental Europe has been quite the opposite. Discharge has not been part of bankruptcy law. Compositions have been known, but they have required an acceptance by a qualified majority of the creditors. In the main, bankruptcy debtors still have a fair amount of debt after the bankruptcy. This is quite a striking difference compared to company insolvencies which are final, and a new business activity by the owners is not encumbered by old debts. Lately, after bankruptcy cases in Continental Europe, there have been some signs of a reversal of this rule of unlimited liability. For example, the French Insolvency Law makes discharge possible in many cases. The French Insolvency Law, which is generally only applicable to natural persons who have been merchants, is in certain provinces (Alsace) applied to all consumers. Thus, there is a region in Europe in which a consumer can receive discharge in bankruptcy proceedings. Also in the United Kingdom and Ireland a discharge can be obtained in bankruptcy proceedings. In the UK the discharge period is two to three years and discharge thereafter is the norm. In Ireland, the discharge is obtained after twelve years of bankruptcy. These bankruptcy proceedings are not accessible to consumers because of high costs, but some former business men have benefited from them. Furthermore, the German and Austrian solution to incorporate consumer insolvency proceedings into the bankruptcy can be interpreted as an attempt to alleviate the strict post-bankruptcy liability. In these countries the special debt arrangement at the end of bankruptcy aims at discharge but only after a lengthy payment

[495] **Reifner Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga**, "*Consumer over-indebtedness and consumer law in the European Union*", Presented by the institute for financial services e.V., Erasmus University Rotterdam/School of law, University of Helsinki/Helsinki Collegium for Advanced Studies, to the Commission of the European Communities, Health and Consumer Protection Directorate-General, (2003), at 167-8.

[496] See Id., at 83. See also **Vv. Aa., The World Bank,** "*Insolvency and Creditor/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), at 166-7.

plan. Thus, the American notion of fresh start has not been accepted in any of the Member States, neither in bankruptcy nor in consumer insolvency law. Rather, the discharge of debt is conditioned, in particular by a partial payment obligation but also by a number of requirements concerning the debtor's behaviour. It would therefore seem appropriate to use the term "earned start".[497]

3.6.2 Structuring a payment plan for the successful reorganization of a natural person

The payment plan is a key feature of all bankruptcy reorganization processes:

> "Some of the most difficult questions in natural person insolvency policy arise in the context of formulating a payment plan, especially the twin issues of how long debtors should be required to toil for the benefit of their creditors, and how much debtors should be required to pay during that period; that is, how much can they retain, with all "excess" applied to paying off debt. Once the plan is established, an effective insolvency regime must consider assigning responsibility for monitoring the debtor's compliance and the possibility of modifications to the plan for changed circumstances."[498]

Conceiving a balanced plan structured for natural persons presents a number of challenges that are not as relevant (or that, in general, differ) within the business bankruptcy setting. The first challenge is determining its duration[499]: how long is it reasonable to bind an individual to a project aimed at fixing his past default?

The study on European overindebtedness of 2003 made the following evaluation:

> "When a payment plan is an essential part and condition of the discharge, we can speak about an earned start. A payment plan is required in all Member States which have consumer insolvency regulations. The duration of the plan varies from three years in Denmark to seven years in Austria and even more in the United Kingdom. The most common maximum duration of the plan is five years. Even though shorter plans are allowed in accordance with the laws of most countries, the maximum duration of the plan seems to be the most commonly used length of plan in most Member States. In some Member States, the requirement for a mandatory payment plan has caused problems for debtors who have no payment capacity at all. At the one extreme is France, where discharge is granted only to debtors with no prospect of paying at all and even they can receive it after a waiting period of three years.205 In some countries, zero payment plans are accepted but the debtor has the same status as other debtors during a plan period, including the same reporting etc. duties (see further in subchapter II.D.4.e)). Somewhat exceptional is the situation in Austria which has a very stringent requirement for a minimum payment of ten percent of the total debt. This rule seems to exclude the poorest debtors from consumer insolvency proceedings and is therefore considered unjust. As these examples show, and as will be explained in more detail in subchapter II.D.4.e), European insolvency laws require that the new economic start is earned through a long and demanding payment plan. This requirement seems to be more of a manifestation of the importance of "good payment morals" than of economic interest of the creditors. The yields of the payment plans are never big and in most cases they are quite modest. Some studies have shown that the average outcome to creditors is about 15% of total debt outstanding. It requires quite a large amount of administrative and judicial work to draw up a plan and to monitor it. Therefore the economic rationale of such plans sometimes seems questionable, this being most obvious in the case of zero-plans. The payment

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[497] **Reifner Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga**, "*Consumer over-indebtedness and consumer law in the European Union*", Presented by the institute for financial services e.V., Erasmus University Rotterdam/School of law, University of Helsinki/Helsinki Collegium for Advanced Studies, to the Commission of the European Communities, Health and Consumer Protection Directorate-General, (2003), at 165-6.

[498] **Vv. Aa., The World Bank**, "*Insolvency and Creditor/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), at 83-84.

[499] *Id.,* at 84.

morals, on the contrary, are very much emphasized in European discussions on consumer insolvency regulation. Therefore, our conclusion is that the payment plan also manifests the European moral attitude towards payment of debts."[500]

In Europe, today:

"Only a handful of European states now provide a discharge within three years, however. The Dutch law originally left the discharge period to judicial discretion, though judges chose a three-year term in so many cases that this term was adopted as the statutory norm as of 2008. The discharge term under the Latvian law began at seven years in 2008, reduced in 2010 to a unique sliding scale that provides a discharge after as little as one year, with a maximum of three-and-one-half years. Ireland took a giant step in 2013 from a previous 12-year payment period, following which debtors might earn a discharge only if the court found such a result "reasonable and proper." Now, Irish debtors earn an automatic, non-discretionary discharge three years after entry of the order opening their bankruptcy cases. Also in 2013, Poland adopted a standard three-year discharge plan period, reduced from five in the original law. Other regimes remain above the three-year mark, despite years of chaotic reform on this issue. The enormously complex French system originally limited court-imposed payment plans to five years, increased to eight years from 1999-2003, then again to ten years until 2010, then back to eight years until 2016, when an ordinance reduced the maximum plan period to seven years. In both Germany and Austria, a seven-year term was the original choice, which has been challenged as overly long from the very beginning. The German discharge period was reduced to six years in 2001,69 and in 2013, it was reduced further to five years for the relatively few debtors able to pay administrative costs, and to three years for debtors able to produce a 35% dividend for unsecured creditors. The new Romanian system includes a sliding scale, as well: One year for a 50% dividend, three years for 40%, and five years if less than 40%. Belgian legislators considered a seven-year period but reduced it to five at the last minute, without explanation. Elsewhere in Europe, a five-year payment plan is standard, with the exception of Greece and Italy at four years. In all of Scandinavia, five-year plans predominate, though under a very recent Swedish reform, effective November 1, 2016, entrepreneurs will be subject to a standard three-year plan. If the Guide could offer any perspective on which of these myriad approaches is most appropriate, much anguish by legislators and debtors could be avoided."[501]

Creditors, of course, benefit greatly from a lengthy plan. The debtor's future earnings, in the end, represent a major source of income for distribution; consequently, a long plan will probably grant creditors higher returns. At the same time, exceedingly lengthy plans become a great disincentive for debtors, who find themselves to be unmotivated. Excessive duration, therefore, lowers the chances of success of the whole process[502]:

"Constructing a payment plan regime begins with a seemingly simple but devilishly divisive and challenging question: How long should debtors be expected to devote their surplus income to paying down their debts? Policymakers have long struggled to formulate a reasoned basis for choosing any particular time period, and no single choice has attracted a consistent following among existing systems. In part, the answer to this question depends on the desired goals of imposing a payment plan on debtors in exchange for a

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[500] **Reifner Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga**, "*Consumer over-indebtedness and consumer law in the European Union*", Presented by the institute for financial services e.V., Erasmus University Rotterdam/School of law, University of Helsinki/Helsinki Collegium for Advanced Studies, to the Commission of the European Communities, Health and Consumer Protection Directorate-General, (2003), at 166-7.

[501] **Kilborn Jason J.**, "*Elaborating UNCITRAL's Legislative Guide on Insolvency Law: Principles for Natural Persons*", (2016), at 10.

[502] **Vv. Aa., The World Bank**, "*Insolvency and Creditor/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), at 84.

promise of insolvency relief. If the goal is simply to maximize payment to creditors, one might think that a longer term would be appropriate, but this immediately raises the most salient countervailing consideration here. Recall that several of the primary goals of insolvency regimes for natural persons generally relate to removing disincentives to being productive. A lifetime of liability can be a debilitating disincentive to productivity, but even a limited repayment term can squelch the debtor's motivation and delay the debtor's rehabilitation and the attainment of the many other goals of the insolvency regime discussed earlier. The point of rapidly diminishing returns can be reached quite quickly when deciding on the proper repayment term. Moreover, experience in every major insolvency regime in existence has revealed that few debtors will have the wherewithal to produce anything substantial for creditors beyond covering the debtor's basic needs and the administrative costs of the insolvency system, no matter how long or short the repayment period might be. Increasing the repayment period thus is likely to actually depress creditor returns and to reduce the numbers of debtors who can be helped by the system, sharply limiting the positive effects of the system. A more generally attainable goal is simply to inculcate payment responsibility and avoid moral hazard among debtors. Accepting that most debtors are unlikely to be able to produce a significant return to creditors, many existing systems seem to pursue primarily this sort of educational goal. Habituating debtors to regular budgeting, paying bills, and submitting tax returns has been regarded by some policymakers as a benefit in its own right. This approach is far more complicated than trying to maximize returns to creditors. Returns to creditors can be easily quantified and measured, whereas making debtors more financially responsible represents a hidden battle with minds and attitudes. Whether or not an insolvency system can have a meaningful impact on debtor attitudes and behaviors is a question that eludes satisfying analysis. Nonetheless, available evidence suggests that it is all but certain that a longer repayment term will have a quite powerful suppressing influence on the number of debtors who seek and receive the relief and thus achieve the goals of such a system. Experience in many existing systems has shown that, once debtors discover the demands and rigors of an extended, multi-year payment plan, some will abandon the process for fear they will be unable to withstand the sacrifices, and many will be forced out by their actual failure to do so."[503]

To be feasible and successful in the long term, the plan cannot become a kind of slavery; the active and willing cooperation of the debtor is essential in order to develop a positive, constructive attitude toward the proceeding. Debtors cannot feel hopelessly bound to earn money for others or that their reasonable needs, and the ones of their families or dependents, are not accounted for. If it is so they will not have a constructive attitude.

Ultimately, they may also be tempted to cheat the system, hence damaging the whole process.[504]

Two methods can be applied to determine an effective and balanced duration of a plan: 1) a case-by-case approach under the discretion of a decision making body such as a bankruptcy judge; 2) a statutorily predefined and fixed term to be applied in all circumstances. Arguments exist in favor of both methods.

The first method is the fruit of a successful mediation between a debtor and his creditors and it represents a very efficient solution. If the parties are capable of finding a reasonable agreement, it is a

[503] *Id.,* at 84-85.

[504] See Kilborn discussing the current evaluations in Europe, at 9: "Policymakers have wrestled for many years in setting the appropriate term for debtors to earn their discharge. The European Commission has recently begun pressing for a three-year maximum discharge period, but many European states remain resistant to reducing their longer required terms. In April 2015, an EU Commissioner contrasted the US and European approaches, noting "[a]s for natural persons, in the U.S. the average debt discharge period is less than one year, while in most EU countries it's between five and seven years," and praising the shorter period, as "[t]here is evidence which shows that shorter discharge periods allowed US households to recover more quickly from the crisis." In late November 2016, the European Commission redoubled its emphasis on the three-year term by taking the extraordinary step of proposing a Directive which would compel Member States to establish three-year maximum discharge periods for individual debtors." **Kilborn Jason J**., "*Elaborating UNCITRAL's Legislative Guide on Insolvency Law: Principles for Natural Persons*", (2016).

success. The results of the plan are likely to lead to higher returns and there will be little need for the involvement of courts, since, as long as all interest holders are satisfied, the duration or the terms of the proceeding will be of scarce relevance to the overall system. On the other hand, if the agreement is the result of an abuse by one of the parties, then the end result can be expected to be poor and courts will have to be more active.

The second method would allow a higher degree of transparency and predictability within the framework. Borrowers would know beforehand the consequences of failure and would be in the best position to adjust the costs of credit and to reduce the chances of default through. However, finding an efficient one-size-fits-all parameter is a challenge.

As often happens, a reasonable middle ground would probably prove the most beneficial. An effective system should account for variables such as the percentage of claims repaid immediately through the sale of the debtor's available assets or the stability of the debtor's employment. Moreover, the model should also include penalties and incentives to help the debtor in accomplishing his or her goal.[505]

3.6.3 Exemptions[506]

One of the most characteristic elements of insolvency frameworks for natural persons is the availability of exemptions:

> "(b) Where the debtor is a natural person
> 18. In the case of insolvency of a natural person, the insolvency law may exclude certain assets from the estate, such as post-application earnings from the provision of personal services by the debtor or monies received for public works by the debtor, assets that are necessary for the debtor to earn a living and personal and household assets, such as furniture, household equipment, bedding, clothing and other assets necessary to satisfy the basic domestic needs of the debtor and his or her family. Some jurisdictions also exclude torts of a personal nature such as defamation, injury to credit or reputation or personal bodily injury. The debtor remains personally entitled to sue and to retain what is recovered in such actions on the basis that the incentive to vindicate wrongdoing otherwise would be diminished, but the debtor may not be entitled to sue for any loss of earnings associated with those causes of action. Such exclusions generally would not be available to legal person debtors.
> 19. Where an insolvency law excludes certain assets from the estate of a natural person, those assets should be clearly identified and the number and value of the exclusions limited to the minimum necessary to preserve the personal rights of the debtor and allow the debtor to lead a productive life. In identifying such exclusions, consideration might need to be given to applicable human rights obligations, including international treaty obligations, which are intended to protect the debtor and relevant family members and may affect the exclusions that should be made. A further consideration may be the economic effects of exclusions; some research suggests that the full or substantial exemption of personal assets from insolvency proceedings may have a positive effect on entrepreneurship and risk-taking."[507]

Exemptions aim to provide an effective fresh start by allowing the debtor to keep certain assets that are deemed necessary to return to being a productive member of society:

[505] **Vv. Aa., The World Bank**, "*Insolvency and Creditor/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), at 85-86.

[506] *Id.,* at 74. See also **Reifner Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga**, "*Consumer over-indebtedness and consumer law in the European Union*", Presented by the institute for financial services e.V., Erasmus University Rotterdam/School of law, University of Helsinki/Helsinki Collegium for Advanced Studies, to the Commission of the European Communities, Health and Consumer Protection Directorate-General, (2003), at 186-9.

[507] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2005), at 80.

> "The notion of exempting some of the debtor's property from liquidation and distribution to creditors is closely tied to the discharge principle. It is also related to the exemption policy in many countries' non-bankruptcy law safeguarding certain assets from post-judgment (and in some countries, pre-judgment) execution and garnishment. The idea is that when debtors receive a discharge, exit from insolvency, and obtain a fresh start, they should first be provided with sufficient property to meet post-insolvency minimum domestic needs for themselves and their families and, where necessary, minimum business needs. The discussion below distinguishes between exemptions relating to property existing at the time the insolvency case is commenced and property that comes into existence post-commencement."[508]

This is a tool that was historically met with great opposition.

The idea of allowing a bankrupt to retain valuable property despite having contracted overwhelming debts was deemed to be unacceptable.[509] With time, societies evolved and so did bankruptcy systems, developing a more humanitarian attitude towards the misfortunes of honest debtors. Models began to grant bankrupts a chance to retain a few items of little value that they needed to sustain themselves.

Initially, in fact, exemptions involved items of extremely limited economic importance, the bare minimum necessary to meet the most basic domestic needs and remain just above the poverty line:

> "Historically, insolvency systems looked to the debtor's assets as the sole source of value to be distributed among creditors in payment of their claims. There is one system that uniquely relies on debtors themselves to sell their own assets and distribute the value to creditors before seeking relief, as a sign of the debtor's seriousness about dealing with her debt problems and responsibly applying available value. In virtually every other system, however, a public administrator or trustee of some kind is appointed to inventory, collect, and sell the debtor's assets to produce value for creditors. A notable trend has developed in many insolvency and creditor/debtor regimes to abandon exclusive reliance on public auctions for such sales and instead to give the insolvency representative flexibility to choose to dispose of the debtor's assets in private sales if that solution is likely to produce greater value for creditors.
>
> Most modern systems continue to take the approach of focusing on the debtor's assets, at least initially (for a discussion of payment plans, see below in section II.5.B), but usually this is little more than a formality. Practically, the overwhelming majority of debtors in every existing system of insolvency for natural persons have proven to have few if any assets of any value that are available for liquidation and distribution to creditors. Consequently, several systems have all but abandoned the step of attempting to liquidate the debtor's available assets unless the debtor appears to have substantial assets to warrant the significant administrative expenses of the inventory and liquidation process.
>
> One reason for the paucity of debtor assets is that most societies have decided that debtors cannot be left with no assets whatsoever with which to support themselves and their families. Any discussion of liquidation of debtors' assets must therefore focus on which assets are not available as a matter of law, as very few other assets of any value are likely to be available as a matter of practical reality."[510]
>
> "Historically, most systems set exempt property levels at very low levels. In some areas, the fact that exemption provisions set a low monetary limit to the total value of goods that the debtor may retain, inclusive of tools of the trade and necessary wearing apparel and bedding of himself and his dependents, reflects a harsh approach, operating in a cultural environment in which creditors were skeptical about the bona fides of bankrupt

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[508] **INSOL International, International Federation of insolvency professionals**, "*Consumer Debt Report - Report of Findings and Recommendations*", (2001), at 74-5.

[509] See Chapters IV and V.

[510] **Vv. Aa., The World Bank**, "*Insolvency and Creditor/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), at 74.

> debtors, and granting debtors just the bare minimum. A problem that arises with outdated provision for exemptions is that they become unworkable and ignored in practice."[511]

> "Historically, the level of exempt assets for debtors left them but slightly above the poverty line. The modern trend is to enable debtors to have a true fresh start and the debate revolves around defining the level of sufficiency." [512]

> "The limitations as to both the amount and the scope of the exempt assets in these old laws are far from reasonable by modern standards, and they left many debtors in a depressed state, sacrificing their future contributions to society. Over the years, in many countries adopting this approach, if the levels and the scope of the exemptions were not increased, the limits were often ignored in practice." [513]

With time, the needs of societies and markets have changed. The modern view has turned to a more debtor-friendly approach. As discussed in the previous sections, it is more common, today, to deem the award of an effective fresh start to honest debtors beneficial for the whole community and not just for directly interested parties. In order to make a good use of such an opportunity, debtors need a base to build on; a fully impoverished individual will have little chance to return to productivity.

How rich such a base should be is a matter of discussion and interpretation; systems vary greatly in their approach and much depends on other local factors. We will have a chance to discuss the depth of such differences more in Chapter V, when we analyze local and federal exemption statutes in America. For now, it will be sufficient to mention some basic information on how rules may be crafted.

Several methods are used to design effective and efficient exemption statutes.

Some identify specific items that should be spared from distribution due to their relevance for the future life of the individual (for example, a wedding ring or a family's automobile). Others select categories or groups of assets (using our previous example, we would be speaking of jewelry and vehicles), giving the debtor more power to decide what he wishes to protect upon having different options. Statutes may provide a maximum value up to which a specific good can be shielded (although, in some cases, the exemption may be unlimited as long as certain assets fit in an exempted category):

> "This approach grows out of the approach in many systems for providing protection for debtors from the execution (usually post-judgment) against a debtor's assets. In such systems, the exemptions that are provided to a debtor depend on a variety of factors, such as where a debtor lives, what the debtor's profession is, and whether the debtor has a family. Thus, the exemptions, and values of exempt property, might be different in farming and urban areas; or might be different for individual debtors and debtors with families. In the systems that follow this approach, the law sets out a broad range of categories of assets that the debtor may seek to exempt including family homes, automobiles, household goods and furnishings, and tools of the trade."[514]

The following items of property are often protected, at the least partially, by exemptions included in modern insolvency frameworks[515]:

1) **The family home**[516]: a debtor's home usually is the most valuable asset available. Protecting it relieves the debtor and his or her family of much stress and ensures greater cooperation. However,

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[511] *Id.,* at 75.
[512] *Id., at* 82.
[513] *Id.,* at 76.
[514] **Vv. Aa., The World Bank**, "*Insolvency and Creditor/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), at 77.
[515] Reifner Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga, "Consumer over-indebtedness and consumer law in the European Union". Presented by the institute for financial services e.V., Erasmus University Rotterdam/School of law, University of Helsinki/Helsinki Collegium for Advanced Studies, to the Commission of the European Communities, Health and Consumer Protection Directorate-General, (2003), at 183-4.

shielding part or all of the value of such major item of property may deprive creditors of all of their chances of recovery.

This is a particularly relevant topic today considering the difficulties faced by many as a consequence of the mortgage crisis[517].

Systems have approached this issue providing a variety of solutions[518]. Some exempt the whole asset; others do not provide any protection. Some provide exemptions up to a certain value; others up to a certain size.

Nevertheless, it is important to remember that exemptions usually have no impact on the rights of secured creditors:

> "Policymakers generally fear that any undermining of the rights of secured creditors will have a broad and deeply detrimental effect on the availability of credit to finance important social activities, especially home acquisition. In societies where home acquisition lending is widespread, such high-value lending activity is often a central component of national financial markets and a foundation for a healthy economic system. A broad array of benefits flow both from the activity of lending and the stability that broad-based home ownership provides as a societal support for economic activity. As lenders collect large portfolios of claims secured by home mortgages, the value of these rights to collect—and the value of the home assets backing up the right to collect—becomes a vital component of the balance sheets and financial health of these banks. In many countries, it has been argued that any significant weakening of the value of creditors' rights to collect claims secured by home mortgages could have devastating impacts on the health of broad segments of the lending sector."[519]

2) **Automobiles**[520]: many statutes exempt cars, motorbikes, or other vehicles. At times, this protection may not be awarded under a specific "automobile exemption" but it may be available by inclusion in other groups, such as a homestead exemption encompassing trailer homes or "wild card" exemptions which allow a debtor to protect a certain value in any property of his choice.

> "In some systems, if the debtor is unable to use up the exemption limits in some categories of assets (e.g., the family home) the debtor may instead apply the unused amount (perhaps up to a limit) to other assets. Some systems even allow the debtor to sell off some assets to buy exempt assets. To take this to the limit, in those places where the exemption law places the family home entirely outside the reach of creditors, there are incentives for debtors to buy as expensive a house as they can afford. This behavior would not be considered fraudulent in such systems because the debtor is merely taking advantage of an available exemption in the law. To prevent these types of machinations some systems have established a limit on the value of a home that may be exempted for those debtors who have purchased the home within a certain period (perhaps as long as 3 or 4 years) leading up to the insolvency case."[521]

By protecting vehicles, statutes attempt to ensure that debtors can take care of basic needs, such as commuting to their place of employment. This is necessary to ensure that they may reorganize their finances following a plan.

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[516] Concerning a variety of dwellings and residential property in rural and city areas. Some statutes protect, for example, mobile homes, plots of land and even boats (see tables).

[517] *Id.,* at 112-3.

[518] **Vv. Aa., The World Bank**, "*Insolvency and Creditor/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), at 79.

[519] **Vv. Aa., The World Bank**, "*Insolvency and Creditor/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), at 106.

[520] *Id.,* at 80 - Concerning a variety of vehicles depending on statutes.

[521] *Id.,* at 234.

Motor vehicles, though, are another item of great value in an estate. Protecting them for high amounts often deprives creditors of the opportunity of obtaining something out of the distribution process.

3) **Household furnishings**[522]**; musical instruments; family pictures and other personal items**: these groups are part of a variety of generic categories that cover items that should be of little or no commercial value, but are of great importance and use to debtors.
Great issues of valuation, though, may arise. A statute exempting musical instruments, for example, would aim to serve a valuable social and cultural purpose. When the instrument which is awarded special protections is a priceless Stradivarius violin, though, things change. It may be, in fact, an attempt to defraud creditors.
4) **Salaries and pension plans**[523]: frameworks apply a variety of formulas to ensure that a debtor is not left in absolute poverty. Most systems, moreover, strategically protect parts of the debtor's future earnings so that he or she can provide for himself/herself and his or her family while increasing the chances of repaying higher portions of his or her debts.
5) **Professional books, tools of trade, equipment**[524]: this particular exemption has been applied in business systems and it has a long history. The taking of professional books and tools from artisans has been historically equal to ousting them from the market or preventing them from working. Protections have been developed over time, therefore, to allow debtors to retain such items so that through their work they could repay portions of their debts.

A great variety of items can, therefore, be protected through exemptions, which in a relevant number of cases shield the majority, if not all, of the value present in an individual's estate and limit the proceeds available for distribution to the creditors. The opportunities presented by such benevolent statutes may, therefore, induce bankrupts into temptation. They may for example:

- use the remaining liquidity to buy, before filing, items that they know will be protected under the available exemption statute;
- change their habits and sell items that would not be protected, converting them into others that would be;
- interpret the rules to achieve goals that have little to do with the original policies that animated them (just like in the Stradivarius example);
- move to other territories where they would be allowed to retain more property (forum shopping).

Insolvency frameworks must try to impose a strict balance and punish such behaviors. Finding an effective formula, though, is a major challenge and solutions vary greatly among local settings.

3.6.4 Discharge and exceptions to discharge[525]

Exemptions alone cannot guarantee debtors the support that they need to start over[526]:

> "In some systems, property exemptions function as an imperfect alternative to an insolvency relief regime. In these systems, exemptions have played the role, historically, of alleviating the condition of the insolvent debtor, especially in the absence of a discharge. However, the effects of exemptions are insufficient to provide debtors with a real opportunity for starting anew. While insolvency relief conclusively limits creditors' rights and offers debtors a fresh start and new incentives for future productivity, exemptions generally do not limit creditors' rights over time. That is, while debtors derive some protection from exemptions, their incentives for productivity remain depressed because any future excess property or earnings beyond the exemption limits remain available to

[522] *Id.,* at 80.
[523] *Id.,* at 80.
[524] *Id.,* at 81.
[525] *Id.,* at 115.
[526] See **Kilborn Jason J.**, "*Elaborating UNCITRAL's Legislative Guide on Insolvency Law: Principles for Natural Persons*", (2016), at 7-10.

> creditors, often indefinitely. An exemptions regime is thus insufficient to achieve most of the benefits of an insolvency system."[527]

Ample discharge rules should, therefore, also be made available to allow frameworks to support natural persons effectively:

> "One of the principal purposes of an insolvency system for natural persons is to re-establish the debtor's economic capability, in other words, economic rehabilitation. Rehabilitation can be said to include three elements. First, the debtor has to be freed from excessive debt. Second, the debtor should be treated on an equal basis with non-debtors after receiving relief (the principle of non-discrimination). Third, the debtor should be able to avoid becoming excessively indebted again in the future, which may require some attempt to change debtors' attitudes concerning proper credit use. Awarding discharge to honest debtors is one of the most relevant purposes of insolvency systems for natural persons."[528]

Discharge, though, is a privilege that should not be awarded lightly.

Several requirements are usually imposed to ensure that debtors are "worthy". Insolvency frameworks generally mandate for a debtor to cooperate fully and honestly with the proceeding. Systems may also demand that a minimum amount of debts is paid before such a benefit is obtained.[529]

Fraudulent behaviors and dishonesty in general undermine the trust of the public in the whole system and should be heavily sanctioned.

At the same time, when a discharge is well deserved, it should be easily accessible or automatic. There should be as little administrative or procedural burdens as possible, since it is in the interest of the system to guarantee that worthy individuals take advantage of it.[530]

Nevertheless, even if a debtor does deserve to be supported through an order of discharge, an optimal framework reduces the amounts of debts pending on his head, though it does not wipe all of them out. The intricate balance among interests in bankruptcy includes classes of claims which deserve, by the standards of our societies, special protections and that are, therefore, usually non-dischargeable even by honest debtors. Such claims are shielded by relevant public interests. The following list includes some of the most common ones and a brief explanation of the reasons that justify each exception:

- **Maintenance and support obligations.**[531] This is a commonly applied exception. It protects relevant rights based on strong social policies.

> "The most important and common exceptions apply to maintenance obligations to children and perhaps former spouses. These debts are generally excluded from the discharge for several closely related reasons of fundamental public policy. Insolvency policy generally concerns proper allocation of responsibility and burden, and most systems are simply unwilling to allow the debtor's most fundamental responsibility, to family, to be avoided, nor to allow debtors to externalize this burden onto other, equally vulnerable parties. The creditors in family support claims are regarded as among the most sensitive to disruptions in their rights, and depriving them of their claims to necessary support would endanger their basic welfare and undermine a public policy of family support just as fundamental as the policy of freeing the debtor from undue financial burdens. The notion of family responsibility creates a "non-market" obligation

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[527] **Vv. Aa., The World Bank**, "*Insolvency and Creditor/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), at 75.

[528] *Id.,* at 115.

[529] *Id.*

[530] **Reifner Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga**, "*Consumer over-indebtedness and consumer law in the European Union*", Presented by the institute for financial services e.V., Erasmus University Rotterdam/School of law, University of Helsinki/Helsinki Collegium for Advanced Studies, to the Commission of the European Communities, Health and Consumer Protection Directorate-General, (2003), at 177.

[531] **Vv. Aa., The World Bank**, "*Insolvency and Creditor/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013), at 119.

that is regarded as outside the appropriate realm of insolvency relief. While many non-business and even non-financial debts are included within the discharge for natural persons, the focus of insolvency relief remains largely concentrated on debts created in the commercial marketplace, rather than within the intimate confines of the home and family relations."[532]

- **Fines and taxes.**[533] A variety of taxes have been traditionally enjoyed special protections in the insolvency context. The modern trend is to pose limitations to such special status.

"A number of countries in recent years, however, have repealed special priorities and exceptions to discharge for taxes and other government debts for at least two reasons. First, taxes in particular are often among the largest debts contributing to a debtor's insolvency, especially for current and former small business people. If government debts are not subject to discharge, that undermines the entire insolvency relief system, depriving debtors, creditors, and society of the many benefits of relief discussed in section I.9, above. More and more legislatures have accepted that, if they are willing to force "ordinary" creditors to forego their legitimate claims against debtors, then the state, too, should be willing to play by the same rules and support the relief system, at least for non-punitive debts like taxes and fees. Second, if taxes are not excluded from discharge, they are probably also entitled to a privilege that entitles them to payment before any other creditor. This has been criticized as quite unfair against other creditors, and as legislatures have been convinced to repeal the privilege for taxes, so also their exclusion from discharge has been repealed, at least in some cases. Indeed, some countries that retain the privilege and exclusion from discharge for taxes in business insolvency have abolished it in relief procedures designed for natural persons engaged in little or no business activity."[534]

- **Educational loans**. This particular category is often mentioned due to the importance, within the American system, of student loans, which impact an individual's finances in an extremely relevant manner. Policies on instruction differ greatly among countries, though. In Europe, for example, a number of Member States have limited costs for education, even at the university level, and therefore the application of such an exception may not be necessary.[535] This category shows, therefore, the importance to adapting rules to the society they are enacted within.

3.6.5 Ensuring that debtors will not face discrimination after obtaining discharge

Punishing debtors is not a primary goal of modern insolvency frameworks for natural persons:

"Punishment of debtors is clearly not among the aims of consumer insolvency regulations. This is a clear distinction in the bankruptcy laws of some countries in that punitive measures, such as restrictions on access to credit and prohibitions on acting as executives of companies, are still connected with bankruptcy." [536]

A certain level of social control and deterrents are, nevertheless, necessary in order to maintain a healthy balance within the system and to prevent abuses which lead to a widespread lack of trust in the system:

"There are, however, characteristics that add a flavour of social control to many consumer insolvency procedures. For example, Scandinavian laws regulate access to the debt adjustment procedure with moral attributes, and the exclusion of certain debtors as a

[532] *Id.,* at 119.
[533] *Id.*
[534] *Id.,* at 120.
[535] This is an important point that will be discussed further in the next chapters. Student loans exemptions are a valuable example of how policies, and therefore local bankruptcy rules, vary (greatly) among national settings.
[536] **Reifner Udo, Kiesilainen Johanna, Huls Nik, Springeneer Helga**, "*Consumer over-indebtedness and consumer law in the European Union*", Presented by the institute for financial services e.V., Erasmus University Rotterdam/School of law, University of Helsinki/Helsinki Collegium for Advanced Studies, to the Commission of the European Communities, Health and Consumer Protection Directorate-General, (2003), at 169.

> result of excessive borrowing has a punitive character. Under Austrian and German law, the social control of the debtor is linked with the payment plan since the debtors behaviour during the plan is assessed after completion of the plan, and the discharge may be dismissed in the case of misbehaviour."[537]

Deterrents and punishments, though, are primary sources of stigma and should, therefore, be balanced with great care. Such care in drafting the rules helps to ensure that deserving petitioners and the enacted framework may perform at their best. But there is more. Stigma is a great burden on natural persons; it affects the debtors, their families, and others depending on them, and it may lead to irreparable consequences even after the successful closure of a proceeding.

Being discharged, in fact, does not protect debtors from several of the negative consequences of bankruptcy.

Despite the end of the proceeding society, may still reject, or oust, the debtor. It may treat him and his relatives as second class citizens. It may deprive him of some of his rights or disqualify him holding an active role in the market. It may prevent him from obtaining licenses, or from applying for certain employment positions.

The U.S. bankruptcy code, as we will discuss in Chapter V, with its unique approach and formula, takes direct action in an attempt to ensure that there will be no discriminations on relevant areas that may impact the life of honest, discharged debtors. Section 525 of the Code is an extremely interesting sign of the concrete steps that can be taken within local insolvency frameworks to award a real and meaningful fresh start and, therefore, to ensure trust in the insolvency system and its effective operation.[538]

4. Conclusion

In this chapter, we have discussed several modern best practices which can be deployed to improve local bankruptcy laws. Evaluations on what constitutes an improvement are made based on the capacity of local systems to interact within the globalized (credit) economy. The different documents we discussed also showed the process for modifying such best practices and how they changed within less than two decades. Relevant elements have been added, for example the recent studies on overindebtedness.

Our analysis has shown a high degree of convergence between the strategies adopted at the European level within the process of refoundation and the topics discussed by the World Bank and other relevant international organizations. Effectiveness and efficiency within local insolvency models, today, seem to have acquired some precise, market-related traits. We have seen for example how modern guidelines:

- expand access criteria;
- limit exclusions from bankruptcy;
- incentivize reorganizations and quick discharges for honest debtors;
- "destigmatize" systems; and
- promote cooperation among interested parties;

in an attempt to improve core aspects of commercial law systems, which are fundamental to support a sound investment environment[539].

Such elements, though, are not yet universal in their application. We have observed, in fact, how local models must respond to national needs and problems.[540] As suggested by the World Bank, which designed

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537 *Id.,* at 169.

538 See the more detailed discussion in Chapter V .

539 **The World Bank**, "*Principles for effective insolvency and creditor/debtor rights systems*", (2015), at 2: "Efficient, reliable, and transparent creditor/debtor rights and insolvency systems are of key importance for the reallocation of productive resources in the corporate sector, for investor confidence, and for forward-looking corporate restructuring. These systems also play a pivotal role in times of crisis to enable a country and stakeholders to promptly respond and to resolve matters of corporate financial distress on systemic scales."

540 *Id.*

flexible building blocks for reform, reforms must be rooted in a country's broader cultural, economic, legal, and social context to produce good results.[541]

Societies differ greatly from each other; hence, local frameworks seem to be condemned to present low levels of uniformity. This is a problem based on what we have discussed in Chapter I.

The Union needs to push Member States toward refounding local systems, but also toward much greater levels of harmonization to support its development and to strengthen its common market.

In the next chapter, we will focus on examining elements which impact the levels of effectiveness and efficiency of insolvency models from a transnational, cross-border point of view. We will analyze how the globalization of the modern market has called for renewed attention to the field of international bankruptcy law and the difficulties that are met in structuring supranational systems.

To better understand this complex topic, we will compare traditional and modern approaches. We will discuss, in particular: some important regional agreements; the ABA Concordat; the UNCITRAL Model Law; and, of course, the European Regulations on this topic. The information we collect will shape our understanding of how to pursue the following goals in a way that is congruent with the strategies of the European Union:

- refounding insolvency systems for business debtors;
- adopting effective and efficient bankruptcy systems for non-business debtors;
- harmonizing local regulations;
- enacting an effective cross-border model.

Although some improvements have been made and some goals have been reached in these areas, it seems that an impasse is still preventing the EU from hitting the jackpot. Such an impasse acts as a major barrier to the development of the ten-year plans and stalls progress.

[541] **Leroy Anne-Marie, Grandolini Gloria M.**, "*Principles for effective insolvency and creditor and debtor regimes (English)*", Washington, D.C.; World Bank Group, (2016), at 2.

CHAPTER III.
DEVELOPING EFFECTIVE AND EFFICIENT CROSS-BORDER INSOLVENCY MODELS

1. Introduction

We have just discussed those best practices that can increase the levels of effectiveness and efficiency in modern, local insolvency frameworks. In the next pages we will examine the above-mentioned elements within the transnational context. International aspects of bankruptcy regulations are extremely relevant today.[542]

As discussed in Chapter I, the lack of uniformity and of coordination among local models leads to a number of perverse effects, such as forum shopping[543]; it increases the costs of proceedings[544] and it causes markets to lack of transparency and predictability, decreasing the propensity of investors to take action. Ultimately, this factor acts as powerful barrier to the development of competitive and globalized markets.[545]

The need to find effective formulas for international cooperation in the field of insolvency law, though, is not modern; it has ancient origins.[546] The ongoing expansion of the global market and the magnitude of the recent economic crises have called for renewed attention to this important area, as the number of cases grows exponentially and threatens local economies.[547]

> "Traditionally, national governments could focus on their domestic economies without undue attention to international issues. Today, however, a country's policymakers must respond to the growth in international business activity with appropriate legal changes, Failure to do so will cause their regimes to fall further and further out of step with the

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[542] See for a general introduction on this topic: **Wessels Bob, Hon. Markell Bruce A., Kilborn Jason**, "*International cooperation in Bankruptcy and insolvency matters*"; Oxford University Press, Oxford, (2009); **Omar, P. J.**, "*International insolvency law: themes and perspectives: markets and the law*", Ashgate, Aldershot, England, (2008).

[543] Trying to prematurely uniform approaches to bankruptcy before removing first all the many, sharp, differences among international bankruptcy codes would result in "rampant forum shopping" by multinational companies and "their financiers for favorable systems and the rise of offshore bankruptcy heavens that would specialize in providing such systems". See **LoPucki Lynn M**., "*The Case for Cooperative Territoriality in International Bankruptcy*", 98 Mich. L. Rev. 2216, (2000), at 2251. See also: **LoPucki Lynn M**., "*Cooperation in International Bankruptcy: A Post-Universalist Approach*", 84 Cornell L. Rev. 696, (1999), at 720-723, and **LoPucki Lynn M., Withford William C**., "*Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies*", Wis L. Rev. 11, (1991), at 11 quoting: **LoPucki Lynn M., Withford C.,** "*Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*", 139 U. Pa. L. Rev. 125, (1990): "An empirical study of the bankruptcy reorganization of the forty-three largest, publicly held companies to file and complete bankruptcies from 1979 to 1988 revealed extensive forum shopping. […] In a substantial number, the petitioning company engaged in "forum shopping" by choosing a venue where the company had little or no physical presence. […] In their venue choices, petitioners usually sought to avoid venues that appeared hostile…].

[544] **Westbrook Jay L.,** "*Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*", 65 Am. Bankr. L.J. 457, (1991); at 458-9, 1991, "Furthermore, the current methods of handling cross-border insolvency cases present foreign investors with tremendous risk and uncertainty, leading to a disincentive to partake in transnational investments". **Isham Sara**, *"Uncitral's model law on cross-border insolvency: a workable protection for transnational investment at last*", 25 Brook. J. Int'l L. 1117, (2001), at 1177.

[545] See on this topic **Halliday T.C., Carruthers B.G**., "*Bankrupt: global lawmaking and systemic financial crisis*" Stanford University Press, Stanford, (2009).

[546] This topic will be discussed in greater depth in Chapter IV.

[547] **Gerber Elizabeth J**., "*Not all politics is local: the new Chapter 15 to govern cross-border insolvencies*", 71 Fordham L. Rev., 2051, (2003), at 2051-2.

> needs of the global marketplace. The exact content of the changes to be made, however, remains uncertain."[548]

The European Union has attempted to create an efficient and effective international framework to direct and coordinate the efforts of its Member States for decades. It achieved this target in 2002, with the enactment of the Regulation on cross-border insolvencies, which was updated and modified in 2017. Much, nevertheless, remains to be done.

2. International bankruptcy issues

The complex issues arising with regard to cross-border insolvency cases cannot be said to be new or modern. They have been manifesting themselves ever since the early expansions in trade. In Chapter IV, we will briefly discuss this topic, mentioning some of the rules and principles which constituted international frameworks in the 12th-18th centuries. It will be an occasion to learn about the issues faced by our ancestors, the solutions they provided, and an interesting and useful element of comparison with more modern ones.[549]

With regard to initiatives that took place in more recent times (between the 19th and the beginning of the 20th century), which are more closely related to our current topic of discussion, it is possible to mention several examples of international agreements stipulated at a regional level:

- The Bustamante Code of Private International Law (together with the Treaty of Havana on Private International law) of 1928;
- The Montevideo Treaties of 1889 and 1940;
- The Copenhagen convention among Scandinavian countries (Denmark, Sweden, Finland, Norway, and Iceland), signed at the Nordic Convention of 1933.[550]

Such regional agreements were conceived to bring stability within specific areas characterized by frequent international trade, mostly happening between the same parties[551].

These agreements, though, have proven to be inadequate palliatives. The advantages that could be reached though their adoption were limited[552] and mostly, if not exclusively, confined to the signing parties. The effort needed to negotiate, write, and approve such conventions was often not proportional to the benefits that could derive from their enactment:

> "In addition to the lack of national law reform efforts, there has been a lack of multilateral treaty arrangements with global effect. A few treaties have been negotiated at a regional level, but those arrangements are generally only possible (and suitable) for countries of a particular region whose insolvency law regimes and general commercial laws are similar. Experience has shown that despite the potential of international treaties to provide a vehicle for widespread harmonization, the effort required to negotiate such treaties is generally substantial and, as one commentator has noted, the greater the degree of practical utility that is pursued by means of a treaty, the greater the difficulty in bringing it to fruition and the greater the risk of ultimate failure. The search for comity in insolvency in Europe provides a good example. Beginning in 1960 the intention was to develop a bankruptcy convention that would parallel the 1968 Convention on Jurisdiction and the

[548] **Guzman Andrew T**., "*International bankruptcy: in Defense of Universalism*", 98 Mich L. Rev. 2177 (2000), at 2177.
[549] **Anderson Kent**, "*The cross-border insolvency paradigm: a defense of the modified universal approach considering the Japanese experience*", 21 U. Pa. J. Int'l Econ. L. 679, (2000), at 680; See also the discussion in Chapter IV.
[550] November, 7, 1933; between Denmark, Sweden, Norway, Finland.
[551] **UNCITRAL (United Nations Commission on International Trade Law),** "Practice guide on cross-border insolvency cooperation", United Nations, New York, ISBN 978-92-1-133688-7, (2010), at 15.
[552] "While no doubt improving the situation among those contracting States, the increasing globalization of business and investment and the consequent spread of international insolvencies is likely to include non-participating States, underlining the limitations inherent in any regional treaty regime. Nevertheless, regional arrangements may prove to be a useful starting point for broader cooperation." **UNCITRAL (United Nations Commission on International Trade Law)**, "*Practice Guide on cross-border insolvency cooperation*", United Nations, New York, ISBN 978-92-1-133688-7, (2009), at 15.

> Enforcement of Judgments in Civil and Commercial Matters. These efforts led to the 1990 European Convention on Certain International Aspects of Bankruptcy (the Istanbul Convention). Following only one ratification (Cyprus), the 1990 Convention was superseded by a draft European Union convention on insolvency proceedings. Although European Union Member States came close to adopting that draft convention in November 1995, implementation ultimately proved impossible. The convention was revived in the form of a European Council regulation in May 1999, which was adopted by the Council on 29 May 2000 and came into effect on 31 May 2002."[553]

The magnitude of the consequences of major cross-border bankruptcies in recent decades, and the need to find ways to promote investments, has called for renewed attention in the field of international insolvency laws in an attempt to find more effective and efficient solutions.[554] The task, though, is great. Countless differences separate local models and pose obstacles to their interaction and cooperation, ultimately affecting the levels of transparency and predictability within markets and discouraging investments and damaging interested parties:

> "Large differences exist among the bankruptcy laws of different countries. Several examples illustrate these differences: (1) The laws of some countries treat a creditor with a right to set off as secured; the laws of others threat them as unsecured. (2) In some countries tort creditors share pro rata with commercial creditors; in other countries, tort creditors are subordinated to commercial creditors; and in yet others, tort creditors who have not yet reduced their claims to judgments before bankruptcy do not share at all. (3) In some countries employees are willing to extend substantial credit to their employers, because they know they will have first priority –ahead of even secured creditors—in the factories in which they work; in other countries such extensions would be foolish because employee's priorities are limited sharply or even nonexistent. These differences in legal doctrine occur against even sharper differences in system operation. In some countries bribery is common. In others –particularly small nations—the local courts might be under the corrupt influence of a multinational company based there."[555]

> "In addition to the inadequacy of existing laws, the absence of predictability as to how they will be applied and the potential cost and delay involved in application has added a further layer of uncertainty that can impact on capital flows and cross-border investment. Acceptance of different types of proceedings, understanding of key concepts and the treatment accorded to parties with an interest in insolvency proceedings differ. Reorganization or rescue procedures, for example, are more prevalent in some countries than others. The involvement of and treatment accorded to secured creditors in insolvency proceedings vary widely. Different countries also recognize different types of proceedings with different effects. An example in the context of reorganization proceedings is the case in which the law of one State envisages a debtor in possession continuing to exercise management functions, while under the law of another State in which contemporaneous insolvency proceedings are being conducted with respect to the same debtor, existing management will be displaced or the debtor's business liquidated. Many national insolvency laws have claimed, for their own insolvency proceedings, application of the principle of universality, with the objective of a unified proceeding where court orders would be effective with respect to assets located abroad. At the same time, those laws do not accord recognition to the universality claimed by foreign insolvency proceedings. In addition to differences between key concepts and treatment of

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[553] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Practice Guide on cross-border insolvency cooperation*", United Nations, New York, ISBN 978-92-1-133688-7, (2009), at 10.

[554] "Not since the economic catastrophe of the second and third decades of the Twentieth century has there been so much worldwide concern with the reform of laws governing the general default of an enterprise". See **Westbrook Jay L.**, "*Multinational Enterprises in General Default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1, (2002), at 1.

[555] **LoPucki Lynn M**., "*The Case for Cooperative Territoriality in International Bankruptcy*", 98 Mich. L. Rev. 2216, (2000), at 2224.

> participants, some of the effects of insolvency proceedings, such as the application of a stay or suspension of actions against the debtor or its assets, regarded as a key element of many laws, cannot be applied effectively across-borders."[556]

> "An insolvency law that will treat foreign and domestic creditors equally will aid the inflow of foreign investment.[…] If the nations adopt similar laws, a uniform insolvency law, investors and creditors will not waste resources and time examining and interpreting the laws of each individual nation."[557]

Several studies have been concerned with this issue and different models have been proposed by international organizations. Unfortunately, players in the globalized market are often unwilling to sacrifice control over proceedings and wish to apply local regulations, privileging national interests. An ongoing mediation process has started in an attempt to take steps forward, finding solutions that could be widely accepted and shared.

> "Although the number of cross-border insolvency cases has increased significantly since the 1990s, the adoption of legal regimes, either domestic or international, equipped to address cases of a cross-border nature has not kept pace. The lack of such regimes has often resulted in inadequate and uncoordinated approaches that have not only hampered the rescue of financially troubled businesses and the fair and efficient administration of crossborder insolvency proceedings, but have also impeded the protection and maximization of the value of the assets of the insolvent debtor and are unpredictable in their application. Moreover, the disparities and, in some cases, conflicts between national laws have created unnecessary obstacles to the achievement of the basic economic and social goals of insolvency proceedings. There has often been a lack of transparency, with no clear rules on recognition of the rights and priorities of existing creditors, the treatment of foreign creditors and the law applicable to cross-border issues. While many of these inadequacies are also apparent in domestic insolvency regimes, their impact is potentially much greater in cross-border cases, particularly where reorganization is involved."[558]

Over the centuries, different approaches have been applied in structuring models of international cooperation in cross-border insolvency cases. The two main ones are defined: "territorialism" and "universalism". They can be briefly summarized as follows:

Territorialists follow the *lex situs.*[559] This is the traditional, more "primitive"[560] approach, also eloquently referred to as the "the grab rule."[561] The basic idea is that a country has the exclusive right to apply its substantive laws within its borders.[562] Hence, independent bankruptcy proceedings should be

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[556] **UNCITRAL (United Nations Commission on International Trade Law),** "*Practice guide on cross-border insolvency cooperation*", United Nations, New York, ISBN 978-92-1-133688-7, (20010), at 9.

[557] **Devling Brian M**., "*The continuing vitality of the territorial approach to cross-border insolvency*", 70 UMKC L. Rev. 435, (2001).

[558] **UNCITRAL (United Nations Commission on International Trade Law),** "*Practice Guide on cross-border insolvency cooperation*", United Nations, New York, ISBN 978-92-1-133688-7, (2009), at 9.

[559] **Pottow John A.E**., "*Symposium; Bankruptcy in the Global Village the Second Decade, Co-Sponsored by the Brooklyin Law School Center for the Study of International Business Law*", 32 Brook J. Int'l L. 785 (2007), at 2.

[560] **Westbrook Jay L**., "*Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*", 65 Am. Bankr. L.J. 457, (1991), at 460.

[561] *Id.,* at 460. See also: **Guzman Andrew T**., "*International bankruptcy: in Defense of Universalism*", 98 Mich L. Rev. 2177, (2000), at 2179.

[562] **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry**, "*A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group*", The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010), at 229-230; **LoPucki Lynn M**., "*Cooperation in International Bankruptcy: A Post-Universalist Approach*", 84 Cornell L. Rev. 696, (1999), at 700-2; **LoPucki Lynn M.,** "*The Case for Cooperative Territoriality in International Bankruptcy*", 98 Mich. L. Rev. 2216 (2000), at 2218.

opened in every country in which assets of the debtor are present[563], allowing an easier piecemeal liquidation of the patrimony of the estate.

Universalists follow the *lex fora.*[564] This is the more modern[565] approach to cross-border insolvency cases.[566] Its strictest, purest expression postulates that there should be just one proceeding commenced in the location of the home country of the debtor and, consequently, one court administering, it following a single set of substantive and procedural insolvency rules governing the whole liquidation or reorganization of the international debtor.[567] [568] [569] Hence, the local insolvency framework would expand beyond national borders to reach all of the debtor's assets, no matter the jurisdiction they may be located in.

Both approaches have shown relevant weaknesses that prevent them from being the answer to the modern issues faced in global market. The following brief sections will analyze such weaknesses and present possible alternatives that have been conceived to bring improvements.

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[563] See **Westbrook Jay L**., "*Multinational Enterprises in General Default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1, (2002), at 5-6: "It rests upon a notion of national sovereignty, but its central characteristic is the idea of 'vested rights' which has also been at the heart of traditional ideas of private international law (conflicts of law, in United States terminology). In this approach, national sovereignty imposes the law of the sovereign on all within territorial reach, and that law grants vested rights in assets so situated at the time an insolvency is instituted. Thus the law of the *situs* controls distribution of those assets, a system which was assumed to benefit local creditors. Given that system, the local law was generally applied to all or most issues, not merely distribution".
See also **LoPucki Lynn M**., "*The Case for Cooperative Territoriality in International Bankruptcy*", 98 Mich. L. Rev. 2216, (2000), at 2218: "When applied to the bankruptcy of a multinational company, territoriality means that the bankruptcy courts of a country have jurisdiction over those portions of the company that are within its borders and not those portions that are outside of them."

[564] **Pottow John A.E.,** "*Symposium; Bankruptcy in the Global Village the Second Decade, Co-Sponsored by the Brooklyn Law School Center for the Study of International Business Law*", 32 Brook J. Int'l L. 785, (2007), at 2.

[565] See **Guzman Andrew T**., "*International bankruptcy: in Defense of Universalism*", 98 Mich L. Rev. 2177, (2000); quoting also **Lowell John**, "*Conflict of Laws as Applied to Assignment of Creditors*", 1 Harv. L. Rev. 259, (1888), at 264: "In recent years, the increased number of international insolvencies has brought attention to the question of how to deal with international bankruptcies. That said, it must be noted that cross-border business failures are new to neither the business work nor academia. Nor has there been a great shift in the perspective of legal academics over the years - *it is obvious that…it would be better in nine cases out of ten that all settlements of insolvent debtors with their creditors should be made in a single proceeding, and generally at a single place".*

[566] "Universalism – administration of multinational insolvencies by a leading court applying a single bankruptcy law – is necessarily the correct long term solution. Bankruptcy is one of those laws that cannot perform its function unless it is symmetrical to the market in which it operates". See **Westbrook Jay L.**, "*A Global Solution to Multinational Default*", 98 Mich. L. Rev. 2276, (2000), at 2277.

[567] **Westbrook Jay L**., "*Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*", 65 Am. Bankr. L.J. 457, (1991), at 464: "The home-country law is the one law that can be most reliably predicted in advance". See for a critique of this approach **LoPucki Lynn M**., "*The Case for Cooperative Territoriality in International Bankruptcy*", 98 Mich. L. Rev. 2216, (2000); at 2216-7.

[568] **Gerber Elizabeth J**., "*Not all politics is local: the new Chapter 15 to govern cross-border insolvencies*", 71 Fordham L. Rev., 2051, (2003), at 2055-2057; **LoPucki Lynn M**., "*Cooperation in International Bankruptcy: A Post-Universalist Approach*", 84 Cornell L. Rev. 696, (1999); at 699: "Under universalism, one court plays the tune, and everyone else dances."

[569] "The central theoretical point is "market symmetry": the requirement that some systems in a legal regime mist be symmetrical with the market, covering all or nearly all transactions and stakeholders in that market with respect to the legal rights and duties embraced by those systems". **Westbrook Jay L**., "*Multinational Enterprises in General Default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1, (2002), at 6; see also **Westbrook Jay L.,** "*Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*", 65 Am. Bankr. L.J. 457, (1991), at 461.

3. International approaches to solve cross-border insolvency issues

3.1 Territorialism

> "For centuries, jurisdictions followed the so called territoriality principle; i.e. they closed their doors to foreign administrators (and creditors as well) and did not allow their law to reach out beyond the borders of their respective jurisdictions."[570]

In a "territorialist" system, eventual cross-border controversies would be solved in an effective[571] manner, by the application of local rules.[572] This *in rem* approach[573] sees creditors eventually filing multiple petitions, following the different rules of the national courts in front of which they may have standing. This is the older, simpler[574], and more traditional way of solving international conflicts.

The framework can be applied immediately, for it does not require any kind of pre-established coordination among international entities. Each proceeding is local and the laws of the country in which it is started provide all the rules necessary for its commencement and its development until its closure.[575] The system is not free of drawbacks, though.

The most relevant faults of the application of a purely territorial system are:

a) lack of notice, or the enactment of imperfect information systems, which have negative effects on foreign creditors;

b) low levels of predictability, which discourage international investors;

c) the inefficiency of opening multiple simultaneous proceedings and therefore duplicating costs;

d) parochialism.[576]

The implementation of ineffective information systems is a great burden on international trades. Giving effective notice of the commencement of a proceeding is a fundamental step guaranteeing the rights of all interested parties. Keeping them informed through every stage is also highly relevant. A purely local proceeding, disconnected from all the other scenarios that may regard the debtor's default, leads to lack of transparency. Moreover, local rules may be difficult for foreigners to comply with or understand. Public records providing the necessary information may not be accessible or available (at all, or in foreign languages). The system is, therefore, likely to prevent foreign creditors from taking part to the proceeding effectively unless they seek professional advice, which may cause skyrocketing costs and excessive burdens.

Lack of transparency and ineffective communication also lead to low predictability. Investors may find themselves forced into the uneasy position of "guessing about their rights"[577], due to their lack of knowledge or their limited understanding of local rules. The application of a territorial approach to insolvencies forces multinational entities to choose between: a) splitting up and creating local branches

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[570] **Paulus, Christoph G.**, "*Future Developments in Cross-Border Insolvency Law*", in OECD, Asian Insolvency Systems: Closing the Implementation Gap, OECD Publishing, (2006), at 255.

[571] **LoPucki Lynn M.**, "*Cooperation in International Bankruptcy: A Post-Universalist Approach*", 84 Cornell L. Rev. 696, (1999), at 760.

[572] **Costa Levenson David**, "*Proposal for reform of choice of avoidance law in the context of international bankruptcies from a U.S. perspective*", 10 Am. Bankr. Inst. L. Rev. 291, (2002), at 293-4.

[573] Under the traditional way a court would have jurisdiction over the entire estate owned by the debtor and would make all decisions for the benefit of the creditors. **Westbrook Jay L.,** "*Multinational Enterprises in General Default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1, (2002), at 6.

[574] See **LoPucki Lynn M.**, "*The Case for Cooperative Territoriality in International Bankruptcy*", 98 Mich. L. Rev. 2216, (2000), at 2219.

[575] "In the past, as compared to today, technological limitations restricted the ability of business to operate on a multinational scope and the level of understanding of foreign legal systems. Perhaps, reflecting this, earlier jurisprudence tended to apply considerations of territoriality, focusing on local law, when confronted with multinational insolvency proceedings." See **Flaschen D. Evan, Silverman Ronald J.,** "*Cross-border Insolvency Cooperation Protocols*", 33 TILJ 587, (1988); at 588.

[576] **Isham Sara**, "*UNCITRAL's Model Law on Cross-border Insolvency: a workable protection for transnational investment at last*", 26 Brook. J. Int'l L. 1177, (2001), at 1181.

[577] *Id.,* at 1183.

operative in each country in which they are active in, hence deterring investments and multiplying costs while increasing uncertainty; or b) eventually giving up investing in a national setting at all to avoid risks.

The coexistence of a multitude of uncoordinated local proceedings revolving around the same debtor is also, *per se*, inefficient.[578] There is no doubt that costs could be more effectively contained by avoiding duplications.[579]

Another negative consequence of "the grab rule" is the fact that (theoretically) equally situated creditors are likely to receive an uneven treatment. The difference could be caused, for example, by the enactment of different priority rules which may advantage some and not others depending on purely local policies. Higher returns, though, may also be the consequence of mere luck; a debtor holding a valid claim in a forum where the majority of the debtors' assets is located will likely have more chance of being paid.

The "territorialist" approach, although traditionally valid, presents several relevant drawbacks that limit its application in, and make it not an ideal solution for, the modern globalized insolvency setting. Alternatives have therefore been sought.

3.2 Universalism

The supporters of the universalist approach deem it to be not just more efficient, but also fairer[580], to administer a single insolvency proceeding even in those cases in which the assets of a debtor are scattered across national borders. Such model attempts to reduce costs and burdens achieve equality in protecting the interest of *all* creditors, local and foreign[581].

Through universalim, experts attempt to secure the following main advantages compared to the territorial approach[582]:

a) paying greater proceeds in the liquidation of multinational companies;
b) structuring more effective reorganizations;
c) reducing the costs of proceedings in all phases;
d) implementing a more predictable system;
e) implementing a fairer distribution, process preventing discrimination between local and foreign creditors.

Despite the several improvements that seem to be achievable through universalism, this approach is not free of imperfections. Universalism is ,at the least at the moment, an unattainable utopia. As discussed

[578] "Traditionally, the way most states and scholars resolved the international issues inherent in these cases was by partitioning an insolvency along national borders. This approach –known as territorialism- is consistent with classical concepts of sovereignty and jurisdiction and permits local courts to control local assets pursuant to local laws. The system is simple and predictable, but results in duplicative administrative costs and potentially disparate treatment of similar creditors who happen to be in different countries." See **Anderson Kent**, "The cross-border insolvency paradigm: a defense of the modified universal approach considering the Japanese experience", 21 U. Pa. J. Int'l Econ. L. 679, (2000), at 681.

[579] **Westbrook Jay L**., "*Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*", 65 Am. Bankr. L.J. 457, (1991), at 461-2.

[580] Id., at 466 "A universalist system would be far more fair, and produce more equality in distribution among creditors. Because equality of distribution is a central principle of default management in every country, universalism would serve a global notion of fairness."; **Westbrook Jay L**., "*A Global Solution to Multinational Default*", 98 Mich. L. Rev. 2276 (2000), at 2293.

[581] **Westbrook Jay L**., "*Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*", 65 Am. Bankr. L.J. 457 (1991), at 466: "This argument of fairness is most often the leading argument for a universalist principle. Unfortunately, the fairness argument has two serious and inherent weaknesses. The first is that every country honors equality of distribution primarily in the breach. Every enactment is riddled with exceptions for secured parties, landlords, grain farmers, the revenue authorities – the list is long and varies from country to country. As a result, a universalist rule will only make equal distributions somewhat less unequal and will produce results contrary to some interested country's distribution policies in every case."

[582] **LoPucki Lynn M**., "*Cooperation in International Bankruptcy: A Post-Universalist Approach*", 84 Cornell L. Rev. 696 (1999), at 706-8.

in Chapter I, it is not a factual possibility to operate today in an international market regulated by uniform laws[583], and it will not be so for maybe the far[584] future.[585]

Nevertheless, we will examine some of its key principles, as the notions we will acquire will be useful for our discussion of middle ground options among the two systems. Such compromises, in fact, may be the best options available at the moment.

Universalism demands the proceeding to be opened in the debtor's home country, or where the debtor's "center of main interests" (COMI) may be located, to increase the levels of transparency and predictability of models and to prevent confusion within markets.[586] The discussion on the identification of the COMI in international models will be developed in greater depth in the next sections while analyzing the UNCITRAL model[587] and EU Regulations. For now, it will be sufficient to mention that it is a great challenge to apply such a principle effectively; the home country of a debtor, in fact, may not be its actual center of main interests, or, at times, multiple countries may be argued to be the COMI (this is particularly true in the case of subsequent modifications.[588])

The divergences in national laws, therefore, can still be the cause of forum shopping. Parties attempt to manipulate parameters such as COMI to ensure that proceedings will be opened in forums that provide them with greater advantages[589]:

> "Given the huge differences in the bankruptcy laws of the countries of the world, the incentives to forum shop in a universalist system would be tremendous. The debtor's manager's might want a forum that would leave them in control of the company during reorganization rather than appoint a trustee. They might want one that would allow them to cram down a plan of reorganization over the objections of the creditors, or one that would attempt to override regulatory laws of some of the countries in which the debtor does business. Particular groups of creditors will each want a forum in which the group's claim have priority. Because any increase in the priority of one group of creditors necessarily is accompanied by a corresponding decrease in the priority of another group, creditor groups will tend to favor different *fora*." [590]
>
> "Because it is impossible to fix the location of a multinational company in a global economy, the introduction of universalism in current world circumstances would give each multinational company a choice of countries in which to file. By its choice, the company

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[583] **Westbrook Jay L**., "*Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*", 65 Am. Bankr. L.J. 457 (1991), at 468 : "the second prerequisite to obtaining the benefits of universalism is general similarity of laws. Similar laws about distributions, avoidance, and the like are not in principle necessary to the acceptance of universalism, but in practice similarity is very important."

[584]See **LoPucki Lynn M**., "*The Case for Cooperative Territoriality in International Bankruptcy*", 98 Mich. L. Rev. 2216 (2000), at 2217.

[585] **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry**, "*A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group*", The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010); at 230-232.

[586] "all of the debtor's assets wherever located be subject to the exclusive jurisdiction of the court in which the bankuptcy is pending", **Richard A. Glitin, Evan D. Flaschen**, "*The international Void in the Law of Multinational Bankruptcies*", Int'l Loan Workouts 3, (1989), at 16. See also **LoPucki Lynn M.,** "*Cooperation in International Bankruptcy: A Post-Universalist Approach*", 84 Cornell L. Rev. 696 (1999), at 709-10.

[587] The UNCITRAL Model Law remains generic in its applicability allowing local frameworks to set the necessary rules. Since it is only in recent times that several National insolvency systems have been adopted rules concerning consumers and natural persons it is evident that at the time of its elaboration the Model was mostly concerned with business debtors.

[588] See **LoPucki Lynn M**., "*The Case for Cooperative Territoriality in International Bankruptcy*", 98 Mich. L. Rev. 2216 (2000), at 2216-2217; **LoPucki Lynn M**., "*Cooperation in International Bankruptcy: A Post-Universalist Approach*", 84 Cornell L. Rev. 696, (1999), at 713.

[589] **LoPucki Lynn M**., "*Cooperation in International Bankruptcy: A Post-Universalist Approach*", 84 Cornell L. Rev. 696 (1999), at 721-2.

[590] **LoPucki Lynn M**., "*The Case for Cooperative Territoriality in International Bankruptcy*", 98 Mich. L. Rev. 2216 (2000), at 2235.

> could choose not only the procedure for its bankruptcy, but also the substantive rights its creditors would have. Universalism would require other nations to recognize the effects of that strategic choice. Given the money potentially at stake governments rightly fear that opportunism would run rampant"[591]

It has been observed that:

> "…differing interests will give rise to conflicting strategies in the period prior to bankruptcy. A debtor may seek to improve its claims to an advantageous venue by manipulating the factors relevant to the venue's test of "home country". Large public companies frequently change their jurisdictions of incorporation, headquarters, and even operations."[592]

Due to the factors that we have just discussed, universalism cannot be the answer to the difficulties met in the international insolvency setting today. With time, if greater levels of harmonization among local models were to be reached, though, this approach could effectively support the growth of a globalized market:

> "Universalism: the central point is "market symmetry": the requirement that some systems in a large regime must be symmetrical with the market, covering all or nearly all transactions and stakeholders in that market with respect to the legal rights and duties embraced by those systems."[593]
> "Because bankruptcy is a market-symmetrical law, a global market requires a global bankruptcy law."[594]

This is the direction towards which modern bankruptcy is moving[595], but in the meanwhile, compromises have to be reached in order to make models functional and applicable in today's legal and economic frameworks.

3.3 The meeting of the minds: "cooperative territorialism"[596] and "modified universalism"[597]

Since territorialism is not sufficiently supportive of modern globalized markets and results can be costly and burdensome, while pure universalism is (at the least for the moment) a utopia[598], modified, more practical versions of the two approaches have been gaining support.[599]

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[591] *Id.,* at 2216.
[592] *Id.,* at 2235.
[593] **Westbrook Jay L.,** "*A Global Solution to Multinational Default*", 98 Mich. L. Rev. 2276 (2000), at 2283.
[594] *Id.,* at 2288.
[595] A good example of a country that has moved from a strongly territorial approach to a more universalist one (and that has done so also through the enactment of the UNCITRAL Model Law) is Japan. For an in depth analysis of the Japanese transformation see Abe Shinichiro, "Recent developments of insolvency laws and cross-border practices in the United States and Japan", 10 Am. Inst. L. J. 47, (2002); **Anderson Kent**, "*The cross-border insolvency paradigm: a defense of the modified universal approach considering the Japanese experience*", 21 U. Pa. J. Int'l Econ. L. 679, (2000).
[596] **LoPucki Lynn M.,** "*Cooperation in International Bankruptcy: A Post-Universalist Approach*", 84 Cornell L. Rev. 696, (1999); see also **Guzman Andrew T.,** "*International bankruptcy: in Defense of Universalism*", 98 Mich L. Rev. 2177 (2000), at 2204-2214, and **Westbrook Jay L**., "*A Global Solution to Multinational Default*", 98 Mich. L. Rev. 2276 (2000), at 2308 expressing a contrary opinion.
[597] **Westbrook Jay L**., "*A Global Solution to Multinational Default*", 98 Mich. L. Rev. 2276, (2000). **LoPucki Lynn M.,** "*Cooperation in International Bankruptcy: A Post-Universalist Approach*", 84 Cornell L. Rev. 696 (1999), at 725-732.
[598] **LoPucki Lynn M**., "The Case for Cooperative Territoriality in International Bankruptcy", 98 Mich. L. Rev. 2216, (2000), at 2216: "Universalism can work only in a world with essentially uniform laws governing bankruptcy and priority among creditors a world that does not exist yet."
See also See **Nielsen Anne, Sigal Mike, Wagner Karen**, "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999), at 533: "Developing a workable international insolvency order which reconciles the principles of universality and territoriality has proven to be

Modified universalism[600] and cooperative territorialism[601], while moving from the two opposite starting points[602], attempt to meet in an effective middle ground.[603] Such approaches seek to create a practical and realistic system of coordination among cross-border proceedings to reach the highest possible levels of effectiveness and efficiency, in the current scenario.[604]

Modified universalism, for example, allows for the opening of a plurality of coordinated proceedings: a leading one (the proceeding) and a number of ancillary ones[605].

Under cooperative territoriality, on the other hand, several local proceedings continue to exist. Each may autonomously decide whether to reorganize or to simply liquidate the business, but the levels of coordination are greater. Such concurrent proceedings, in fact, do not remain completely isolated islands. This approach requires:

a) the establishment of specific procedures to replicate claims which are filed in one country so that they can be known in all of the nations that are involved;

b) the sharing of distribution lists by representatives to ensure that later distributions do not favor creditors who have already recovered the full amount of their claims;

c) the joint sale of assets when a joint sale would produce a higher price than separate sales in multiple countries or when the value of assets within a country is not sufficiently large to warrant a separate administration;

d) the voluntary investment by representatives in one country in the debtor's reorganization effort in another;

e) the seizure and return of assets that have been the subject of avoidable transfers.[606]

Both models, therefore, accept compromises. They abandon some of the key aspects of their original matrixes, pure territorialism and universality, to improve their practical application in the current globalized market.

International cross-border insolvency systems are, therefore, moving towards formulas in which one or few main, leading proceedings are opened in those locations holding the most relevant connections to the debtor's business operations, and a number of secondary, coordinated proceedings are opened in all those countries in which relevant residual assets may be located. "Ancillary proceedings" and "parallel proceedings" are opened to increase coordination and ensure that frameworks may work effectively and efficiently. Ancillary proceedings are not full, independent, domestic insolvency proceedings[607]; they are

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difficult"; **LoPucki Lynn M.,** "*The Case for Cooperative Territoriality in International Bankruptcy*", 98 Mich. L. Rev. 2216 (2000), at 2222: "universalism, requiring the world to agree on a single law "would necessitate revision not only of the bankruptcy laws of all nations, but also of the laws governing creditor priority, set-off and security interests. In addition, each country would have to revise its laws governing debt collection in the absence of bankruptcy to make it compatible with the new bankruptcy law."

[599] "In practice, no country applies either the universality principle or the territoriality principle without deviation" **Berends Andrè J**., "The *UNCITRAL Model Law on Cross-Border Insolvency: a comprehensive overview*", 6 Tul. J. Int'l & Comp. L. 309 (1998), at 314, See also **Costa Levenson David**, "*Proposal for reform of choice of avoidance law in the context of international bankruptcies from a U.S. perspective*", 10 Am. Bankr. Inst. L. Rev. 291, (2002); at 292-299.

[600] "Modified Universality' recognizes the difficulty, given strong national interests in the preservation of sovereignty and the absence of treaties, in creating truly unified proceedings." See **Nielsen Anne, Sigal Mike, Wagner Karen**, "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999), at 534.

[601] **LoPucki Lynn M**., "*Cooperation in International Bankruptcy: A Post-Universalist Approach*", 84 Cornell L. Rev. 696, (1999), at 742-759.

[602] *Id.,* at 696.

[603] **Westbrook Jay L**., "*Multinational Enterprises in General Default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1, (2002), at 8-9.

[604] See **Nielsen Anne, Sigal Mike, Wagner Karen**, "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999), at 534.

[605] **LoPucki Lynn M**., "*Cooperation in International Bankruptcy: A Post-Universalist Approach*", 84 Cornell L. Rev. 696, (1999), at 726-732.

[606] *Id,.* at 742-759.

[607] See **Westbrook Jay L**., "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1 (2002), at 10.

started with the sole goal of assisting a foreign, main proceeding in reaching its goals.[608] As such, they are usually cheaper, swifter, and more flexible.[609] "Parallel proceedings" are full, local insolvency proceedings (hence they are lengthier and costlier). A sub-category of parallel proceedings mentioned in the EU model laws is the one of "secondary proceedings".[610]

Through such organization, the different courts and insolvency administrators involved can cooperate and coordinate their efforts in an attempt to guarantee the fair and equitable allocation and distribution of all resources to benefit both local and foreign creditors.

As we will see upon discussing different models, collaborating effectively and efficiently remains, though, a difficult task.[611]

3.4 An alternative to territorialism and universalism: contractualism[612]

Another alternative deserves to be briefly mentioned. Contractualism is yet another approach proposed to solve cross-border insolvency disputes today.

Contractualists believe that a basic framework containing all the rules and information to regulate cases if default occurs should be provided and made available to the interested parties, such as investors, *ex ante*. Stakeholders should be able meet and design the preferred formula to be placed in the debtor's corporate charter. Through such an approach, even in the absence of a unified international bankruptcy code, multinational companies could select the law that should be applied.

Having access to such information would (or should) allow all interested parties to evaluate potential risks and would also allow a swift response to financial difficulties[613]:

> "In a competitive market – the most reasonable assumption for capital markets – 'adjusting creditors' (those who adjust the terms of their lending to reflect the risks they face) will earn a market rate of return regardless of the choice of bankruptcy rule."[614]

Under a contractualist approach, the product of a mediation that leads to a transparent and predictable consensual agreement is deemed to provide greater benefits than the sudden application of a local or crossborder model in effect at the moment of the commencement of a proceeding.[615] At the same time, the risk of abuses by stronger parties would remain relevant.

3.5 The modern European approach and the riddle of refounding insolvency systems

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[608] See, for example ***Maxwell Communication Corp. v. Barklays Bank plc*** *(In re Maxwell Communication Corp.), 170 B.R. 800 (Bankr. S.D.N.Y. 1994), aff'd, 186 B.R. 807 (S.D.N.Y. 1995), aff'd, 93 F.3d 1036 (sd Cir. 1996)*; **LoPucki Lynn M**., "*Cooperation in international bankruptcy: a post-universalist approach*", 84 Cornell L. Rev. 696, (1999); at 714-718.

[609] **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry**, "*A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group*", The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010), at 233-4; **Westbrook Jay L**., "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1 (2002), at 10.

[610] *Id.,* at 11-12.

[611] **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry**, "*A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group*", The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010), at 235-6.

[612] **Rasmussen Robert K**., "*A new approach to transnational insolvencies*", 19 Mich. J Int'l L. 1 (1997); **LoPucki Lynn M.,** "*Cooperation in International bankruptcy: A post-universalist approach*", 84 Cornell L. Rev. 696 (1999), at 737-42; **LoPucki Lynn M**., "*The case for cooperative territoriality in international bankruptcy*", 98 Mich. L. Rev. 2216 (2000), at 2241-2250; **Westbrook Jay L**., "*A global solution to multinational default*", 98 Mich. L. Rev. 2276 (2000), at 2303-07.

[613] See **Rasmussen Robert K**., "*A new approach to transnational insolvencies*", 19 Mich. J Int'l L. 1 (1997); and **LoPucki Lynn M**., "*The case for cooperative territoriality in international bankruptcy*", 98 Mich. L. Rev. 2216, (2000), at 2243-2250.

[614] **Guzman Andrew T**., "*International bankruptcy: in defense of universalism*", 98 Mich L. Rev. 2177 (2000), at 2180.

[615] **LoPucki Lynn M**., "*Cooperation in international bankruptcy: a post-universalist approach*", 84 Cornell L. Rev. 696, (1999), at 2242-2250.

In the previous sections, we discussed of the major issues present within the international bankruptcy scenario and approaches which have been developed to solve them. In the next pages, we will examine three different formats which have been adopted to structure specific frameworks: a list of principles, a model law, and regulations imposed from the top to bind local systems. Such formats have much in common.

Despite the differences in their structures, in fact, they address the same key points which are recognized as necessary pillars of these particular models. They all regulate, for example, ways to access and recognize proceedings and cooperation among foreign administrators and courts. They all also present a common characteristic or weakness: flexibility.

All the attempts that have been made up to today to create uniform frameworks to coordinate local insolvency systems, or to regulate in a predictable and transparent manner cross-border insolvency cases, have resulted in the implementation of more or less flexible tools.

As we have already mentioned in the previous pages, in fact, the levels of harmonization currently existing among local rules make it impossible to create a common, monolithic, one-size-fits-all approach to crossborder cases or to implement a single body of laws to be applied universally (or to be imposed on all the players competing within the globalized market). Flexibility is, therefore, an inalienable component of the present cross-border insolvency scenario; a necessary compromise in a process structured to make decisive steps forward. The analysis and conclusion sections for Chapters II and III, though, will show the intricate issues which derive from the adoption of excessively flexible transnational models and the reasons why finding a good balance within the process of refoundation of insolvency frameworks is a great challenge.

European strategies aim to both reform local regulations, using a specific formula which is rooted in the best practices which we have discussed in Chapter II, and to increase the levels of cross-border harmonization. For local models to be effective and efficient, though, they need to match the needs of local societies and economies, while supranational frameworks need high levels of uniformity. These two elements are in contrast with each other.

A complex riddle stands, therefore, on the path to European growth.

4. Proposals of models for the efficient administration of cross-border insolvency cases

In the second half of the twentieth century the increasing number, size, and impact, of cross-border cases, caused by the expansion of trade within the growing globalized markets, pressured national and international organizations to structure more effective models which could substitute the previous limited regional agreements. As a result, in the past years, several proposals[616] have been presented in the format of lists of principles, model laws, and full regulations.[617] Three frameworks will be briefly discussed in the next sections as an example of each format:

- The IBA Concordat – as an example of a list of cross-border insolvency principles that aims to inspire a uniform approach to international insolvency issues;
- The UNCITRAL Model Law – as an example of a "model law", a body of articles that has to be merged with the local insolvency framework to produce effects and lead to greater levels of international uniformity;
- The EU Insolvency Regulations – as examples of the development of fully binding statutes that impose uniformity, from the top, upon signatory countries.

[616] See, for example in chronological order: the different attempts made by the EU (former ECC) to create a uniform set of rules, the IBA Concordat; the MIICA; the UNCITRAL'S Model law; the ALI principles adopted among NAFTA counties. For a general and comparative comment on the ALI principles see: **Westbrook Jay L.**, "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1, (2002), at 30-39.

[617] See **Wessels Bob,** "*Three outstanding issues in co-ordinating insolvency cases*" in *'The European Insolvency Regulation: an update – Papers from the INSOL Europe Academic Forum Annual Conference, Stockholm, Sweden, 30 September – 1 October 2009'*, Eds. Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-5-9, (2010).

4.1 The International Bar Association Cross-Border Insolvency Concordat

The Concordat was an early attempt to create an effective framework for coordination in cross-border insolvency cases. It is the fruit of exceptional work. The project took a very short time to become operative; a draft was already available within the first year from the commencement of the study in 1993.

A special committee was formed by the International Bar Association (IBA)[618] to develop guidelines to be used in transnational insolvency cases[619]:

> "6. Another initiative of Committee J[620] was the development, in the early 1990s, of a Cross-Border Insolvency Concordat based on rules of private international law. The purpose of the Concordat was to suggest guidelines for cross-border insolvencies that participants or courts could adopt as practical solutions to a variety of issues. These include designation of the administrative forum, application of that forum's priority rules, rules for cases involving more than one administrative forum and designation of applicable rules for avoidance of certain specified pre-insolvency transactions. The initial application of the Concordat, by some of the judges who had been instrumental in developing it, was in cases involving Canada and the United States of America. Cross-border insolvency agreements based on the Concordat model have also been entered into between the United States and each of the following: Israel, the Bahamas, the Cayman Islands, England, Bermuda and Switzerland."
>
> "7. This form of cooperation has emerged as a common practice, at least in certain States. The absence of formal treaties or national legislation to address the problems arising from international insolvencies has encouraged insolvency practitioners to develop, on a case-by-case basis, strategies and techniques for resolving the conflicts that arise when the courts of different States attempt to apply different laws and enforce different requirements on the same set of parties. The terms and duration of agreements vary, and amendment or modification in the course of the proceedings takes account of the changing dynamics of a multinational insolvency to facilitate solutions for unique problems that arise in the course of the proceedings. An early use of an insolvency agreement was in the 1992 insolvency proceedings concerning the Maxwell Communication Corporation. In those proceedings, the corporation was placed into administration in England and contemporaneously into Chapter 11 proceedings in New York, with administrators and an examiner appointed respectively."

The final draft favored the universalist approach, postulating that the most beneficial solution to cross-border insolvencies is achieved through the administration of a single bankruptcy proceeding originating in one forum.[621] [622] To achieve such a goal, the focus was placed on:

- the enhancement of elements for the effective coordination and cooperation between the different local proceedings, to achieve high levels of efficiency in the administration of all of the available assets;
- the maximization of the value of businesses attempting reorganizations;
- ensuring fair treatment to all (foreign and local) creditors.[623]

[618] www.ibanet.org

[619] See **Nielsen Anne, Sigal Mike, Wagner Karen**, "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999), at 537.

[620] Referring to the Model International Insolvency Cooperation Act (MIICA) which will not be discussed.

[621] See **Nielsen Anne, Sigal Mike, Wagner Karen**, "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999).

[622] Principle 1: "If an entity or an individual with cross-border connections is the subkect of an insolvency proceeding, a single administrative forum should have primary responsibility for co-ordinating all insolvency proceedings relating to such entity or individual."

[623] See **Nielsen Anne, Sigal Mike, Wagner Karen**, "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999).

The policies furthered by the Concordat promoted reorganizations over liquidations in all those cases in which a business would be worth more as a going concern[624]; a principle which, as we have discussed in Chapter I, has been widely embraced as well by European authorities.

4.1.1 Flexibility in the Concordat

The "preamble" to the Concordat addressed the relevant topic of flexibility within the proposed model:

> "Flexibility in rules appears to be indispensible in international bankruptcy. The situations which arise are so varied that any rigid rule cannot solve all of them satisfactorily. Neither the theory of territoriality nor the theory of ubiquity can cope adequately with the divergent situations."[625]

From its very *incipit*, therefore, the IBA admitted that a certain degree of flexibility is necessary in the international insolvency scenario. The introduction continued as follows:

> "This Cross-Border Insolvency Concordat is a framework for harmonising cross-border insolvency proceedings. There exists today no uniform statute or treaty adopted by commercial nations dealing with the policy and commercial problems that arise in cross-border insolvencies. Yet crossborder insolvencies are increasing both in number and size, as well as in complexity. The Concordat attempts to aid in filling this gap in international law. International commerce will be encouraged if the insolvency bench and bar develop a set of general guidelines, a 'concordat', which may be used in developing solutions to individual cross-border insolvencies. The purpose of this Concordat is to suggest generalised principles, which the participants or courts could tailor to fit the particular circumstances and then adopt as a practical approach towards dealing with the process. To be supportive of international commerce, any insolvency regime must be reasonably predictable, fair and convenient. Supporting international commerce is a worthy goal, because, as some have noted, countries which trade together rarely make war upon one another. International commerce will be furthered by an understanding in the international business community that general principles exist which, in the event of business crisis, are recognised as an under pinning to harmonise insolvency proceedings. These principles should reflect respect for the legitimate private expectations of the parties transacting business with the debtor, including their reasonable reliance upon laws of particular jurisdictions. However, legislation reflecting a particular jurisdiction's policies regarding such matters as priorities among claims must be given due weight where jurisdictionally appropriate, as should regulatory laws governing businesses such as banking or insurance. This Concordat has been prepared as an initial effort to provide a framework of general principles for addressing cross-border insolvencies. The Concordat deals with some of the important conceptual issues that arise in cross-border insolvencies. Some principles have been framed in the alternative, reflecting among other things extensive comment from many countries. Refinements will be made in future editions of the Concordat, as appropriate."[626]
>
> "It is important to note what the Concordat is not. The Concordat is not intended to be used as, or as a substitute for, a treaty or statute. The Concordat is not a rigid set of rules; indeed, it is expected to change as it is used. Rather, the Concordat is an interim measure until treaties and/or statutes are adopted by commercial nations. It is intended, in the absence of an applicable treaty or statute, to guide practitioners in harmonising cross-

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[624] Appendix II, US authority for use of the Concordat, § (a) (2).
https://www.ibanet.org/Document/Default.aspx?DocumentUid=2D55E76F-CAB1-493D-B0A9-4B4B967B353F

[625] IBA Cross-border Insolvency Concordat quoted as: "**Solomons v. Ross** and International Bankruptcy Law, 9 Mod. L.R. 154, 167 – 68 (1946)", at 2.

[626] IBA Cross-border Insolvency Concordat quoted, at 2, at
file:///C:/Users/Fede/Downloads/IBA_Resolutions_Cross_Border_Insolvency_Concordat_1995%20(1).pdf

> border insolvencies. The Concordat, as modified by counsel to fit the circumstances of any particular cross-border insolvency, could be implemented by court orders or formal agreements between official representatives or informal arrangements, depending upon the rules and practices of the particular fora involved."[627]

The Concordat, therefore, did not impose a structure; it proposed relevant guidelines embodied in generalized principles, which could be tailored at need by lawmakers to reflect local policies.

The high degree of flexibility on which the IBA framework was founded came at a price[628], though.

Although it allowed the Principles to merge with any local framework and it provided guidance in an ample variety of relevant situations, by leaving too much discretion to national systems it did not cure the lack of uniformity in the international scenario.[629] Moreover, the proposed model did not attempt to define relevant substantive aspects of bankruptcy regulations. It did not provide the users, for example, with a clear, standardized definition of "insolvency" (even if it did define other relevant aspects, such as the concept of "discharge"[630]).

The formula chosen by the Concordat and its high levels of flexibility limited, therefore, its application in real practice.

4.1.2 The Concordat's Principles

Principle 1 extended the application of the Concordat to both corporate entities and individuals[631] without introducing clear limitations in favor of the exclusive access of business debtors:

> "If an entity or individual with cross-border connections is the subject of an insolvency proceeding, a single administrative forum should have primary responsibility for coordinating all insolvency proceedings relating to such entity or individual."

The foresight of the Concordat derives from its foundation within the American framework, which addressed this issue well before others. The UNICTRAL Model Law and the European Regulations, for example, chose to focus mostly on business-related international insolvencies. However, in modern times the pressure to address the issue of the insolvency of natural persons, or consumers, has led to continuous revisions.

The first Principle of the framework proposed by the IBA Concordat also introduced a form of "modified universality"[632], which was concerned with identifying the center of main interests around which proceedings should revolve. On this point, the guide stated that:

> "In most cases, an enterprise will have its nerve centre and many of its assets in one country. In the usual circumstance that country is the most appropriate forum for the administrative centre of its insolvency. Having a primary administrative forum presents the possibility of many benefits enhancing control of assets, increasing business values,

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[627] *Id*., at 3.

[628] The Concordat is flexible in its form that allows the application of its principles disjointly with a case by case practical approach. See **Nielsen Anne, Sigal Mike, Wagner Karen**, "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999): "It allows the facts of a particular case to determine how many of the principles in the Concordat are to be applied and in what manner".

[629] IBA Cross-border Insolvency Concordat https://webcache.googleusercontent.com/search?q=cache:PGoK0f6aQ2QJ:https://www.ibanet.org/Document/Default.aspx%3FDocumentUid%3D2D55E76F-CAB1-493D-B0A9-4B4B967B353F+&cd=1&hl=it&ct=clnk&gl=it

[630] "A court order or provision o fan instrument effecting a composition releasing a debtor from all liabilities that were, or could have been , addressed in the insolvency proceeding, including contracts that were modified as part of a composition". IBA Cross-border Insolvency Concordat at 4 https://webcache.googleusercontent.com/search?q=cache:PGoK0f6aQ2QJ:https://www.ibanet.org/Document/Default.aspx%3FDocumentUid%3D2D55E76F-CAB1-493D-B0A9-4B4B967B353F+&cd=1&hl=it&ct=clnk&gl=it 4

[631] See **Nielsen Anne, Sigal Mike, Wagner Karen**, "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999), at 538-9.

> and ensuring fair treatment of creditors. Predictability of the 'natural' administrative forum will also be most supportive of international commerce. As Professor Nadelmann counselled nearly a half century ago, flexibility is the key. Circumstances may exist in any insolvency which do require more than one forum. Compelling circumstances which may influence the decision may include the presence of a large workforce or extensive property holdings in another country. One forum, however, should have the primary responsibility for co-ordinating the proceedings. The forum should usually be the jurisdiction in which the entity subject to insolvency proceedings has its 'nerve centre', as evidenced by the presence of its board of directors or senior management, or any jurisdiction the laws of which its creditors would reasonably have expected to govern their relationships with the entity."[633]

The Concordat relied, therefore, on the law of the "main forum" which would have to coordinate the administration and collection of all assets and the distribution process among secured and unsecured creditors:

> "PRINCIPLE 2 Where there is one main forum:
> a) Administration and collection of assets should be coordinated by the main forum.
> b) After payment of secured claims and privileged claims, as determined by local law, assets in any forum other than in the main forum shall be turned over to the main forum for distribution.
> c) Common claims are filed in and distributions are made by the main forum. Common creditors not in the main forum must file claims in the main forum but (to the extent allowable under the procedural rules of the main forum) may file by mail, in their local language and with no formalities other than required under their local insolvency law.
> d) The main forum may not discriminate against non-local creditors.
> e) Filing a claim in the main forum does not subject a creditor to jurisdiction for any purpose, except for claims administration subject to the limitations of principle 8 and except for any offset (under voiding rules or otherwise) up to the amount of the creditor's claim).
> f) A discharge granted by the main forum should be recognised in any forum."

The convention advocated the creation of a centralized system of claim administration within the main forum to protect the interests of all creditors simultaneously, both locals and foreigners[634]:

> "International commerce is encouraged to the extent that participants may rely upon the expectation that if they engage in transactions with a multinational enterprise, and an insolvency proceeding is commenced in any nation with which the enterprise has a connection, that participant will not suffer discriminatory treatment based solely upon nationality or domicile. While a creditor may be subject to the inconvenience of an insolvency proceeding in another country, that risk is part of engaging in business with a multinational enterprise. But the risk of discriminatory treatment should not be a risk of engaging in such business. Nor should the risk that the evaluation of a creditor's pre-insolvency claim will be based upon the law of an unanticipated jurisdiction, unilaterally chosen by the entity or individual commencing insolvency proceedings, be a risk of doing such business.[635]
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> "PRINCIPLE 3

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[633] IBA Cross-border Insolvency Concordat, at 9 https://webcache.googleusercontent.com/search?q=cache:PGoK0f6aQ2QJ:https://www.ibanet.org/Document/Default.aspx%3FDocumentUid%3D2D55E76F-CAB1-493D-B0A9-4B4B967B353F+&cd=1&hl=it&ct=clnk&gl=it
[634] Principle 3 is particularly relevant on this point.
[635] IBA Cross-border Insolvency Concordat, at 11 https://webcache.googleusercontent.com/search?q=cache:PGoK0f6aQ2QJ:https://www.ibanet.org/Document/Default.aspx%3FDocumentUid%3D2D55E76F-CAB1-493D-B0A9-4B4B967B353F+&cd=1&hl=it&ct=clnk&gl=it

> a) If there is more than one forum, the official representatives appointed by each forum shall receive notice of, and have the right to appear in, all proceedings in any fora. If required in a particular forum, an exequatur or similar proceeding may be utilised to implement recognition of the official representative. An official representative shall be subject to jurisdiction in all fora for any matter related to the insolvency proceedings, but appearing in a forum shall not subject him/her to jurisdiction for any other purpose in the forum state.
> b) To the extent permitted by the procedural rules of a forum, ex parte and interim orders shall permit creditors of another jurisdiction and official representatives appointed by another jurisdiction the right, for a reasonable period of time, to request the court to reconsider the issues covered by such orders.
> c) All creditors should have the right to appear in any forum to the same extent as creditors of the forum state, regardless of whether they have filed claims in that particular forum, without subjecting themselves to jurisdiction in that forum (including with respect to recovery against a creditor under voiding rules or otherwise in excess of a creditor's claim).
> d) Information publicly available in any forum shall be publicly available in all fora. To the extent permitted, non-public information available to an official representative shall be shared with other official representatives."

The system would effectively coordinate the official representatives appointed in the different jurisdictions under which the proceedings were opened:

> "Because the guiding principle of this Concordat is that all common creditors should be treated as creditors of a single world-wide estate, even though the estate is administered by more than one forum, as a matter of fairness all creditors should have a right to be heard (where a forum permits creditors to speak) on administrative matters in which they have an interest without submission to jurisdiction of the administrative forum for any purpose other than administrative matters and claims administration. No creditor not otherwise found in the administrative forum state, or whose claim is not connected to the forum state, should, as a result of administrative participation, lose its rights to jurisdictional and other international law arguments with respect to an adversary proceeding against the creditor."[636]

The ongoing exchange of information was presented as a "duty" to communicate and to cooperate:

> "The exchange of information is an important element in co-ordination. Both the Council of Europe Convention and the draft EU Convention recognise the importance of ongoing exchanges of information between Official Representatives in the main and limited or secondary proceedings. The representatives are under a duty to communicate and to cooperate with one another. Some jurisdictions are more restrictive than others about some types of information, including bank records. Any forum must respect the laws of the forum in which such information is found, but the Concordat supports the free flow of, and equal access to, information relevant to a crossborder case."

Principles 4 and 5 addressed issues related to the coexistence of more proceedings under a modified universality approach, to achieve higher levels of effectiveness and efficiency in the liquidation or reorganization of the whole debtor:

> "In many situations, it may be useful, where a plenary insolvency proceeding is pending on one jurisdiction, to commence a proceeding in another jurisdiction to serve limited objectives, such as collection of assets, where there is no need for a second comprehensive proceeding. In some countries there exist defined statutory vehicles for limited proceedings, such as 'secondary proceedings' recognised in the Council of Europe

[636] *Id.,* at 12.

Convention and the draft EU Convention and 'ancillary proceedings' in the United States. In many countries, the only available vehicle is a plenary proceeding. However, it appears that in most countries a plenary proceeding may be tailored by the presiding judge to effect limited objectives. The Concordat favours the exercise of discretion, where available, to limit proceedings. This will avoid conflict with plenary proceedings in other jurisdictions and will reduce the cost of cross-border cases."[637]

Principle 4 addressed the issue of coordination in the case of the absence of a main proceeding:

> "Principle 4: Where there is more than one plenary forum and there is no main forum: a) Each forum should co-ordinate with each other, subject in appropriate cases to a governance protocol. b) Each forum should administer the assets within its jurisdiction, subject to principle 4 (F). c) A claim should be filed in one, and only one, plenary forum, at the election of the holder of the claim. If a claim is filed in more than one plenary forum, distribution must be adjusted so that recovery is not greater than if the claim were filed in only one forum.3 d) Each plenary forum should apply its own ranking rules for classification of and distribution to secured and privileged claims. e) Classification of common claims should be coordinated among plenary fora. Distributions to common claims should be pro-rata regardless of the forum from which a claim receives a distribution. f) Estate property should be allocated (after payment of secured and privileged claims) among, or distributions should be made by, plenary fora based upon a pro-rata weighing of claims filed in each forum. Proceeds of voiding rules not available in every plenary forum should be: ALT A: Allocated pro-rata among all plenary fora for distribution. ALT B: Allocated for distribution by the forum which ordered voiding. g) If the estate is subject to local regulation that involves an important public policy (such as a banking or insurance business), local assets should be used first to satisfy local creditors that are protected by that regulatory scheme (such as bank depositors and insurance policy holders) to the extent provided by that regulatory scheme."

Principle 5 permitted a court in a secondary proceeding to determine secured and prioritized claims in accordance with local laws; once secured claims were paid, the surplus would be transferred to the main forum, or other designated ones[638]:

> "Principle 5: A limited proceeding shall, after paying secured and privileged claims, as determined by local law, transfer any surplus to the main forum or another appropriate plenary forum."

Such centralization of proceedings, and, in particular, of the process of administration of (all) claims, aimed to promote the fair and equal treatment of creditors.[639] [640]

Principles 6[641], 7[642], and 8[643] were connected and addressed relevant issues concerning the administration of proceedings. They regulated:

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[637] *Id*., at 19.

[638] See **Nielsen Anne, Sigal Mike, Wagner Karen**, "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999), at 550.

[639] "All common creditors should be treated as creditors of a single world-wide estate." IBA Corss-border insolvency concordat and rationales at 4.

[640] IBA Corss-border insolvency concordat and rationales 2-3 https://webcache.googleusercontent.com/search?q=cache:PGoK0f6aQ2QJ:https://www.ibanet.org/Document/Default.aspx%3FDocumentUid%3D2D55E76F-CAB1-493D-B0A9-4B4B967B353F+&cd=1&hl=it&ct=clnk&gl=it

[641] Principle 6: "A limited proceeding shall, after paying secured and privileged claims, as determined by local law, transfer any surplus to the main forum or another appropriate plenary forum."

[642] Principle 7: "Subject to principle 8, the official representatives may exercise voiding rules of any forum."

[643] Principle 8: "a) Each forum should decide the value and allowability of claims filed before it using a choice of law analysis based upon principles of international law. A creditor's rights to collateral and set-off should also be determined under principles of international law. b) Parties are not subject to a forum's substantive rules unless under

- avoidance actions;
- priorities among claims and the process for their verification.

The ultimate goal of the Concordat was to maximize the outcomes by taking advantage of the different local statutes involved in a cross-border case and allowing administrators to avail themselves of the most convenient rules available[644]:

> "Where it is found appropriate that administrative supervision of a cross-border insolvency be exercised in more than one country, it should also be appropriate that administrative rules applicable in a particular forum be available for use by the Official Representative to enhance the assets of the estate. For example, if the entity in insolvency proceedings is a party to executory contracts in a nation whose insolvency law permits rejection of executory contracts that are burdensome, the Official Representative should be enabled to use such procedures for the benefit of all creditors. Thus an Official Representative appointed in Country A could, subject to Principle 8, use a rejection power available in Country B (the main forum) even if Country A's laws provide no such power. Where appropriate, an exequatur or similar proceeding would be used in Country B.
> However, the Official Representative is not permitted to use such rules in an unexpected manner. If the pre-insolvency entity was a party to executory contracts to be performed in a country in which rejection is not permissible, the rejection procedure of another country may not be used. Again, international commerce is hindered if parties entering into contracts with multinational entities are concerned that unexpected unilateral use by such entities of favourable law will occur in the event of insolvency. Application of principles of international law may determine whether use of administrative procedures is appropriate."[645]

Principle 9[646] favored compositions, or agreements between debtor and creditors, and reorganizations (despite the fact that not all local regulations allowed them), as long as they were executed in a non-discriminatory manner[647]:

> "Not all nations have insolvency laws which provide for a composition. The policy decision whether to permit a composition is based upon a socio-economic view as to whether society benefits from maintaining the debtor as an on-going enterprise rather than liquidating it. Will a composition result in maintaining jobs, paying employee benefits,

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applicable principles of international law such parties would be subject to the forum's substantive laws in a lawsuit on the same transaction in a non-insolvency proceeding. The substantive and voiding laws of the forum have no greater applicability than the laws of any other nation. c) Even if the parties are subject to the jurisdiction of the plenary forum, the plenary forum's voiding rules do not apply to transactions that have no significant relationship with the plenary forum."

[644] See **Nielsen Anne, Sigal Mike, Wagner Karen,** "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999), at 550. "The Concordat is similar to other model laws in that it recognizes the need for one principal forum and ancillary proceedings. […] The Concordat provides very flexible rules in determining which laws to apply to ancillary proceedings. For example under principle 6, the foreign representative may employ the "administrative rules of "any plenary forum in which an insolvency proceeding is pending, even though similar rules are not available in the forum appointing the representative. The rationale is that the representatives should be able to maximize the value of the estate.", see **Costa Levenson David**, "*Proposal for reform of choice of avoidance law in the context of international bankruptcies from a U.S. perspective*", 10 Am. Bankr. Inst. L. Rev. 291, (2002), at 352-353.

[645] IBA Cross-border Insolvency Concordat, at 16-17 https://webcache.googleusercontent.com/search?q=cache:PGoK0f6aQ2QJ:https://www.ibanet.org/Document/Default.aspx%3FDocumentUid%3D2D55E76F-CAB1-493D-B0A9-4B4B967B353F+&cd=1&hl=it&ct=clnk&gl=it

[646] Principle 9: "A composition is not barred because not all plenary fora have laws which provide for a composition as opposed to a liquidation, or a composition cannot be accomplished in all plenary fora, as long as the composition can be effected in a non-discriminatory manner."

[647] **Culmer David H.,** "*The cross-border insolvency concordat and customary international law: is it ripe yet?*", 14 Conn. J. Int'l L. 563, (1999), at 589.

fostering environmental cleanup and provide greater value for creditors, or will it simply result in the entrenchment of poor managers? Also, the rules that govern the requirements to be satisfied in order to achieve a composition will differ from nation to nation. Thus, it is possible that a composition would be achievable in some, but not all, administrative fora."[648]

Finally, Principle 10[649] protected the reasonable expectations of participants in international transactions while preserving the integrity of commerce:

> "Insolvency laws are designed to protect the integrity of commerce. They do so by allocating the assets of a failed enterprise in a manner which attempts to weight claims arising from different non-insolvency law bases in an equitable manner. While preferences and priorities reflecting a particular nation's political decisions are also part of many insolvency statues, these are usually quite limited and are known in advance to the participants in commercial activity relating to that nation. The reasonable commercial expectation of the parties should not be upset by ad hoc intervention, post-insolvency, of the executive of a nation by use of any act of state. For example, the pre-insolvency obligations of a private entity should not be invalidated by any sovereign after the onset of insolvency proceedings. Participants in international commerce should not be required to assume that risk, or reflect that risk in the price of transactions relating to a nation in which such action is feared."[650]
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> "to the extent permitted to the substantive law of a forum, courts of that forum will not give effect to acts or state of another jurisdiction used to invalidate otherwise valid pre-insolvency transactions" and of creditors in general for, by doing so, it prevents the alienation of assets that would otherwise be included in the liquidation."[651]
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> "8. An insolvency agreement may not be the appropriate solution for all cases, being case-specific as to its content and requiring time for its negotiation as well as a sufficient asset base to justify the costs associated with negotiation and cooperation between the courts and between the insolvency representatives in each jurisdiction. Nevertheless, the cases in which these agreements have been used provide examples of how cooperation and coordination between the judges, courts and the insolvency profession can improve the international regime for insolvency in the absence of comprehensive national, regional or international law reform solutions. The agreements developed have often provided innovative solutions to cross-border
> issues and have enabled courts to address the specific facts of individual cases. Although there are limitations on the extent to which they can be used to achieve more widespread harmonization of international insolvency law and practice, insolvency agreements are being increasingly used and information about them is being more and more widely disseminated."[652]

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[648] IBA Cross-border Insolvency Concordat, at 21 https://webcache.googleusercontent.com/search?q=cache:PGoK0f6aQ2QJ:https://www.ibanet.org/Document/Default.aspx%3FDocumentUid%3D2D55E76F-CAB1-493D-B0A9-4B4B967B353F+&cd=1&hl=it&ct=clnk&gl=it

[649] Principle 10: "To the extent permitted by the substantive law of a forum, courts of that forum will not give effect to acts of state of another jurisdiction used to invalidate otherwise valid pre-insolvency transactions."

[650] IBA Cross-border Insolvency Concordat, at 22 https://webcache.googleusercontent.com/search?q=cache:PGoK0f6aQ2QJ:https://www.ibanet.org/Document/Default.aspx%3FDocumentUid%3D2D55E76F-CAB1-493D-B0A9-4B4B967B353F+&cd=1&hl=it&ct=clnk&gl=itat

[651] **Culmer David H.**, "*The cross-border insolvency concordat and customary international law: is it ripe yet*?", 14 Conn. J. Int'l L. 563, (1999), at 589.

[652] UNCITRAL (United Nations Commission on International Trade Law), "Practice guide on cross-border insolvency cooperation", United Nations, New York, ISBN 978-92-1-133688-7, (2009), at 11-12.

4.2 The Model Law on cross-border insolvency (UNCITRAL)[653]

The UNCITRAL Model Law on cross-border insolvencies was adopted in 1997. Subsequent guides and studies that have been published in this field of law over time are the product of twenty years of cooperation and research at an international level between relevant international organizations:

> "4. The project was initiated by the United Nations Commission on International Trade Law (UNCITRAL), in close cooperation with INSOL. The project benefited from the expert advice of INSOL during all stages of the preparatory work. In addition, assistance during the formulation of the Law, consultative assistance was provided by Committee J (Insolvency) of the Section on Business Law of the International Bar Association.
> 5. Prior to the decision by UNCITRAL to undertake work on cross-border insolvency, the Commission and INSOL held two international colloquiums for insolvency practitioners, judges, government officials and representatives of other interested sectors. The suggestion arising from those colloquiums was that work by UNCITRAL should have the limited but useful goal of facilitating judicial cooperation, court access for foreign insolvency administrators and recognition of foreign insolvency proceedings.
> 6. When UNCITRAL decided in 1995 to develop a legal instrument relating to crossborder insolvency, it entrusted the work to the Working Group on Insolvency Law, one of the three subsidiary bodies of UNCITRAL. The Working Group devoted four two week sessions to the work on the project.
> 7. In March 1997, another international meeting of practitioners was held to discuss the draft text as prepared by the Working Group. The participants (mostly judges, judicial administrators and government officials) generally considered that the model legislation, when enacted, would constitute a major improvement in dealing with crossborder insolvency cases.
> 8. The final negotiations on the draft text took place during the thirtieth session of UNCITRAL, held in Vienna from 12 to 30 May 1997. UNCITRAL adopted the Model Law by consensus on 30 May 1997. In addition to the 36 States members of UNCITRAL, representatives of 40 observer States and 13 international organizations participated in the deliberations of the Commission and the Working Group. Subsequently, the General Assembly adopted resolution 52/158 of 15 December 1997, in which it expressed its appreciation to UNCITRAL for completing and adopting the Model Law."[654]

The Model was published with the support of a guide that provided the necessary background and explanatory information to help legislators in its enactment.[655] More guides were subsequently published, offering relevant updates on the progress made in the field of cross-border insolvency through in-depth studies of specific topics and of areas of great relevance.

In its process of continuous development, the Model Law never ceased to be inspired by other international frameworks:

> "Model Law takes into account the results of other international efforts, including the negotiations leading to the European Council (EC) Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings (the "EC Regulation"), the European Convention on Certain International Aspects of Bankruptcy (1990), the Montevideo treaties on international commercial law (1889 and 1940), the Convention regarding Bankruptcy between Nordic States (1933) and the Convention on Private International Law (Bustamante Code) (1928).3 Proposals from non-governmental organizations that have

[653] See http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency.html

[654] **UNCITRAL (United Nations Commission on International Trade Law),** "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2004), at 308-9; see also **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry**, "*A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group*", The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010), at 247.

[655] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2004), at 309.

been taken into account include the Model International Insolvency Cooperation Act and the Cross-Border Insolvency Concordat, both developed by the former Committee J (Insolvency) of the Section on Business Law of the International Bar Association." [656]

Hence, it provided a continuously updated discussion of the most relevant best practices in the field of cross-border insolvency law.

4.2.1 Structure and goals of the Model Law

The UNCITRAL attempted to provide effective solutions and wished to help progress in the area of international insolvencies in several modest but significant ways, through the enactment of its comprehensive Model Law, which was subdivided into five chapters and a total of 32 articles:

I. General provisions (Articles 1 to 8);
II. Access of foreign representatives and creditors to court in this State (Articles 9 to 14);
III. Recognition of foreign proceedings and relief (Articles 15 to 24);
IV. Cooperation with foreign courts and foreign representatives (Articles 25 to 27);
V. Concurrent proceedings (Articles 28 to 32).

Its ambitious goal was stated in the Guide for the Enactment:

"The UNCITRAL Model Law on Cross-Border Insolvency, adopted in 1997, is designed to assist States to equip their insolvency laws with a modern, harmonized and fair framework to address more effectively instances of cross-border proceedings concerning debtors experiencing severe financial distress or insolvency. Those instances include cases where the debtor has assets in more than one State or where some of the creditors of the debtor are not from the State where the insolvency proceeding is taking place. In principle, the proceeding pending in the debtor's centre of main interests is expected to have principal responsibility for managing the insolvency of the debtor regardless of the number of States in which the debtor has assets and creditors, subject to appropriate coordination procedures to accommodate local needs.
The Model Law reflects practices in cross-border insolvency matters that are characteristic of modern, efficient insolvency systems. Thus, the States enacting the Model Law would be introducing useful additions and improvements in national insolvency regimes designed to resolve problems arising in cross-border insolvency cases. By adopting legislation based upon the Model Law, States recognize that certain laws relating to insolvency may have to be or might have been amended in order to meet internationally recognized standards."[657]

The Preamble served as an introduction to the different chapters:

"The purpose of this Law is to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of:

a) cooperation between the courts and other competent authorities of this State and foreign States involved in cases of cross-border insolvency;
b) greater legal certainty for trade and investment;
c) fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;
d) protection and maximization of the value of the debtor's assets;
e) facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment."

[656] **UNCITRAL (United Nations Commission on International Trade Law),** "*Legislative guide on insolvency law, the Judicial perspective*", United Nations, New York, (2013), at 22.
[657] *Id.,* at 19; see also **UNCITRAL (United Nations Commission on International Trade Law),** "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2004), at 307.

The Preamble addressed four specific key areas that had been identified for their relevance through international studies since the early nineties[658]:

1) **Access:** to grant insolvency representatives and creditors easier access to foreign insolvency proceedings;
2) **Recognition:** to provide swifter, cheaper recognition of foreign proceedings and court orders;
3) **Relief:** to offer effective and ample relief in cross-border cases;
4) **Cooperation:** to increase coordination and dialogue in the international scenario.

Moreover the Guide of 2005 presented the following list of points, providing further clarification on the objectives pursued within the four areas:

> "(a) Providing the person administering a foreign insolvency proceeding ("foreign representative") with access to the courts of the enacting State, thereby permitting the foreign representative to seek a temporary "breathing space", and allowing the courts in the enacting State to determine what coordination among the jurisdictions or other relief is warranted for optimal disposition of the insolvency;
> (b) Determining when a foreign insolvency proceeding should be accorded "recognition" and what the consequences of recognition may be;
> (c) Providing a transparent regime for the right of foreign creditors to commence, or participate in, an insolvency proceeding in the enacting State;
> (d) Permitting courts in the enacting State to cooperate more effectively with foreign courts and foreign representatives involved in an insolvency matter;
> (e) Authorizing courts in the enacting State and persons administering insolvency proceedings in the enacting State to seek assistance abroad;
> (f) Providing for court jurisdiction and establishing rules for coordination where an insolvency proceeding in the enacting State is taking place concurrently with an insolvency proceeding in a foreign State;
> (g) Establishing rules for coordination of relief granted in the enacting State in favour of two or more insolvency proceedings that may take place in foreign State regarding the same debtor."[659]

The Model, therefore, attempted to bring predictability and transparency in the interaction of international courts and local systems.

4.2.2 The flexibility of the Model Law: a source of success and weakness

Through the application of best practices, the UNCITRAL[660] Model Law has attempted to find an effective and successful solution to the difficulties arising out of the growing number of cases within the globalized market:

> "The increasing incidence of cross-border insolvencies reflects the continuing global expansion of trade and investment. However, national insolvency laws by and large have not kept pace with the trend, and they are often ill-equipped to deal with cases of cross-border nature. This often results in inadequate and inharmonious legal approaches, which hamper the rescue of financially troubled businesses, are not conducive to a fair and efficient administration of cross-border insolvencies, impede the protection of assets of the insolvent debtor against dissipation and hinder maximization of the value of those

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[658] **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations"*, United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 20.

[659] **UNCITRAL (United Nations Commission on International Trade Law),** "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2045), at 307.

[660] United Nations Commission on International Trade Law; see www.uncitral.org.

> assets. Moreover the absence of predictability in the handling of cross-border insolvency cases can impede capital flow and be a disincentive to cross-border investment."[661]

The law, as it was designed, holds a relevant degree of flexibility which has permitted its diffusion and allows its application in the international scenario.

Today, twenty years from its enactment, we can say that the proposed system has been successful.[662] Several countries worldwide have, in fact, decided to adopt it and share its principles[663], just as recommended by influential international organizations such as the International Monetary Fund and the World Bank.[664] This is despite the fact that the Model Law is not binding:

> "By definition, the model law has no binding force but tries to convince local (national as well as regional legislators by its quality and the authority of its authorship."[665]

> "A model law is a legislative text that is recommended to States for incorporation into their national law. Unlike an international convention, a model law does not require the State enacting it to notify the United Nations or other States that may have also enacted it."[666]

This is the case of: Eritrea in 1998; Japan, South Africa, and Mexico in 2000; the British Virgin Islands in 2003; the United States and Canada in 2005; Colombia, the Republic of Korea, Great Britain, and New Zealand in 2006; Australia in 2008; the Mauritius in 2009; the Philippines in 2010; Uganda in 2011; Chile, the Seychelles, and Vanuatu in 2013; Gibraltar in 2014; and Benin, Burkina Faso, Cameroon, the Central African Republic, Chad, the Comoros, Congo, the Ivory Coast, the Democratic Republic of Congo, Equatorial Guinea, Gabon, Guinea, Guinea Bissau, Kenya, Malawi, Mali, Niger, Senegal, and Togo in 2015.[667]

Many European countries have also adopted rules inspired by the Model Law. This is the case of Montenegro in 2000; Serbia and Poland in 2002; Romania in 2003; the United Kingdom in 2006; Slovenia in 2007; and Greece in 2010. The adoption of the Model Law by EU members is particularly meaningful. While EU regulations work only between EU members, nations that adopt the UNCITRAL model expand their options and can solve issues which arise with non-EU countries as well[668] [669]:

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[661] **UNCITRAL (United Nations Commission on International Trade Law)**, "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 20-21; see also **UNCITRAL (United Nations Commission on International Trade Law),** "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2004), at 310.

[662] **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry**, "*A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group*", The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010), at 248.

[663] Id.: "The global impact of the model law on cross-border insolvency had become more and more visible. Although at the outset there was not a "big run" on the national enactment of the model law – most countries adopted a wait-and-see attitude- the model law nevertheless influenced the national theoretical discussions right from its publication".

[664] **Westbrook Jay L**., "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1 (2002), at 4.

[665] **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry**, "*A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group*", The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010), at 247.

[666] **UNCITRAL (United Nations Commission on International Trade Law)**, "*Legislative guide on insolvency law*", United Nations, New York, ISBN 92-1-133736-4, (2004), at 309.

[667] http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html

[668] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 22. See also http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html#$35287

[669] For a discussion of the benefits of the application if the Model Law within the EU scenario and the EU Regulations see also **Van Galen Robert, André Marc, Fritz Daniel, Gladel Vincent, van Koppen Frans, Marks David, Wouters Nora**,

> "The EC Regulation establishes a cross-border insolvency regime within the European Union for cases where the debtor has the centre of its main interests in a State member of the Union. The Regulation does not deal with cross-border insolvency matters extending beyond a State member of the European Union into a non-Member State. Thus, the Model Law offers to States members of the European Union a complementary regime of considerable practical value that could address the many cases of cross-border cooperation not covered by the EC Regulation."

> "Some feel that the adoption of the EU Regulation obviates any need for adoption of the Model Law by the EU or its members. Whether or not that is true within the EU, it is certainly not true vis-à-vis the rest of the world. As important as regional integration may be, it must surely be part of the continuing expansion of economic ties among all nations around the world. Thus it is important that regional initiatives avoid the reality, or even the appearance, of creating a "club" that looks only inward. More broadly, insofar as it is accepted that insolvency regimes must expand in scope to be as symmetrical as possible with the market, the steady extension of economic unity from the regional to the global level requires that the scope of the insolvency regime, at the least at the level of coordination and perspective, must do the same. […] Adoption of the Model Law by the EU Member States would serve several purposes. One is that such adoption would be regarded as a very friendly gesture in other states. […] An important purpose served by the adoption of the Model Law is that it would produce a uniform law within the EU as to non-EU companies. The Regulation states that any insolvency case involving a debtor whose center of main interests is outside the Union is excluded from its coverage. Thus if a United States company with assets in several EU Member States goes into insolvency in New York, the treatment of requests for recognition and assistance by the United States debtor in possession or foreign representatives must be considered by courts in each relevant EU Member State. If each of them has adopted the Model Law, however, all of those courts will be applying the same law and the same law will also be likely be adopted in the United States by that time. The improvement in coordination and communication would obviously be enormous, to the benefit of rescue chances and creditor recoveries, and the likelihood of inconsistent results within the EU would be greatly reduced."[670]

The diffusion of the Model within great numbers of local frameworks is the key to its success[671] and, at the same time, a sign of its main weakness. The more, in fact, the framework is shared at the international level, the greater is its impact. At the same time, the law is not structured as an independent, fully inclusive bankruptcy code[672]; it is designed to become operative as a part of a pre-existing national insolvency statute.[673]

'Revision of the European Insolvency Regulation – Proposals by INSOL Europe", INSOL EUROPE, ISBN 978-0-9570761-0-5, (2012), at 109-122.

[670] **Westbrook Jay L.,** "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1 (2002), at 38-40.

[671] **Devling Brian M**., "*The continuing vitality of the territorial approach to cross-border insolvency*", 70 UMKC L. Rev. 435, (2001), at 448: "[…] the Model Law is probably the most practical tool available for stabilizing global insolvency laws. Given the many cultural and ideological differences among nation, UNCITRAL faced a difficult task in creating a law that many nations would adopt. Even if the model Law reflected a purer form of universalism, the law would be useless if a majority of nations rejected the law".

[672] **Berends Andrè J**., "*The UNCITRAL Model Law on Cross-Border Insolvency: a comprehensive overview*", 6 Tul. J. Int'l & Comp. L. 309, (1998), at 9.

[673] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 33; **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry**, "*A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group*", The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010), at 247: "The model law is designed in such a way that it can be adopted without greater efforts by any legislators of this world".

The Model is, in fact, structured to be a “flexible”[674] and adaptable procedural addition to the local regulation that hosts it. The high degree of flexibility which allows it to be applied easily in the international scenario also causes great lack of uniformity and, ultimately, weakens it:

> “A model law is a legislative text that is recommended to States for incorporation into their national law. Unlike an international convention, a model law does not require the State enacting it to notify the United Nations or other States that may have also enacted it.”[675]

By merging with the multitude of local frameworks, the law attempts to become a “bridge”[676] to overcome variations between nations[677], which act as a barrier to their effective cooperation and coordination at the international level. Such a goal is laudable, but it implicitly means that:

a) changes to its structure may be made, and in some cases ought to be[678];

b) the enacted framework will scarcely affect the relevant substantive discrepancies among international statutes;

c) the Model Law remains a purely procedural framework:

> “The model Law **respects** the differences among national procedural laws and does not attempt a substantive unification of insolvency law.”[679]

Despite early attempts, in fact, the Model does not aim to bring uniformity in substantive insolvency elements. It does not, for example, provide uniform definitions aside from the ones necessary and useful in the cross-border setting included in Article 2. Too much is, therefore, still left to local regulations. The compromises that have been made in order to allow the Model to be popular, therefore, appear to be capable of depriving it of much of its universalism, leaving the Law somehow “incomplete”.[680]

It can be stated that the UNCITRAL Model Law has been built to be widely adopted and has achieved much success up to today. The high degree of flexibility present in the draft, though, leaves several areas in need of improvement.

It is affirmed in the Guides, in fact, that some degree of modification is to be expected, in particular when the Model Law addresses issues related to a state’s court and procedural systems, so that integration between the National laws and the Model Law may be the least “traumatic”[681]:

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[674] *Id.*, at 26: “(f) The Model Law is in the flexible form of model legislation that takes into account differing approaches in national insolvency laws and the varying propensities of States to cooperate and coordinate in insolvency matters (Articles 25-27)."

[675] See **UNCITRAL (United Nations Commission on International Trade Law)**, “*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*”, United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 24.

[676] **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry,** “*A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group*”, The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010), at 247.

[677] It is important to notice that the diversities are not limited to the application of substantive principles of insolvency law but to the entire legal systems. Among the countries that enacted the Model Law, in fact, there are both common law and civil law countries.

[678] **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry**, “*A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group*”, The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010), at 247-8.

[679] *Id.*, at 19; **UNCITRAL (United Nations Commission on International Trade Law)**, “*Legislative guide on insolvency law*”, United Nations, New York, ISBN 92-1-133736-4, (2004), at 307.

[680] **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry,** “*A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group*”, The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010), at 250.

[681] See **UNCITRAL (United Nations Commission on International Trade Law),** “*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*”, United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 25.

> "In incorporating the text of a model law into its system, a State may modify or leave out some of its provisions. In the case of a convention, the possibility of changes being made to the uniform text by the States parties (normally referred to as "reservations") is much more restricted; in particular trade law conventions usually either totally prohibit reservations or allow only specified ones. The flexibility inherent in a model law is particularly desirable in those cases when it is likely that the State would wish to make various modifications to the uniform text before it would be ready to enact it as a national law. Some modifications may be expected in particular when the uniform text is closely related to the national court and procedural system (which is the case with the UNCITRAL Model Law on Cross-Border Insolvency). **This, however, also means that the degree of, and certainty about, harmonization achieved through a model law is likely to be lower than in the case of a convention**. Therefore, in order to achieve a satisfactory degree of harmonization and certainty, it is recommended that States make as few changes as possible in incorporating the Model Law into their legal systems."[682]

Although the proposed framework attempts to be rigid rather than flexible, in promoting the achievement of its goals (it is suggested that users make the minimum necessary number of modifications when regulations are adopted) so that the highest level of international uniformity and effectiveness can be reached, the absence of a binding structure does not efficiently support this purpose.

Chapter 15 of the US Bankruptcy Code is a valuable example of the application of the Model Law in a complex insolvency context, in the form hoped for by the Model itself[683]:

> "The three most important features of the United States legislation are the attempt to follow the Model Law's language and intent as closely as possible; the emphasis on an ancillary rather than a parallel approach; and the exclusion of small, natural person debtors. […]
> Chapter 15 tracks the Model Law from start to finish. The drafters even maintained the numbering of the original law so that section 1501 of Chapter 15 adopts Article 1 of the Model Law and so on. They made a conscious effort to avoid changing the Model Law's language even where different formulations would fit more easily the United States statutory style and practice. For example, the definitions section of Chapter 15, section 1503, defines a foreign main proceeding in the exact language of the Model Law, even though the phrase "center of its main interests" is quite different from the usual United States formulation for a similar idea. Although various American commentators argued for a change to a more usual formulation, so as to give the United States courts a familiar phrase to interpret, the drafters decided that it was more important to have a uniform worldwide phrase (at the least in English) for such a central point. Similar decisions to follow the Model Law's organization and language were made throughout Chapter 15, despite frequent comments in favor of change.
> Nonetheless, there are a number of changes in the wording of the Model Law as it is found in Chapter 15. Even with a strong commitment to the original, the drafters found that fitting the Model Law into the United States legal system required working changes and additional provisions in sections where no substantive change in the policy of the Model Law was intended. […]
> Those changes that are not merely semantic are usually procedural and are not meant to change the substance of the Model Law[684]

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[682] *Id.,* at 25.

[683] See **Austin Daniel A.,** "*Cross-border insolvencies under Chapter 15 of the United States Bankruptcy Code*" in *'Substantive harmonization and convergence of laws in Europe – Papers from the INSOL Europe Academic Forum annual insolvency conference 21-22 September 2011, Molino Stucky Hotel, Venice, Italy'*, Ed. Parry Rebecca., INSOL EUROPE, ISBN 978-0-9570761-4-3, (2012).

[684] **Westbrook Jay L**., "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1 (2002), at 18-21.

But others versions, such as Japan's, show high degrees of modifications.[685] It can be therefore affirmed that the Model is a step forward toward the goal of achieving uniformity compared to mere lists of Principles such as the Concordat; but despite its popularity, it is still far from bringing the changes that are necessary to reform this field of law.[686]

4.2.3 Application of the procedural framework provided by the Model

The Model Law is not intended to be a mere collection tool[687] [688] or to assist in the winding up of corporations.[689] The procedural framework is drafted to apply to "collective"[690], judicial or administrative, insolvency proceedings[691], even *ad interim* ones.[692] The Model applies, therefore, to both voluntary and involuntary insolvency proceedings[693], whether they be in the form of liquidations or reorganizations[694] [695],

[685] *Id.,* at 24.

[686] See **Devling Brian M**., "*The continuing vitality of the territorial approach to cross-border insolvency*", 70 UMKC L. Rev. 435, (2001); at 447 quoting **Liza Perkins**: "*The Model law is a weak tool for advancing the goals of universalism*". See also **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 26: "The flexibility to adapt the Model Law to the legal system of the enacting State should be utilized with due consideration for the need for uniformity in its interpretation (see paras. 106-7 below) and for the benefits to the enacting State of adopting modern, generally acceptable international practices in insolvency matters. Thus it is advisable to limit deviations from the uniform text to a minimum. This will assist in making the national law as transparent as possible for foreign uses (see also paras 20 and 21 above). The advantage of uniformity and transparency is that it will make it easier for enacting States to demonstrate the basis of their national law on cross-border insolvency and obtain cooperation from other States in insolvency matters".

[687] **Gerber Elizabeth J**., "*Not all politics is local: the new Chapter 15 to govern cross-border insolvencies*", 71 Fordham L. Rev., 2051, (2003); quoting the Guide to enactment, 2063-2064.

[688] See **UNCITRAL (United Nations Commission on International Trade Law),** *"UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 39: "For a proceeding to qualify for relief under the Model law, it must be a collective proceeding because the Model Law is intended to provide a tool for achieving a coordinated, global solution for all stakeholders of an insolvency proceeding. It is not intended that the Model law be used merely as a collection device for a particular creditor or group of creditors who may have initiated a collection proceeding in another State."

[689] See *Id.,* at 39-40.

[690] *Id.,* 32-33.

[691] Article 2; See **Berends Andrè J**., "*The UNCITRAL Model Law on Cross-Border Insolvency: a comprehensive overview*", 6 Tul. J. Int'l & Comp. L. 309, (1998), at 323-4: "For a Proceeding to qualify it must: 1) be collective in nature; 2) Judicial or administrative; 3) commenced in a foreign State; 4) pursuant a law concerning insolvency; 5) The assets and affairs of the debtor must be subject to control or supervision by the court; 6) The aim of the proceeding is a reorganization or a liquidation".

[692] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 43-44; **Westbrook Jay L.**, "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1 (2002), at 12.

[693] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations",* United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 48.

[694] "According to Article 1, the Model Law shall apply to any collective judicial or administrative proceeding in a foreign state, including an interim proceeding, for the purpose of reorganization or liquidation", see **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry**, "*A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group*", The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010), at 248.

[695] Article 2 (a): "For the purpose of this Law, "foreign proceeding" means a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation."

concerning a variety of different debtors[696] (including natural persons when local rules allow them access) and a variety of entities.[697]

The proposed framework, in fact, does not prevent its application to any specific category of debtors as long as they can be part of a collective proceeding; limitations, if any, would be included in the substantive rules of the national statutes. Due to the flexibility of the Model, in fact, a Government can limit its application simply by listing[698] (Article 1, 2) those entities that may be left out of its scope.

The Guideline mentions banks or insurance companies as examples of such typical exclusions:

> "The particular need to protect vital interests of a large number of individuals or that the insolvency of such entities usually requires particularly prompt and circumspect action."[699]

But the same option could be used for other categories also mentioned in the Guide, such as natural persons or non-business debtors, hence limiting its applicability to the business setting. Quantitative limits may also be placed as barriers so that entities or natural persons may not be debtors as long as the cumulative value of their debts, for example, remains below a certain minimum ceiling.[700]

Two articles pose general limitations to the application of the Model, which are not automatic upon its adoption into a local insolvency statute. A limitation concerning conflicts among the Model Law and other treaties or international agreements, stating that the latter would prevail on the first[701], is contained in Article 3.

> "Article 3, expressing the principle of supremacy of international obligations of the enacting State over internal law, has been modeled on similar provisions in other model laws prepared by UNCITRAL."[702]

A second limitation in the form of a narrowly tailored[703] "public policy exception"[704] is included in Article 6. The article allows a country not to recognize a proceeding if it would be in contrast with its "public

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[696] Article 2.

[697] Interestingly enough the U.S. limited CH 15 and did not include individual debtors. See **Westbrook Jay L.**, "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1 (2002), at 14: " The United States delegation was one of those delegations arguing that natural persons should be excluded from the Model law entirely. Although some rich persons might have enough in assets and liabilities to justify multinational insolvency proceedings, the United States was concerned about the entanglement of a number of social issues, like marital property and exemption of property from seizure, that arise only in the insolvency of natural persons. [..] UNCITRAL ultimately decided to include natural persons, but with the understanding that countries like the United States, who have special bankruptcy provisions for consumers, might decide to exclude them from its operation."

[698] The guide suggests that specific exclusions are expressly mentioned for the benefit of foreign users of the law. See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 48.

[699] Article 1; Article 2.

[700] **Berends Andrè J**., "*The UNCITRAL Model Law on Cross-Border Insolvency: a comprehensive overview*", 6 Tul. J. Int'l & Comp. L. 309, (1998), at 325-7.

[701] Article 3. International obligations of this State: "To the extent that this Law conflicts with an obligation of this State arising out of any treaty or other form of agreement to which it is a party with one or more other States, the requirements of the treaty or agreement prevail."

[702] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 48.

[703] **Westbrook Jay L**., "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1, (2002), at 13.

[704] Article 6. Public policy exception: "Nothing in this Law prevents the court from refusing to take an action governed by this Law if the action would be manifestly contrary to the public policy of this State."

policies" to do so, but it does not provide a definition of what may constitute public policy. Since such parameters may vary greatly among societies and frameworks, little guidance is provided on the topic:

> "102. In some States the expression "public policy" may be given a broad meaning in that it might relate in principle to any mandatory rule of national law. In many States, however, the public policy exception is construed as being restricted to fundamental principles of law, in particular constitutional guarantees; in those States, public policy would only be used to refuse the application of foreign law, or the recognition of a foreign judicial decision or arbitral award, when that would contravene those fundamental principles."[705]

Although interpretations vary greatly among different insolvency frameworks, exceptions should be narrowly interpreted to preserve the effectiveness of the Model:

> "104. The purpose of the expression "manifestly", used also in many other international legal texts as a qualifier of the expression "public policy", is to emphasize that public policy exceptions should be interpreted restrictively and that Article 6 is only intended to be invoked under exceptional circumstances concerning matters of fundamental importance for the enacting State."[706]

> "Differences in insolvency schemes do not themselves justify a finding that enforcing one State's law would violate the public policy of another State."[707]

The model does not provide a uniform definition of insolvency. Article 2 states that the Model applies in connection to:

> "a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation."[708]

It can be therefore stated that, to be eligible, a debtor must be facing a situation of great financial distress (the Guide mentions the cessation of payments or acts in dissipation of the patrimony[709]), but need not to have necessarily reached the state of insolvency. An interesting remark can be made on the relevance of insolvency within the Model in connection with Article 31:

> "Article 31. Presumption of insolvency based on recognition of a foreign main proceeding
> In the absence of evidence to the contrary, recognition of a foreign main proceeding is, for the purpose of commencing a proceeding under [identify laws of the enacting State relating to insolvency], proof that the debtor is insolvent."

[705] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations"*, United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 52.
[706] *Id.*
[707] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 28.
[708] Article 2 (a).
[709] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 40; **Berends Andrè J.,** "*The UNCITRAL Model Law on Cross-Border Insolvency: a comprehensive overview*", 6 Tul. J. Int'l & Comp. L. 309, (1998), at 326-7.

The Guide on this topic states that[710]:

> "235. **In some jurisdictions, proof that the debtor is insolvent is required for the commencement of insolvency proceedings**. In other jurisdictions, insolvency proceedings may be commenced under specific circumstances defined by law that do not necessarily mean that the debtor is in fact insolvent; those circumstances may be, for example, cessation of payments by the debtor or certain actions of the debtor such as a corporate decision, dissipation of its assets or abandonment of its establishment.
>
> "236. In jurisdictions where insolvency is a condition for commencing insolvency proceedings, Article 31 establishes, upon recognition of a foreign main proceeding, a rebuttable presumption of insolvency of the debtor for the purposes of commencing an insolvency proceeding in the enacting State. The presumption does not apply if the foreign proceeding is a non-main proceeding. The reason is that an insolvency proceeding commenced in a State other than the State where the debtor has the centre of its main interests does not necessarily mean that the debtor is to be subject to laws relating to insolvency in other States.
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> 237. For the national laws where proof that the debtor is insolvent is not required for the commencement of insolvency proceedings, the presumption established in Article 31 may be of little practical significance and the enacting State may decide not to enact it.
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> 238. This rule, however, would be helpful in those legal systems in which commencement of an insolvency proceeding requires proof that the debtor is in fact insolvent. Article 31 would have particular significance when proving insolvency as the prerequisite for an insolvency proceeding would be a time-consuming exercise and of little additional benefit bearing in mind that the debtor is already in an insolvency proceeding in the State where it has the centre of its main interests and the commencement of a local proceeding may be urgently needed for the protection of local creditors. Nonetheless, the court of the enacting State is not bound by the decision of the foreign court, and local criteria for demonstrating insolvency remain operative, as is clarified by the words "in the absence of evidence to the contrary.""

"Presuming" insolvency may, indeed, be practical and time-saving. At the same time, though, one may wonder about the burdensome consequences deriving from it in those cases in which the involved local insolvency frameworks are heavily stigmatizing, e.g. when they still impose heavy civil disqualifications and criminal punishments on bankrupts.

4.2.4 Universality and the debtor's "COMI"

The Model Law applies a stringent approach based on modified universality. A leading, "main" proceeding is opened in the country where the center of main interests (COMI) of the debtor is located[711] to manage his or financial difficulties.[712] Ancillary proceedings may be opened in those countries in which

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[710] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 105-6;

[711] **Westbrook Jay L., Booth Charles D., Paulus Christoph G., Rajak Harry,** "*A global view of business insolvency systems – with a foreword by Anne-Marie Leroy Senior Vice President and General Counsel of the World Bank Group*", The World Bank, Martinus Nujhoff Publishers, ISBN 978-0-8213-8103-8, (2010), at 249; **Vv. Aa.,** "*Trattato di diritto fallimentare e delle alter procedure concorsuali – Volume V. – Profili storici, comunitari, internazionali e di diritto comparato*", Editors Vassalli F., Luiso F.P., Gabrielli E., G. Giappichelli Editore – Torino; at 70. **Westbrook Jay L.**, "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1 (2002), at 14.

[712] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations"*, United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 19.

the debtor has an establishment or where his assets are located[713] as long as they are "harmonized" with the main one.[714]

Article 2 defines what "foreign main proceeding" and "non-main proceeding" are:

> *"(b)* "Foreign main proceeding" means a foreign proceeding taking place in the State where the debtor has the centre of its main interests;
> *(c)* "Foreign non-main proceeding" means a foreign proceeding, other than a foreign main proceeding, taking place in a State where the debtor has an establishment within the meaning of subparagraph *(f)* of this Article."

Nevertheless, providing a clear definition of "center of main interest" created several issues of interpretation[715], despite the key relevance of this concept for the operation of the whole framework. The UNCITRAL was inspired on this matter by European studies and Regulations[716] [717]:

> "82. The Model Law does not define the concept "centre of main interests". However, an explanatory report (the Virgos-Schmit Report), prepared with respect to the European Convention, provided guidance on the concept of "main insolvency proceedings" and notwithstanding the subsequent demise of the Convention, the Report has been accepted generally as an aid to interpretation of the term "centre of main interests" in the EC Regulation. Since the formulation "centre of main interests" in the EC Regulation corresponds to that of the Model Law, albeit for different purposes, jurisprudence interpreting the EC Regulation may also be relevant to interpretation of the Model Law.
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> 83. Recitals (12) and (13) of the EC Regulation state: "(12) This Regulation enables the main insolvency proceedings to be opened in the Member State where the debtor has the centre of his main interests. These proceedings have universal scope and aim at encompassing all the debtor's assets. To protect the diversity of interests, this Regulation permits secondary proceedings to be opened to run in parallel with the main proceedings. Secondary proceedings may be opened in the Member State where the debtor has an establishment. The effects of secondary proceedings are limited to the assets located in that State. Mandatory rules of coordination with the main proceedings satisfy the need for unity in the Community. "(13) The 'centre of main interests' should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties." [718]

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[713] Article 2.

[714] Under the Model Law all foreign proceedings are either 'main' or 'non-main' proceedings. […] There can be only one main proceeding, which must be the proceeding in which the debtor has the 'center of main interests'" **Cronin Mattew T**., "*Uncitral model Law on cross-border insolvency: procedural approach to substantive problem*", 24 J. Corp. L. 709, (1999), 715-6.

[715] "There was much debate within the Working Group regarding how to define the 'centre of its main interests'. For simplicity's sake some advocated a simple determination that the proceeding in the state where the debtor has its registered office would be, per se, the main proceeding. The Working Group was worried, however that a debtor would have its registered office solely for tax purposes rather than because that state truly was the center of its main interests". See **Cronin Mattew T**., "*Uncitral model Law on cross-border insolvency: procedural approach to substantive problem*", 24 J. Corp. L. 709, (1999), 716.

[716] "The drafters of the of the Model Law copied the words of Article 2(b) from the EU Convention", see **Berends Andrè J**., "*The UNCITRAL Model Law on Cross-Border Insolvency: a comprehensive overview*", 6 Tul. J. Int'l & Comp. L. 309, (1998), at 329; **Westbrook Jay L**., "*Multinational Enterprises in General Default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1 (2002), at 14.

[717] See **UNCITRAL (United Nations Commission on International Trade Law),** "UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 44-45.

[718] *Id.,* at 44.

> “**73. Main insolvency proceedings** “Article 3 (1) enables main insolvency universal proceedings to be opened in the Contracting State where the debtor has his centre of main interests. Main insolvency proceedings have universal scope. They aim at encompassing all the debtor’s assets on a world-wide basis and at affecting all creditors, wherever located. “Only one set of main proceedings may be opened in the territory covered by the Convention.
>
> 75. The concept of ‘centre of main interests’ must be interpreted as the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties. “The rationale of this rule is not difficult to explain. Insolvency is a foreseeable risk. It is therefore important that international jurisdiction (which, as we will see, entails the application of the insolvency laws of that Contracting State) be based on a place known to the debtor’s potential creditors. This enables the legal risks which would have to be assumed in the case of insolvency to be calculated. “By using the term ‘interests’, the intention was to encompass not only commercial, industrial or professional activities, but also general economic activities, so as to include the activities of private individual (e.g. consumers). The expression ‘main’ serves as a criterion for the cases where these interests include activities of different types which are run from different centers. “In principle, the centre of main interests will in the case of professionals be the place of their professional domicile and for natural persons in general, the place of their habitual residence. “Where companies and legal persons are concerned, the Convention presumes, unless proved to the contrary, that the debtor’s centre of main interests is the place of his registered office. This place normally corresponds to the debtor’s head office.”[719]

Despite the universalist soul of the Model Law, secondary proceedings remain an important element to improving the efficiency of the framework. Commencing an ancillary case to protect the interests of the creditors on foreign assets that may be swiftly dispersed can be an urgent and vital matter in international insolvency:

> “114. A foreign representative has this right without prior recognition of the foreign proceeding because the commencement of an insolvency proceeding might be crucial in cases of urgent need for preserving the assets of the debtor. Article 11 recognizes that not only a representative of a foreign main proceeding but also a representative of a foreign non-main proceeding may have a legitimate interest in the commencement of an insolvency proceeding in the enacting State. Sufficient guarantees against abusive applications are provided by the requirement that the other conditions for commencing such a proceeding under the law of the enacting State have to be met.”[720]

Article 11[721] gives standing to a representative of a proceeding to petition the commencement of a new proceeding in a foreign nation. Such standing, though, may be challenged in a number of local contexts.[722] Whether the power may have been vested exclusively in the administrator of the main proceeding or also in an administrator of a secondary one has been a topic widely debated.[723]

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[719] *Id.,* at 44-45.

[720] *Id.,* at 57.

[721] Article 11: “Application by a foreign representative to commence a proceeding under [identify laws of the enacting State relating to insolvency] A foreign representative is entitled to apply to commence a proceeding under [identify laws of the enacting State relating to insolvency] if the conditions for commencing such a proceeding are otherwise met."

[722] See **UNCITRAL (United Nations Commission on International Trade Law),** “*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*”, United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 56.

[723] See for example **Berends Andrè J**., “*The UNCITRAL Model Law on Cross-Border Insolvency: a comprehensive overview*”, 6 Tul. J. Int’l & Comp. L. 309, (1998), at 340, explaining that the European Convention, which was contemporaneous, applied a different rationale explicitly limiting the powers of the administrators of secondary

4.2.5 A brief overview of the key areas addressed by the Model Law

[A] Access

Granting insolvency representatives and interest holders access in foreign proceedings is a relevant target. The Model provides a framework to allow representatives to interact successfully in the international insolvency scenario and, in particular it allows:

- **powers to act in a foreign state on behalf of the local proceeding** (Article 5);
- **the right to have access to the courts of the enacting state** (Article 9) – through which the Model Law aims to provide foreign representatives with the right to appear in local courts without the need to comply with elaborate and expensive diplomatic procedures[724];
- **the right to apply for the commencement of a case under local rules in a foreign country** (Article 11);
- **the right to apply for recognition of a local proceeding** (Article 15).

Foreign creditors also greatly benefit from the cross-border framework. Under Article 13, in fact, they are awarded "national treatment", meaning that foreign and national creditors have the right to apply for the commencement of a case and to receive the same treatment:

> *"Article 13. Access of foreign creditors to a proceeding under*
> [identify laws of the enacting State relating to insolvency]
> 1. Subject to paragraph 2 of this Article, foreign creditors have the same rights regarding the commencement of, and participation in, a proceeding under [*identify laws of the enacting State relating to insolvency*] as creditors in this State.
> 2. Paragraph 1 of this Article does not affect the ranking of claims in a proceeding under [*identify laws of the enacting State relating to insolvency*], except that the claims of foreign creditors shall not be ranked lower than [*identify the class of general non-preference claims, while providing that a foreign claim is to be ranked lower than the general non-preference claims if an equivalent local claim (e.g. claim for a penalty or deferred-payment claim) has a rank lower than the general non-preference claims*].[2]
> 2 The enacting State may wish to consider the following alternative wording to replace Paragraph 2 of Article 13(2):
> 2. Paragraph 1 of this Article does not affect the ranking of claims in a proceeding under [*identify laws of the enacting State relating to insolvency*] or the exclusion of foreign tax and

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proceedings "The drafters of the EU Convention chose another solution. Article 29 of the EU Convention provides that the opening of a secondary proceeding may be requested by the liquidator in the main proceeding as well as by any other person empowered under the law of the contracting State to request the opening of insolvency proceedings within the territory of the State in which the secondary proceedings are requested. Therefore, if the law of the State where the opening of the secondary proceeding is sought does not allow the "secondary liquidator" to open such a proceeding, then the "secondary liquidator" does not have that right. A fortiori, a "secondary liquidator" cannot ask for the opening of a main proceeding in another country, at least as long as that other country does not permit such action explicitly in its legislation. The EU Convention does not give the "secondary liquidator" the power to open a main proceeding because some Contracting States want to limit the number of secondary proceedings, which can prove fairly costly. A consequence is that those countries also seek to restrict their own possibilities of opening secondary proceedings. The drafters of the Model Law decided not to follow the precedent set by the EU Convention. A restriction of sovereignty can be agreed upon within the framework of the European Union, but it is not an option on a global level. Moreover, during the sessions of the Working Group and the Commission some arguments were put forward for giving the non-main representative the power to ask for the opening of a main proceeding in another State. One argument was that, if a foreign representative could not ask for the opening of a main proceeding, he could ask a creditor to request the opening. In this way, a "prohibition" for a foreign non-main representative would be quite meaningless. Another argument put forward was that a foreign non-main representative may have some interest in asking for the opening of a main proceeding."

[724] **Westbrook Jay L.,** "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1 (2002), at 13-14.

social security claims from such a proceeding. Nevertheless, the claims of foreign creditors other than those concerning tax and social security obligations shall not be ranked lower than
[*identify the class of general non-preference claims, while providing that a foreign claim is to be ranked lower than the general non-preference claims if an equivalent local claim (e.g. claim for a penalty or deferred-payment claim) has a rank lower than the general non-preference claims*]."

Difficulties arise, though, in granting equality in the distribution process. Disparities may emerge due to special priorities awarded to some classes of claims at the local level. A minimum requirement of non-discrimination of foreign creditors in distribution has been advocated. Foreign creditors should be treated at the least as well as a general unsecured creditors, if a similarly situated creditor would receive at least that treatment:

> "119. Paragraph 2 makes it clear that the principle of non-discrimination embodied in paragraph 1 leaves intact the provisions on the ranking of claims in insolvency proceedings, including any provisions that might assign a special ranking to claims of foreign creditors. Few States currently have provisions assigning special ranking to foreign creditors. However, lest the non-discrimination principle should be emptied of its meaning by provisions giving the lowest ranking to foreign claims, paragraph 2 establishes the minimum ranking for claims of foreign creditors: the rank of general unsecured claims. The exception to that minimum ranking is provided for cases where the claim in question, if it were of a domestic creditor, would be ranked lower than general unsecured claims (such low-rank claims may be, for instance, those of a State authority for financial penalties or fines, claims whose payment is deferred because of a special relationship between the debtor and the creditor or claims that have been filed after the expiry of the time period for doing so). Those special claims may rank below the general unsecured claims, for reasons other than the nationality or location of the creditor, as provided in the law of the enacting State."[725]

Article 14 addresses the issue of due process, access to information and notifications to foreign creditors:

> "Article 14. Notification to foreign creditors of a proceeding under [identify laws of the enacting State relating to insolvency]
> 1. Whenever under [identify laws of the enacting State relating to insolvency] notification is to be given to creditors in this State, such notification shall also be given to the known creditors that do not have addresses in this State. The court may order that appropriate steps be taken with a view to notifying any creditor whose address is not yet known.
> 2. Such notification shall be made to the foreign creditors individually, unless the court considers that, under the circumstances, some other form of notification would be more appropriate. No letters rogatory or other, similar formality is required.
> 3. When a notification of commencement of a proceeding is to be given to foreign creditors, the notification shall:
> (a) Indicate a reasonable time period for filing claims and specify the place for their filing;
> (b) Indicate whether secured creditors need to file their secured claims;
> and
> (c) Contain any other information required to be included in such a notification to creditors pursuant to the law of this State and the orders of the court."

As we have discussed in Chapter II, obtaining information about international proceedings is an essential component of an effective local insolvency system. Its relevance can only increase in the

[725] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 60.

international, cross-border setting. An effective system of notifications allows creditors to have knowledge of proceedings and to be activ" participants, filing claims, casting votes or taking any other action that may be necessary, requested, or allowed. Limiting notice to the rules deployed by local frameworks may ultimately give an advantage to local creditors, affecting the rights of foreigners:

> "122. States have different provisions or practices regarding the methods for notifying creditors, for example, publication in the official gazette or in local newspapers, individual notices, and affixing notices within the court premises or a combination of such procedures. If the form of notification were to be left to national law, foreign creditors would be in a less advantageous situation than local creditors, since they typically do not have direct access to local publications. For that reason, paragraph 2 in principle requires individual notification for foreign creditors but leaves discretion to the court to decide otherwise in a particular case (e.g. if individual notice would entail excessive cost or would not seem feasible under the circumstances)."[726]

As discussed in previous sections, though, providing effective notice in the international setting and keeping all creditors informed may be costly and constitute a practical challenge:

> "The drafters of the Model Law found it undesirable to require the language in which notification should be given. They did not decide whether notifications should be in the language of the creditor, the language of the country where the insolvency proceeding was opened, or the language of the contract on which the claim is based. The drafters also refused to suggest that notification be given in each of the six official languages of the United Nations. Such a requirement would be too inflexible. The language issue is left to other provisions of the legislation of the enacting State." [727]

This is a specific area in which further developments are much needed. Local frameworks are often not structured to provide effective solutions. Traditional means of communication, via regular mail and, eventually, publication on national newspapers, are often unfit to meet the task within a global community. Others, such as registered e-mail systems, may not be compatible. It must also be considered that, in an obscure and intricate field such as the one of bankruptcy (which becomes, if possible, even more complex at the international level with the application of substantive principles that may not find a match among different local frameworks), language and legal barriers can become a formidable obstacle, affecting the capacity of creditors and other interest holders to be active parties in the process.

[B] Recognition

Recognition of a foreign, main or non-main, proceeding leads to several effects:

- it provides access to relief under Articles 20 and 21;
- it allows a foreign representative to participate under Article 13, to initiate actions for the avoidance of antecedent transactions, and to intervene in proceedings in which the debtor is a party under Articles 23 and 24.[728]

Recognition is not automatic, although the process described by Articles 15[729], 16[730] and 17[731] attempts to provide a simple, expeditious, and inexpensive structure for application, removing a number of the time-

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[726] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 61.

[727] **Berends Andrè J.,** "*The UNCITRAL Model Law on Cross-Border Insolvency: a comprehensive overview*", 6 Tul. J. Int'l & Comp. L. 309, (1998), at 349.

[728] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 29.

[729] Article 15: "Application for recognition of a foreign proceeding

consuming and intricate obstacles connected with tools such as letters of rogatory and other forms of diplomatic communications, hence facilitating a coordinated and cooperative approach.[732] [733]

> "One of the key objectives of the Model Law is to establish simplified procedures for recognition of qualifying foreign proceedings that would avoid-time consuming legalization or other processes and provide certainty with respect to the decision to recognize."[734]
>
> "127. The Model Law avoids the need to rely on cumbersome and timeconsuming letters rogatory or other forms of diplomatic or consular communications that might otherwise have to be used. This facilitates a coordinated, cooperative approach to cross-border

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1. A foreign representative may apply to the court for recognition of the foreign proceeding in which the foreign representative has been appointed.
2. An application for recognition shall be accompanied by:
(a) A certified copy of the decision commencing the foreign proceeding and appointing the foreign representative; or
(b) A certificate from the foreign court affirming the existence of the foreign proceeding and of the appointment of the foreign representative; or
(c) In the absence of evidence referred to in subparagraphs (a) and (b), any other evidence acceptable to the court of the existence of the foreign proceeding and of the appointment of the foreign representative.
3. An application for recognition shall also be accompanied by a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative.
4. The court may require a translation of documents supplied in support of the application for recognition into an official language of this State."

[730] Article 16: "Presumptions concerning recognition
1. If the decision or certificate referred to in paragraph 2 of Article 15 indicates that the foreign proceeding is a proceeding within the meaning of subparagraph (a) of Article 2 and that the foreign representative is a person or body within the meaning of subparagraph (d) of Article 2, the court is entitled to so presume.
2. The court is entitled to presume that documents submitted in support of the application for recognition are authentic, whether or not they have been legalized.
3. In the absence of proof to the contrary, the debtor's registered office, or habitual residence in the case of an individual, is presumed to be the centre of the debtor's main interests."

[731] Article 17: "Decision to recognize a foreign proceeding
1. Subject to Article 6, a foreign proceeding shall be recognized if:
(a) The foreign proceeding is a proceeding within the meaning of subparagraph
(a) of Article 2;
(b) The foreign representative applying for recognition is a person or body within the meaning of subparagraph (d) of Article 2;
(c) The application meets the requirements of paragraph 2 of Article 15; and
(d) The application has been submitted to the court referred to in Article 4.
2. The foreign proceeding shall be recognized:
(a) As a foreign main proceeding if it is taking place in the State where the debtor has the centre of its main interests; or
(b) As a foreign non-main proceeding if the debtor has an establishment within the meaning of subparagraph (f) of Article 2 in the foreign State.
3. An application for recognition of a foreign proceeding shall be decided upon at the earliest possible time.
4. The provisions of Articles 15, 16, 17 and 18 do not prevent modification or termination of recognition if it is shown that the grounds for granting it were fully or partially lacking or have ceased to exist."

[732] See **Westbrook Jay L.,** "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1 (2002), at 14.

[733] **Omar Paul**, "On the origins and challenges of court to court communication in international insolvency law" in *'Comparative and international insolvency law central themes and thoughts'*, Eds. Verweij Anthon and Wessels Bob., INSOL EUROPE, ISBN 978-0-9958364-5-9, (2009); Farley James, "A practical approach to court-to-court communication in international insolvency law" in *'Comparative and international insolvency law central themes and thoughts'*, Eds. Verweij Anthon and Wessels Bob., INSOL EUROPE, ISBN 978-0-9958364-5-9, (2009).

[734] See **UNCITRAL (United Nations Commission on International Trade Law**), "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 29.

insolvency and makes expedited action possible. Article 15 defines the core procedural requirements for an application by a foreign representative for recognition. In incorporating the provision into national law, it is desirable not to encumber the process with additional procedural requirements beyond those referred to. With Article 15, in conjunction with Article 16, the Model Law provides a simple, expeditious structure to be used by a foreign representative to obtain recognition."[735]

The application has to be supported by several documents. Swifter analysis and verification are ensured by translations, when necessary (Article 15 (4)) and by the "presumptions" included in Article 16 (in particular at Article 16 (2)), by which a court is entitled to presume that the documents that are produced in support of the application for recognition are authentic, even if they have not been legalized.

"128. The Model Law presumes that documents submitted in support of the application for recognition need not be authenticated in any special way, in particular by legalization: according to Article 16, paragraph 2, the court is entitled to presume that those documents are authentic whether or not they have been legalized. "Legalization" is a term often used for the formality by which a diplomatic or consular agent of the State in which the document is to be produced certifies the authenticity of the signature, the capacity in which the person signing the document has acted and, where appropriate, the identity of the seal or stamp on the document.
129. It follows from Article 16, paragraph 2, (according to which the court "is entitled to presume" the authenticity of documents accompanying the application for recognition) that the court retains discretion to decline to rely on the presumption of authenticity or to conclude that evidence to the contrary prevails. This flexible solution takes into account the fact that the court may be able to assure itself that a particular document originates from a particular court even without it being legalized, but that in other cases the court may be unwilling to act on the basis of a foreign document that has not been legalized, in particular when documents emanate from a jurisdiction with which it is not familiar. The presumption is useful because legalization procedures may be cumbersome and time-consuming (e.g. also because in some States they involve various authorities at different levels)."[736]

Recognition is, of course, limited to those proceedings which meet the requisites of Article 2[737] and it can be refused under Article 6 when it would be manifestly against the public policies of the State in which the recognition would take place.[738]

Upon verification of all of the necessary prerequisites, the proceeding can be recognized as the main proceeding if it is being opened in the location of the center of main interest of the debtor, or as an ancillary proceeding in case it is opened in a *situs* where an establishment is present.[739]

"A foreign proceeding should be recognized as either a main proceeding or a non-main proceeding (Article 17, paragraph 2). A main proceeding is one taking place where the debtor had its centre of main interests (COMI) at the date of commencement of the

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[735] *Id.*, at 65.
[736] *Id.,* at 64-65.
[737] *Id.,* at 28: "The Model Law is not intended to accord recognition to all foreign insolvency proceedings. Article 17 provides that, subject to Article 6, when the specified requirements of Article 2 concerning the nature of the foreign proceeding (i.e. that the foreign proceeding is, as a matter of course, a collective proceeding for the purposes of liquidation or reorganization under the control or supervision of the court) and that the foreign representative are met and that the evidence required by Article 15 has been provided, the court should recognize the foreign proceeding without further requirement.
[738] *Id.,* at 28: "No definition of what constitutes public policy is attempted as notions vary from State to State. However, the intention is that the exception be interpreted restrictively and that Article 6 be used only in exceptional and limited circumstances".
[739] *Id.,* at 73-77; **Westbrook Jay L**., "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1 (2002), at 14.

> foreign proceeding. In principle, a main proceeding is expected to have principal responsibility for managing the insolvency of the debtor regardless of the number of States in which the debtor has assets and creditors, subject to appropriate coordination procedures to accommodate local need. Centre of main interests is not defined in the Model Law, but is based on a presumption that it is the registered office of habitual residence of the debtor. A non-main proceeding is one taking place where the debtor has an establishment. This is defined as "any place of operation where the debtor carries out non-transitory economic activity with human means and goods or services". Proceedings commenced on a different basis, such as presence of assets without a centre of main interests or establishment, would not qualify for recognition under the Model Law scheme."[740]

In any case, Article 10[741] acts as an interesting "safe-conduct" rule to ensure that a foreign Court does not acquire jurisdiction over all of a debtor's assets just because an administrator made an application for the recognition of the foreign proceeding.[742] Some limits apply, therefore, in the interaction between the different authorities to ensure an effective dialogue. They do not, for example, shield the administrator's responsibility in case tortuous or criminal acts are committed.[743] Moreover, recognition (and consequentially relief) can be successively revoked or modified under Articles 6, 17, 19, and 22.[744]

[C] Relief

Article 19 and 21 discuss discretionary relief.[745] Article 19 deals with "urgently needed" relief which may be made available by court upon filing the application for recognition; while relief under Article 21 is available upon entering formal recognition only[746]:

> "A basic principle of the Model Law is that the relief considered necessary for the orderly and fair conduct of a cross-border insolvency should be available to assist foreign proceedings, whether on an interim basis or as a result of recognition. Accordingly, the Model Law specifies the relief that is available in both those instances. As such, it neither necessarily imports the consequences of the foreign law into the insolvency system of the enacting State nor applies to the foreign proceeding the relief that would be available under the law of the enacting State. However, it is, possible, as noted above, to align the relief resulting from recognition of a foreign proceeding with the relief available in s comparable proceeding commenced under the law of the enacted State (Article 20)."[747]

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[740] **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 29.

[741] Article 10. Limited jurisdiction The sole fact that an application pursuant to this Law is made to a court in this State by a foreign representative does not subject the foreign representative or the foreign assets and affairs of the debtor to the jurisdiction of the courts of this State for any purpose other than the application.

[742] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 55-56.

[743] **Berends Andrè J**., "*The UNCITRAL Model Law on Cross-Border Insolvency: a Comprehensive Overview*", 6 Tul. J. Int'l & Comp. L. 309, (1998), at 339.

[744] **Westbrook Jay L**., "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1 (2002), 14.

[745] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 83.

[746] *Id.,* 80.

[747] *Id.,* at 29.

During the process of recognition, the court has discretion to allow, when urgent and necessary[748], "interim relief" to protect the estate from dissipation.[749] Such protection would end, in absence of other grounds supporting it, in the case where the petition for recognition was denied or where granting relief would interfere with the administration of a foreign main proceeding; while it would be extended in cases where the petition for recognition was successful.[750] The stay would then:

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[748] Relief is a2 key part of bankruptcy. Protecting certain assets through the stay alters the balance between debtor and creditors. Doing so at a time in which recognition has not; yet, been decided upon is not a decision to be taken lightly. For this reason the stay in Article 19 is limited compared to the one of Article 21 to those cases in which it is "urgently needed". See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 80-81

[749] Article 19: "Article 19. Relief that may be granted upon application for recognition of a foreign proceeding
1. From the time of filing an application for recognition until the application is decided upon, the court may, at the request of the foreign representative, where relief is urgently needed to protect the assets of the debtor or the interests of the creditors, grant relief of a provisional nature, including:
(a) Staying execution against the debtor's assets;
(b) Entrusting the administration or realization of all or part of the debtor's assets located in this State to the foreign representative or another person designated by the court, in order to protect and preserve the value of assets that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy;
(c) Any relief mentioned in paragraph 1 (c), (d) and (g) of Article 21.
2. [Insert provisions (or refer to provisions in force in the enacting State) relating to notice.]
3. Unless extended under paragraph 1 (f) of Article 21, the relief granted under this Article terminates when the application for recognition is decided upon.
4. The court may refuse to grant relief under this Article if such relief would interfere with the administration of a foreign main proceeding."

[750] Article 20: "Effects of recognition of a foreign main proceeding
1. Upon recognition of a foreign proceeding that is a foreign main proceeding:
(a) Commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed;
(b) Execution against the debtor's assets is stayed; and
(c) The right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended.
2. The scope, and the modification or termination, of the stay and suspension referred to in paragraph 1 of this Article are subject to [refer to any provisions of law of the enacting State relating to insolvency that apply to exceptions, limitations, modifications or termination in respect of the stay and suspension referred to in paragraph 1 of this Article].
3. Paragraph 1 (a) of this Article does not affect the right to commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor.
4. Paragraph 1 of this Article does not affect the right to request the commencement of a proceeding under [identify laws of the enacting State relating to insolvency] or the right to file claims in such a proceeding."
and
Article 21: "
Article 21. Relief that may be granted upon recognition of a foreign proceeding
1. Upon recognition of a foreign proceeding, whether main or nonmain, where necessary to protect the assets of the debtor or the interests of the creditors, the court may, at the request of the foreign representative, grant any appropriate relief, including:
(a) Staying the commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities, to the extent they have not been stayed under paragraph 1 (a) of Article 20;
(b) Staying execution against the debtor's assets to the extent it has not been stayed under paragraph 1 (b) of Article 20;
(c) Suspending the right to transfer, encumber or otherwise dispose of any assets of the debtor to the extent this right has not been suspended under paragraph 1 (c) of Article 20;
(d) Providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities;
(e) Entrusting the administration or realization of all or part of the debtor's assets located in this State to the foreign representative or another person designated by the court;
(f) Extending relief granted under paragraph 1 of Article 19;

- halt the commencement or continuation of individual actions or non-main proceedings concerning the estate[751];
- suspend the right to transfer, encumber or dispose of assets;
- revoke the power to entrust protected property to administrators or third parties.

Article 20 lists the effects of the recognition of a foreign proceeding, including the automatic[752] imposition of a stay to the commencement or continuation of actions concerning the debtor's assets, rights, obligations, or liabilities and the right to transfer, encumber, or otherwise dispose of any assets that would be part of the estate.[753] [754] Limitations apply in Article 20; sections (3) and (4) and reserve the right to commence necessary actions to preserve claims against the debtor or to request the commencement of a national proceeding and the right to file claims in such proceeding:

> "Exceptions and limitations to the scope of the stay and suspension (e.g. exceptions for secured claims, payments by the debtor made in the ordinary course of business, set-offs, execution of rights *in rem*) and the possibility of modifying or terminations the stay or suspension are determined by provisions governing comparable stays and suspensions in insolvency proceedings under the law of the enacting State (Article 20, paragraph 2).

(g) Granting any additional relief that may be available to [insert the title of a person or body administering a reorganization or liquidation under the law of the enacting State] under the laws of this State.
2. Upon recognition of a foreign proceeding, whether main or nonmain, the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's assets located in this State to the foreign representative or another person designated by the court, provided that the court is satisfied that the interests of creditors in this State are adequately protected. 3. In granting relief under this Article to a representative of a foreign non-main proceeding, the court must be satisfied that the relief relates to assets that, under the law of this State, should be administered in the foreign non-main proceeding or concerns information required in that proceeding.
3. In granting relief under this Article to a representative of a foreign non-main proceeding, the court must be satisfied that the relief relates to assets that, under the law of this State, should be administered in the foreign non-main proceeding or concerns information required in that proceeding."

[751] See **Berends Andrè J.,** "*The UNCITRAL Model Law on Cross-Border Insolvency: a comprehensive overview*", 6 Tul. J. Int'l & Comp. L. 309 (1998), at 367.

[752] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 30 "Such stay and suspension are "mandatory" (or "automatic) in the sense that either they flow automatically from the recognition of a foreign main proceeding or, in the State where a court order is neded fr the stay or suspension, the court is bound to issue the appropriate order."

[753] Article 20 "Effects of recognition of a foreign main proceeding 1. Upon recognition of a foreign proceeding that is a foreign main proceeding,
(a) Commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed;
(b) Execution against the debtor's assets is stayed; and
(c) The right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended.
2. The scope, and the modification or termination, of the stay and suspension referred to in paragraph 1 of this Article are subject to [refer to any provisions of law of the enacting State relating to insolvency that apply to exceptions, limitations, modifications or termination in respect of the stay and suspension referred to in paragraph 1 of this Article].
3. Paragraph 1 (a) of this Article does not affect the right to commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor.
4. Paragraph 1 of this Article does not affect the right to request the commencement of a proceeding under [identify laws of the enacting State relating to insolvency] or the right to file claims in such a proceeding.

[754] See **Westbrook Jay L.**, "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1, (2002), at 15.

> With respect to interim and discretionary relief, the court can impose conditions and modify or terminate the relief to protect the interests of creditors and other interested persons affected by the relief order (Article 22)."[755]

Articles 22[756] and 23[757] address the need to balance[758] the powerful effects of the stay with the rights of the creditors and other interested persons:[759]

> "196. The idea underlying Article 22 is that there should be a balance between relief that may be granted to the foreign representative and the interests of the persons that may be affected by such relief. This balance is essential to achieve the objectives of cross-border insolvency legislation."[760]

Article 22 invites courts to ensure adequate protection, in all instances in which it may be necessary, through modifications or termination of the relief that has been granted.[761] Such an approach, which is common and necessary in bankruptcy to provide a reasonable balance to protect the interests of creditors and in particular of secured ones, is not in contrast with the general organizational principle that rules a bankruptcy proceeding. A high level of coordination of proceedings derives from accurate organization. An increase in the number of proceedings regarding the same debtor or the same estate within the international setting cannot result in claims being paid twice or in discrepancies of treatment among similarly situated claims.[762]

Article 23 is concerned with the availability and use of avoiding powers so that legal acts detrimental to creditors may be rendered ineffective.[763] The Model Law does not address substantive issues regarding how to bring the action and does not provide guidance on how to solve conflicts of laws among different

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755 See **UNCITRAL (United Nations Commission on International Trade Law)**, "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretation*s", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 30.

756 Article 22: "Protection of creditors and other interested persons

1. In granting or denying relief under Article 19 or 21, or in modifying or terminating relief under paragraph 3 of this Article, the court must be satisfied that the interests of the creditors and other interested persons, including the debtor, are adequately protected.

2. The court may subject relief granted under Article 19 or 21 to conditions it considers appropriate.

3. The court may, at the request of the foreign representative or a person affected by relief granted under Article 19 or 21, or at its own motion, modify or terminate such relief."

757 Article 23. Actions to avoid acts detrimental to creditors

1. Upon recognition of a foreign proceeding, the foreign representative has standing to initiate [refer to the types of actions to avoid or otherwise render ineffective acts detrimental to creditors that are available in this State to a person or body administering a reorganization or liquidation].

2. When the foreign proceeding is a foreign non-main proceeding, the court must be satisfied that the action relates to assets that, under the law of this State, should be administered in the foreign non-main proceeding.

758 See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 90.

759 *Id.*

760 *Id.*

761 *Id.*

762 The so called hotchpotch rule is contained in Article 32: "Rule of payment in concurrent proceedings Without prejudice to secured claims or rights in rem, a creditor who has received part payment in respect of its claim in a proceeding pursuant to a law relating to insolvency in a foreign State may not receive a payment for the same claim in a proceeding under [identify laws of the enacting State relating to insolvency] regarding the same debtor, so long as the payment to the other creditors of the same class is proportionately less than the payment the creditor has already received."; **Westbrook Jay L.,** "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulatio*n", 76 Am. Bankr. L.J. 1 (2002), at 18.

763 See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations"*, United Nations, New York, ISBN 978-92-1-133819-5, (2014), at 92.

stakeholders. It does, though, state that a foreign administrator cannot be prevented from exercising a power exclusively due to the fact of not being the appointed administrator of the national proceeding.[764] This is an intricate matter. Avoiding powers may lead to high levels of uncertainty, complicating the organization of an international proceeding instead of simplifying it.[765] Courts have to be careful in balancing the different interests at stake; nevertheless, the drafters have held it useful to mention that a foreign administrator may not be denied the right to exercise such relevant powers solely on the ground of not being the local administrator.[766]

[D] Cooperation among the courts of states where the debtor's assets are located and coordination of concurrent proceedings

Creating an effective framework for cooperation in the international insolvency setting is an essential goal of the Model, which aims to assist local administrators and courts in communicating directly with their foreign counterparts.[767] Cooperation is a key factor for the obtainment of high levels of efficiency at the cross-border level. Proceedings can cooperate successfully even in the absence of recognition:

> "212. Cooperation is not dependent upon recognition and may thus occur at an early stage and before an application for recognition. Since the Articles of chapter 4 apply to the matters referred to in Article 1, cooperation is available not only in respect of applications for assistance made in the enacting State, but also applications from proceedings in the enacting State for assistance elsewhere (see also Article 5). Cooperation is not limited to foreign proceedings within the meaning of Article 2, subparagraph (a) that would qualify for recognition under Article 17 (i.e. that they are either main or non-main), and cooperation may thus be available with respect to proceedings commenced on the basis of presence of assets. Such a provision may be useful when that proceeding is commenced in the enacting State and assistance is sought elsewhere. That provision may also be relevant when the enacting State, in addition to the Model Law, has other laws facilitating coordination and cooperation with foreign proceeding (see Article 7)."[768]

The enactment of specific procedures supporting interaction within the international setting leads to the obtainment of better results.[769] It allows:

- a reduction of the costs of proceedings and an increase recovery rates;
- fairer distribution and equal relief;
- more equitable treatment of all claims.[770] [771]

The Model Law, therefore, "fills the gap":

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[764] *Id.*

[765] See **Berends Andrè J**., "*The UNCITRAL Model Law on Cross-Border Insolvency: a Comprehensive Overview*", 6 Tul. J. Int'l & Comp. L. 309, (1998), at 366-8.

[766] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 92.

[767] **Westbrook Jay L**., "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1, (2002), at 16-17.

[768] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 95.

[769] *Id.,* at 30-31.

[770] The Model law just, like the Concordat, advocates equal treatment of creditors; a factor that is particularly relevant, just like the flexibility of such proposed international models of laws, to advocate its legitimacy in a global context. Equal treatment is achieved through notice, protection and distribution.

[771] Article 9 entitles representatives of the proceedings to apply directly to a foreign court and Article 12; entitles the representative to participate to the foreign proceeding regarding the common debtor.

"210. Experience has shown that, irrespective of the discretion courts may traditionally enjoy in a State, the passage of a specific legislative framework is useful for promoting international cooperation in cross-border cases. Accordingly, the Model Law fills the gap found in many national laws by expressly empowering courts to extend cooperation in the areas covered by the Model Law (Articles 25-27).

211. Chapter IV (Articles 25-27), on cross-border cooperation, is thus a core element of the Model Law. Its objective is to enable courts and insolvency representatives from two or more countries to be efficient and achieve optimal results. Cooperation as described in the chapter is often the only realistic way, for example, to prevent dissipation of assets, to maximize the value of assets (e.g. when items of production equipment located in two States are worth more if sold together than if sold separately) or to find the best solutions for the reorganization of the enterprise." [772]

Within the Model, the importance of obtaining improvements in this area is emphasized by Articles 25 and 26, which allow courts and representatives to interact directly and provide that the competent court and the designated insolvency representatives "shall cooperate to the maximum extent possible".[773] The discussion on these topics, and in particular on the "forms of cooperation" at Article 27, was developed further with the publication of a specific explanatory text in 2009 entitled: "UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation"[774].

The purpose of the Guide, which is not prescriptive, is to:

"provide information for practitioners and judges on practical aspects of cooperation and communication in cross-border insolvency cases, specifically in cases involving insolvency proceedings in multiple States where the insolvent debtor has assets and cases where some of the debtor's creditors are not from the State in which the insolvency proceedings have commenced. Such cases might involve individual debtors, but typically they involve enterprise groups with offices, business activities and assets in multiple States. The information is based upon a description of collected experience and practice and focuses on the use and negotiation of cross-border insolvency agreements, providing an analysis of a number of those agreements, which range from written agreements approved by courts to oral arrangements between parties to insolvency proceedings entered into in cross-border insolvency cases over the past two decades. The *Practice Guide* is not intended to be prescriptive, but rather to illustrate how the resolution of issues and conflicts that might arise in cross-border insolvency cases could be facilitated by the use of such agreements, tailored to meet the specific needs of each case and the particular requirements of applicable law." [775]

[E] Recent developments: the insolvency of Groups of companies

In 2010 the United Nations Commission on International Trade Law published a new Guide entitled: "UNCITRAL Legislative Guide on Insolvency Law – Part three: treatment of enterprise groups in insolvency". The Guide attempted to focus international attention on the difficulties and heavy consequences that arise at the local and cross-border level in the case of the insolvency of a group of enterprises[776]:

[772] *Id.,* at 95.
[773] See **UNCITRAL (United Nations Commission on International Trade Law),** "*UNCITRAL Model Law on Cross- Border Insolvency with Guide to Enactment and interpretations*", United Nations, New York, ISBN 978-92-1-133819-5, (2013), at 95.
[774] http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency.html
[775] **UNCITRAL (United Nations Commission on International Trade Law),** "*Practice Guide on cross-border insolvency cooperation*", United Nations, New York, ISBN 978-92-1-133688-7, (2009), at 1.
[776] For other sources on this relevant topic see also: **VV.AA**., *'Insolvency and groups of companies – Papers from the INSOL Europe Academic Forum Annual Conference, Vienna, Austria, 13-14 October 2010"*, Editors Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-7-3, (2011).

“1. Most jurisdictions recognize the legal concept of “corporation”, an entity that has a legal personality separate from that of the individuals it comprises, whether as owners, managers or employees. As a legal or juristic person, a corporation is capable of enjoying and being subject to certain legal rights, duties and liabilities, such as the capacity to sue and be sued, to hold and transfer property, to sign contracts and to pay taxes. The corporation also enjoys the characteristic of perpetuity, in the sense that its existence continues, independent of its members at any given time and over time, and shareholders can transfer their shares without affecting the entity’s corporate existence. Corporations may also have limited liability, whereby investors will be liable only for the amount they have intentionally put at risk in the enterprise, providing certainty and encouraging investment; without that limitation, investors would put their entire assets at risk for every business venture they entered into. A corporation depends on a legal process to obtain its legal personality and, once formed, will be subject to the regulatory regime applying to entities so formed. The law generally will determine not only the requirements for formation, but also the consequences of formation, such as the powers and capacities of the corporation, the rights and duties of its members and the extent to which members may be liable for its debts. The corporate form can thus be seen as promoting certainty in the ordering of business affairs, as those dealing with a corporation know that they can rely upon its legal personality and the rights, duties and obligations that attach to it.
2. The business of corporations is increasingly conducted, both domestically and internationally, through “enterprise groups”. The term “enterprise group” covers different forms of economic organization based upon the single legal entity and, for a working definition, may be loosely described as two or more legal entities (group members) that are linked together by some form of control (whether direct or indirect) or ownership. The size and complexity of enterprise groups may not always be readily apparent, as the public image of many is that of a unitary organization operating under a single corporate identity.
3. Enterprise groups have been in existence for some time, emerging in some countries, according to commentators, at the end of the nineteenth and beginning of the twentieth century through a process of internal expansion, which involved corporations taking control of their own financial, technical or commercial capacities. These single-entity enterprises then expanded externally to take legal or economic control of other corporations. Initially these other corporations may have been in the same market, but eventually the expansion encompassed corporations working in related fields, and later in fields that were different or unrelated, whether by reference to a product or geographical location or both. One of the factors supporting this expansion, at least in some jurisdictions, was the legitimatization of ownership of the shares of one corporation by another corporation, a phenomenon-originally prohibited in both common law and civil law systems.
4. Throughout this expansion, corporations retained, and continue to retain, their separate legal personality, even though individual corporations are now probably the typical form of organization only for small private businesses.
Enterprise groups are ubiquitous in both emerging and developed markets, with a common characteristic of operations across a large number of sometimes unrelated industries, often with family ownership in combination with varying degrees of participation by outside investors. The largest economic entities in the world include not only States, but also a number of multinational enterprise groups. Major multinational groups may be responsible for significant percentages of gross national product worldwide and have annual growth rates and turnovers that exceed those of many States.
5. Despite the reality of the enterprise group, much of the legislation relating to corporations, and particularly to their treatment in insolvency, deals with the single corporate entity. Despite the absence of legislation, judges and insolvency representatives in many countries, faced with issues that may better be addressed by reference to a single

> enterprise rather than a single corporate entity, 6 have developed solutions to achieve results that more accurately reflect the economic reality of modern business."[777]

The study had great impact in the international panorama and was included in subsequent documents, drafts, research, and frameworks structured by both the World Bank and the European Union. As we will discuss in Chapter VI, the new approach to the insolvency of groups of companies was also included in the new draft for the reform of the Italian insolvency system.

5. The European approach to cross-border insolvency cases

5.1 Brief overview of the negotiations for a European cross-border insolvency model, 1960-2000

The European cross-border insolvency regulations of the new millennium are the product of research and negotiations that have taken place place since the sixties. Despite the limited dimensions of the Community which, at the time, consisted of just six members (Belgium, West Germany, France, Holland, Italy, and Luxembourg[778]), the barriers posed by the divergent local insolvency statutes were already recognized as a relevant issue:

> "Historically, each European nation had its own insolvency law, which generally allowed liquidation (but not reorganization) insolvency proceedings. Each country's insolvency law differed, from the definition of "insolvent" to such issues as eligibility to file, the extent of "estate property" (Le., property subject to administration in the insolvency proceeding), validity of security interests, avoid ability of certain pre-insolvency transfers, and the applicability of real estate, tax, and labor laws. These differing laws created problems for cross-border or multinational insolvencies. The problems worsened as increasing travel and trade between the European nations resulted in increasing transnational debts and movement of assets from one place to another."[779]

A committee began outlining a convention on the topic of cross-border insolvencies already in 1963. Both the traditional territorial and the more modern universalist approaches were taken into consideration in the attempt to find an effective formula.[780] It took seven years before the first draft could be signed in 1970.[781]

At that time, the proposed framework adopted a strong, purely universalist approach. Under the agreement, in fact, the same official would be responsible for a proceeding in the country of appointment and abroad. No secondary or ancillary proceedings were allowed[782]; the first country to have jurisdiction over the bankrupt could administer the whole case.

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[777] **UNCITRAL (United Nations Commission on International Trade Law),** "*Legislative guide on insolvency law, Part Three; Treatment of enterprise groups in insolvency*", United Nations, New York, ISBN 978-92-1-133803-4, (2010), 5-6.

[778] At the time they constituted the European Economic Community (ECC); the embryo of the modern Union, formed with the treaty of Rome of 1957. See **Balz Manfred**, "*The European Union Convention on Insolvency Proceedings*", 70 Am. Bankr. L.J. 485, (1996), at 491.

[779] **Burton Leslie A.,** "*Toward an international bankruptcy policy in Europe: four decades in search of a treaty*", Annual Survey of International and Comparative Law: Vol. 5: Iss. 1, Article 8, at 208-9.

[780] **Nielsen Anne**, **Sigal Mike, Wagner Karen,** "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999); Burton Leslie A., "*Toward an international bankruptcy policy in Europe: four decades in search of a treaty*", Annual Survey of International and Comparative Law: Vol. 5: Iss. 1, Article 8, at 209.

[781] **Burton Leslie A.,** "Toward an *international bankruptcy policy in Europe: four decades in search of a treaty*", Annual Survey of International and Comparative Law: Vol. 5: Iss. 1, Article 8, at 210-211.

[782] **Nielsen Anne, Sigal Mike, Wagner Karen**, "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999), at 539.

The convention, which was valid only among signatory countries, had a short life. In 1973, three new members joined the Community: the United Kingdom, Denmark, and Ireland.[783] Agreements had to be modified to account for the needs of the new partners.[784]

The subsequent draft came in the eighties and mitigated many of the universalist features by allowing the creation of sub-estates in foreign countries. Such estates would be regulated by principles of international law.[785] Nevertheless, the balance between the territorial and the universal approach remained greatly in favor of the latter. The draft was considered to be unworkable in practice[786] and therefore never gained enough support to be open for signature.[787]

Meanwhile, more countries joined the Community. Greece became a Member in 1981, while Spain and Portugal joined in 1986 as part of the "Mediterranean enlargements". As the European market continued to grow, so did the issues of coordination among the multitude of different, local insolvency regulations.

In 1989, the Council started writing the "European Convention on Certain International Aspects of Bankruptcy", followed by attempts to pass a multilateral treaty at the Istanbul Convention:

> "The Council of Europe commenced its work on the Istanbul Convention during a period of great change in the law of insolvency. In the 1980s, many nations amended their insolvency laws, expanded the use of reorganization proceedings in addition to liquidation proceedings, and in some cases allowed reorganization proceedings for the first time. Ironically, at the same time the Council of Europe was working towards harmonization, the individual countries were enacting national law reforms that resulted in even less harmonization among their insolvency laws."[788]

The new convention rejected the rigid universalist interpretation that had been adopted in the past. The use of secondary proceedings became a relevant part of the new model. This was despite relevant difficulties still present within the framework, such as the ambiguities on defining and indentifying a debtor's center of main interests. The project was, generally speaking, successful; nevertheless, the convention was not ratified by the requested number of Member States.[789]

In 1995, it was the time for Austria, Finland, and Sweden to join the Union.

A working group presented the European Union Convention on Insolvency Proceedings open for signatures on November 23rd, 1995, with a deadline set on May 23rd, 1996. In order to ratify the agreement, all fifteen Member States had to sign it within the deadline, or else the convention would not be effective. Twelve of fifteen signed in November 1995; the Netherlands signed in March and Ireland in April 1996. The United Kingdom was expected to sign before the May 23rd dead when the mad cow disease outbreak hit, leading to a total beef ban on imported meat from the British islands. One of the consequences was the UK's refusal to sign the accord.[790]

The Community would then have to wait four more years before finding a new agreement on the topic of European insolvency law.

[783] The enlargement included also some of the territories under the control of joining countries such as Greenland which, upon gaining more autonomy will also be the first to vote to exit from the Union in '85.

[784] **Burton Leslie A**., "*Toward an international bankruptcy policy in Europe: four decades in search of a treaty*", Annual Survey of International and Comparative Law: Vol. 5: Iss. 1, Article 8, at 212.

[785] See **Tjur Carl** "*An Analysis of the 1980 Draft EEC Bankruptcy Convention*", Int'l Bus. Law. 22, (1982).

[786] **Nielsen Anne, Sigal Mike, Wagner Karen**, "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999), at 539

[787] **Burton Leslie A.,** "*Toward an international bankruptcy policy in Europe: four decades in search of a treaty*", Annual Survey of International and Comparative Law: Vol. 5: Iss. 1, Article 8, at 212.

[788] *Id.,* at 213.

[789] **Nielsen Anne, Sigal Mike, Wagner Karen,** "*The cross-border insolvency concordat: principles to facilitate the resolution of international insolvencies*", 70 Am Bankr. L. J. 533, (1999), at 542.

[790] *Id.,* 540.

5.2 COUNCIL REGULATION (EC) N. 1346/2000

In the year 2000, the European Community finall, adopted a regulation on cross-border insolvency which would enter into force on the 31st of May, 2002.

The final draft was the product of almost forty years of mediation in the field of cross-border insolvency law.[791] Despite some imperfections the new framework had a great impact on the European and international bankruptcy scene. Its principles, in fact, have also served as models for other international initiatives and were shared by the UNCITRAL Model law on cross-border insolvencies.[792]

The model created through the mandatory adoption of the regulation allowed countries to make some steps forward in the struggle for the implementation of more uniform insolvency systems in Europe.

As mentioned in the previous sections, the Concordat consists of a list of principles; although inspirational and fit for practical use (they have indeed found practical application in practice), they remained a "guideline" on relevant issues of cross-border insolvency law, since they ultimately left the task of creating a specific statute or code to the enacting nations. The UNCITRAL's Model law is a step forward, since it is structured in an organized list of parts and articles which made it possible for it to be widely adopted by merger with the pre-existing legal framework of enacting countries with limited changes. This framework, nevertheless, as we have been discussing in previous pages, remains too flexible to ensure high levels of uniformity. By choosing the form of a "Regulation", the Council applied the strongest European legal instrument in an attempt to cure the weaknesses of the previous models. The European cross-border system, in fact, became binding on Member States in accordance with Article 249; a remarkable statement of the relevance of this field of law and on the importance of imposing a common structure for the system to work successfully:

> "Treaty establishing the European Community; Part Five: Institutions of the Community; Title I: Provisions governing the institutions; Chapter 2: Provisions common to several institutions Article 249 Article 189 - EC Treaty (Maastricht consolidated version) Article 189 - EEC Treaty
> Article 249
> In order to carry out their task and in accordance with the provisions of this Treaty, the European Parliament acting jointly with the Council, the Council and the Commission shall make Regulations and issue directives, take decisions, make recommendations or deliver opinions.
> **A Regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States.**
> A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods.
> A decision shall be binding in its entirety upon those to whom it is addressed.
> Recommendations and opinions shall have no binding force."[793]

The European cross-border model implemented, therefore, a common cross-border insolvency scenario imposed upon all Members[794] [795] (with the exception of Denmark[796] [797] [798]) and it mandatorily

[791] The insolvency Regulation was adopted by the Council of the European Union on the 29th of May 2000 and entered into force on the 31st of May 2002. It is the product of research and negotiations that started in the 60's; a first draft was available in the 70's and reviewed in the 80's.

[792] Again the UNCITRAL was inspired by EU studies on cross-border insolvency to define such key element such as the one of "centre of main interest" identifying the Country where the "main proceeding" should be started; moreover, it would have been "unlikely the enterprise (the creation of the Model law) could have been succeeded so quickly, if at all, without this influence and expertise". **Westbrook Jay L**., "*Multinational enterprises in general default: Chapter 15, the ALI Principles, and the EU Insolvency Regulation*", 76 Am. Bankr. L.J. 1, (2002), at 3.

[793] Official Journal C 325 , 24/12/2002 P. 0132 – 013 Official Journal C 340 , 10/11/1997 P. 0278 - Consolidated version Official Journal C 224 , 31/08/1992 P. 0065 - Consolidated version (EEC Treaty - no official publication available).

[794] Point (8) of the Preamble: In order to achieve the aim of improving the efficiency and effectiveness of insolvency proceedings having cross- border effects, it is necessary, and appropriate, that the provisions on jurisdiction,

applied to all the international insolvency cases arising among their borders.[799] Moreover, in an attempt to further promote uniformity, the Regulation was subjected to the interpretation of the European Court of Justice.[800] [801] After decades of negotiations, much was done in an attempt to structure a new, modern, highly effective and efficient tool which could support the process of attainment of the da Feira goals.

Nevertheless, the barriers that originated from the divergent structures and approaches of local regulations were far from removed. As stated in point 11 of the preamble:

> "This Regulation acknowledges the fact that as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope in the entire Community. The application without exception of the law of the State of opening of proceedings would, against this background, frequently lead to difficulties. This applies, for example, to the widely differing laws on security interests to be found in the Community. Furthermore, the preferential rights enjoyed by some creditors in the insolvency proceedings are, in some cases, completely different. This Regulation should take account of this in two different ways. On the one hand, provision should be made for special rules on applicable law in the case of particularly significant rights and legal relationships (e.g. rights in rem and contracts of employment). On the other hand, national proceedings covering only assets situated in the State of opening should also be allowed alongside main insolvency proceedings with universal scope."

and at point 23:

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recognition and applicable law in this area should be contained in a Community law measure which is binding and directly applicable in Member States".

[795] Point (32) of the Preamble: The United Kingdom and Ireland, in accordance with Article 3 of the Protocol on the position of the United Kingdom and Ireland annexed to the Treaty on European Union and the Treaty establishing the European Community, have given notice of their wish to take part in the adoption and application of this Regulation".

[796] Point (33) of the Preamble: "Denmark, in accordance with Articles 1 and 2 of the Protocol on the position of Denmark annexed to the Treaty on European Union and the Treaty establishing the European Community, is not participating in the adoption of this Regulation, and is therefore not bound by it nor subject to its application."

[797] The Regulation does not apply to proceedings in which the Centre of main Interest is not located in a Member State. See Point (14) of the Preamble: "This Regulation applies only to proceedings where the center of main interests is located in the Community". See also **Kolmann Stephan**, "*European International Insolvency Law - Council Regulation (EC) No. 1346/2000 on Insolvency Poceedings*", The European Legal Forum (E) 3-2002, 167 - 177, IPR Verlag GmbH München, (2002), at 169: "Generally speaking, the insolvency Regulation contains no provision as to the relationship to third States, so that the individual states govern to this extent."

[798] **Directorate-General For Internal Policies, Policy Department Citizen's Rights and Constitutional Affairs,** "*Harmonization of Insolvency Law at EU level*", (2010), at 25-6.

[799] Article 43: "Applicability in time: The provisions of this Regulation shall apply only to insolvency proceedings opened after its entry into force. Acts done by a debtor before the entry into force of this Regulation shall continue to be governed by the law which was applicable to them at the time they were done."

[800] **Kolmann Stephan**, "*European International Insolvency Law - Council Regulation (EC) No. 1346/2000 on Insolvency Poceedings*", The European Legal Forum (E) 3-2002, 167 - 177, IPR Verlag GmbH München, (2002).

[801] An important improvement compared to the Instanbul Convension. See **Burton Leslie A.**, "*Toward an international bankruptcy policy in Europe: four decades in search of a treaty*", Annual Survey of International and Comparative Law: Vol. 5: Iss. 1, Article 8, at 214-5.

"Despite its perceived improvements vis-a.-vis the earlier EEC Draft, the Istanbul Convention was nonetheless criticized. One weakness of the Istanbul Convention was the ambiguity of some of its central concepts, such as the terms "center of main interests" and "establishment." These terms were not clearly defined in the Convention, and thus were likely to lead to forum shopping and disputes over jurisdiction. Further, the Istanbul Convention relied on "indirect" jurisdiction, meaning that although it contained rules for recognizing and enforcing judgments, it did not impose any mandatory jurisdictional rules, thus creating a further potential for disagreements. Worse, the Istanbul Convention did not contain any mechanism to resolve interpretation difficulties. The Council of Europe - unlike the European Union - has no European Court of Justice with jurisdiction to interpret provisions of the Istanbul Convention. As a result, any ambiguities in the Istanbul Convention would be subject to differing national interpretations, with no mechanism for uniformity. Paradoxically, the Istanbul Convention, which was meant to lead to more harmony, would in fact lead to more diversity."

> "This Regulation should set out, for the matters covered by it, uniform rules on conflict of laws which replace, within their scope of application, national rules of private international law. Unless otherwise stated, the law of the Member State of the opening of the proceeding should be applicable (lex concursus). This rule on conflict of laws should be valid both for the main proceedings and for local proceedings; the lex concursus determines all the effects of the insolvency proceedings, both procedural and substantive, on the persons and legal relations concerned. It governs all conditions for the opening conduct and closure of the insolvency proceedings."

In fact, the Regulation brought "uniformity" solely in the forms of coordination of local statutes. It did not cure their substantive differences. Its aim was limited to ensure that judgments could be swiftly recognized[802] and enforced within the Union. Flexibility remained, therefore, a barrier.[803]

Another factor (already mentioned in the previous section on the UNCITRAL Model Law) which limited the impact of the European cross-border framework was the fact that the Regulation could bind Member States exclusively, which meant that it would not apply to cases in which the insolvency of the debtor would involve a country outside of the Eurozone.

The enactment of the Regulation was, in any case, a positive and concrete step forward, which did bring relevant improvements within the EU insolvency scenario. The difficulties that came in the following years, though, prevented it from expressing its full potential and, as we will discuss in the next pages, made several reforms necessary.

In the next pages, we will briefly discuss some of the most relevant aspects of the EC Regulation of 2000 and of the process for its modification and the enactment of the "Recast" draft.

5.2.1 Structure and goals of the EC Regulation

The EC Regulation of 2000 contained a preamble consisting of 33 points, and was subdivided in five chapters, a total of 47 articles, and three annexes:

General provisions (Articles 1 to 15);

I. Recognition of insolvency proceedings (Articles 16 to 26);

II. Secondary insolvency proceedings (Articles 27 to 38);

III. Provision of information for creditors and lodgment of their claims (Articles 39 to 42);

IV. Transitional and final provisions (Articles 43 to 47);

ANNEX A

ANNEX B

ANNEX C

The goals pursued through the enactment of the European cross-border insolvency model were the same that characterized Europe's previous attempts. The EC Regulation was designed to support the creation of "an area of freedom, security and justice"[804] and the proper functioning of the internal market:

> "(2) The proper functioning of the internal market requires that cross-border insolvency proceedings should operate efficiently and effectively and this Regulation needs to be

[802] For a discussion of recognition and of the application of the Regulation in France, see **Mailly Myriam**, "*The application of the European Insolvency Regulation in France*" in *'The European Insolvency Regulation: an update – Papers from the INSOL Europe Academic Forum Annual Conference, Stockholm, Sweden, 30 September – 1 October 2009'*, Eds. Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-5-9, (2010).

[803] **Kastrinou Alexandra,** "*Interpretation and application of the COMI Definition by Domestic Courts*" in *'The European Insolvency Regulation: an update – Papers from the INSOL Europe Academic Forum Annual Conference, Stockholm, Sweden, 30 September – 1 October 2009'*, Eds. Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-5-9, (2010), at 3-4.

[804] Preamble point (1): "The European Union has set out the aim of establishing an area of freedom, security and justice".

> adopted in order to achieve this objective which comes within the scope of judicial cooperation in civil matters within the meaning of Article 65 of the Treaty."

protecting it from the risks connected with rampant forum shopping:

> "(4) It is necessary for the proper functioning of the internal market to avoid incentives for the parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favorable legal position (forum shopping)"

These objectives, as discussed in Chapter I, would not be possible to achieve with initiatives starting at local or national level exclusively[805]:

> "(3) The activities of undertakings have more and more cross-borders effects and are therefore increasingly being regulated by Community law. While the insolvency of such undertakings also affects the proper functioning of the internal market, there is a need for a Community act requiring coordination of the measured to be taken regarding an insolvent debtor's assets."
>
> "(5) these objectives cannot be achieved to a sufficient degree at national level and action at Community level is therefore justified."

5.2.2 Application of the provided framework

Upon its enactment, the insolvency Regulation became binding over several heterogeneous, local insolvency proceedings, each supported by, and rooted in, its own traditional social and legal framework.[806] Such proceedings were listed in the provided Annexes and concerned almost exclusively business liquidations.[807] As Article 1 (1) stated, in fact:

> "This Regulation shall apply to collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator".

The "classes" of eligible debtors included a variety of entities and natural persons:

> (9) "This Regulation should apply to insolvency proceedings, whether the debtor is a natural person or a legal person, a trader or an individual."

However, some specific exclusions applied. Article 1 (2) stated that:

> "This Regulation shall not apply to insolvency proceedings concerning insurance undertakings which provide services involving the holding of funds or securities for third parties, or to collective investment undertakings."

The commonly applied exclusion concerning entities such as banks and insurance companies, therefore, was also made part of the newly enacted European framework. On this relevant point, the preamble at point 9 stated that:

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[805] Preamble point (5).

[806] See for example point (10) of the Preamble: "Insolvency proceedings do not necessarily involve the intervention of a judicial authority; the expression 'court' in this Regulation should be given a broad meaning and include a person or body empowered by National law to open insolvency proceedings. In order for this Regulation to apply, proceedings (comprising acts and formalities set down in law) should not only have to comply with the provisions of this Regulations, but they should also be officially recognized and legally effective in the Member State in which the insolvency proceedings are opened and should be collective insolvency proceedings in which entail the partial or total devestment of the debtor and the appointment of a liquidator".

[807] (9) "The insolvency proceedings to which this Regulation applies are listed in the Annexes.

> "Insolvency proceedings concerning insurance undertakings, credit institutions, investment undertakings, holding funds or securities for third parties and collective investment undertakings should be excluded from the scope of this Regulation. Such undertakings should not be covered by this Regulation since they are the subject to special arrangements and, to some extent the national supervisory authorities have extremely wide-ranging powers of intervention."

Groups of companies, also, did not find specific coverage within the first Regulation, a main shortcoming that European law-makers tried to cure in the newly enacted draft that will be discussed in the next sections.[808]

Another shortcoming that affected the EU framework was the lack of a common definition of relevant elements, such as the concept of insolvency; a weakness which affected also the other models we have mentioned.[809] On this important aspect, the Regulation kept relying on the many discordant definitions applied at the local level. Article 2, in fact, stated that:

> "(a) 'insolvency proceedings' shall mean the collective proceedings referred to in Article 1(1). These proceedings are listed in Annex A."

The European framework followed, therefore, the approach adopted by the UNCITRAL Model Law. Access criteria, together with other relevant, substantive rules, remained embodied in the local insolvency statutes of the Member States. Article 4, subsection 2 stated that:

> "2. The law of the State of the opening of proceedings shall determine the conditions for the opening of those proceedings, their conduct and their closure. It shall determine in particular:
> (a) against which debtors insolvency proceedings may be brought on account of their capacity;
> (b) the assets which form part of the estate and the treatment of assets acquired by or devolving on the debtor after the opening of the insolvency proceedings;
> (c) the respective powers of the debtor and the liquidator;
> (d) the conditions under which set-offs may be invoked;
> (e) the effects of insolvency proceedings on current contracts to which the debtor is party;
> (f) the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of lawsuits pending;
> (g) the claims which are to be lodged against the debtor's estate and the treatment of claims arising after the opening of insolvency proceedings;

[808] See **Daehnert Alexander**, "*Groups of companies and the insolvency threat" in 'Insolvency and groups of companies – papers from the INSOL Europe Academic forum annual conference Vienna, 13-14 October 2010'*, Eds. Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-7-3, (2011); **Kastrinou Alexandra**, "*Enterprise groups and the impact of the European Insolvency Regulation*" in *'Insolvency and groups of companies – papers from the INSOL Europe Academic forum annual conference Vienna, 13-14 October 2010'*, Eds. Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-7-3, (2011); **Mailly Myriam**, "*Groups of companies and French insolvency law: present and future*" in *'Insolvency and groups of companies – papers from the INSOL Europe Academic forum annual conference Vienna, 13-14 October 2010'*, Eds. Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-7-3, (2011); **Schmidt Jessica**, "*Groups of companies in German autonomous insolvency law – the lex lata, its applications and proposals for reform*" in *'Insolvency and groups of companies – papers from the INSOL Europe Academic forum annual conference Vienna, 13-14 October 2010'*, Eds. Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-7-3, (2011).

[809] **Vallens Jean-Luc**, "*Scope of European Insolvency Regulation and Definition of Insolvency*" in *'The grand project: reform of the European insolvency Regulation – Papers from the INSOL Europe Academic Forum and Academy of European Law Joint Insolvency Conference Trier, Germany, 18-19 March 2013 and the INSOL Europe Academic Forum Annual Conference Paris, France, 25-26 September 2013'*, Ed. Bariatti Stefania and Omar Paul J., INSOL EUROPE, ISBN 978-0-9570761-8-1, (2014).

> (h) the rules governing the lodging, verification and admission of claims;
> (i) the rules governing the distribution of proceeds from the realisation of assets, the ranking of claims and the rights of creditors who have obtained partial satisfaction after the opening of insolvency proceedings by virtue of a right in rem or through a set-off;
> (j) the conditions for and the effects of closure of insolvency proceedings, in particular by composition;
> (k) creditors' rights after the closure of insolvency proceedings;
> (l) who is to bear the costs and expenses incurred in the insolvency proceedings;
> (m) the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors."

On this relevant point the preamble had much to add, admitting the difficulties that had been faced and compromises that had to be made in organizing an acceptable framework that could be made operative despite the infinite differences standing among local systems:

> "(11) This Regulation acknowledges the fact that as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope in the entire Community. The application without exception of the law of the State of opening of the proceeding would, against this background, frequently lead to difficulties. This applies, for example, to the widely differing laws on security interests to be found in the Community. Furthermore, the preferential rights enjoyed by some creditors, in the insolvency proceedings, are, in some cases completely different. This Regulation should take account of this in two different ways. On the one hand, provision should be made for special rules on applicable law in the case of particularly significant rights and legal relationships (e.g. tights in rem and contracts of employment). On the other hand, national proceedings covering only asset situated in the State of opening should also be allowed alongside main insolvency proceedings with universal scope."

5.2.3 Universality within the European cross-border framework of 2002

As mentioned in the previous pages, discussing the history of the evolution of cross-border insolvency agreements in Europe, the Regulation moved away from the pure universalist approach that the European Community attempted to deploy in its early drafts and implemented a modified model which allowed for the opening of secondary proceedings[810]:

> (12) This Regulation enables the main insolvency proceedings to be opened in the Member State where the debtor has the centre of his main interests. These proceedings have universal scope and aim at encompassing all the debtor's assets. To protect the diversity of interests, this Regulation permits secondary proceedings to be opened to run in parallel with the main proceedings. Secondary proceedings may be opened in the Member State where the debtor has an establishment. The effects of secondary proceedings are limited to the assets located in that State. Mandatory rules of coordination with the main proceedings satisfy the need for unity in the Community.

A "leading" bankruptcy proceeding would, therefore, be opened in the Member Country where the debtor's center of main interest (COMI) would be located[811]. For this purpose, the "COMI" was defined, in

[810] **Moss Gabriel QC**, "*Master and servant? Relationship between main and territorial proceedings in light of Bank Handlowy (Case C-116/11)*" in *'The grand project: reform of the European insolvency Regulation – Papers from the INSOL Europe Academic Forum and Academy of European Law Joint Insolvency Conference Trier, Germany, 18-19 March 2013 and the INSOL Europe Academic Forum Annual Conference Paris, France, 25-26 September 2013'*, Ed. Bariatti Stefania and Omar Paul J., INSOL EUROPE, ISBN 978-0-9570761-8-1, (2014).

absence of proof of the contrary, as "the place of the registered office"[812] for a company or a legal person, while, in the case of a natural person, the COMI would be most likely placed in the place of residence.[813] Point 13 of the preamble explained that the COMI:

> "should correspond to the place where the debtor conducts the administration of his interest on a regular basis and is therefore ascertainable by third parties."

As further stated by Article 3 (1) of the Regulation:

> Article 3: "International jurisdiction: "1. The courts of the Member State within the territory of which the centre of a debtor's main interests is situated shall have jurisdiction to open insolvency proceedings. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary."

Providing effective criteria for the individuation of the center of main interests of the debtor was a task of absolute relevance, not just to locate the jurisdiction of the proceeding but also to verify the applicability of the Regulation.[814] Whenever the COMI was located in a territory outside of the Community, the Regulation would not apply:

> "(14) This Regulation applies only to proceedings where the centre of the debtor's main interests is located in the Community."

Secondary proceedings were limited to the assets a debtor may own within the borders of another Member State.

> "Article 3 (2). Where the centre of a debtor's main interests is situated within the territory of a Member State, the courts of another Member State shall have jurisdiction to open insolvency proceedings against that debtor only if he possesses an establishment within the territory of that other Member State. The effects of those proceedings shall be restricted to the assets of the debtor situated in the territory of the latter Member State."

The opening of such proceedings could be requested by the liquidator of the main proceeding or by another person empowered to do so under local laws:

> "(18) Following the opening of the main insolvency proceedings, the right to request the opening of insolvency proceedings in a Member State where the debtor has an establishment is not restricted by this Regulation. The liquidator in the main proceedings or any other person empowered under the national law of that Member State may request the opening of secondary insolvency proceedings."

This was done in order to protect, for example, local interests, or to simplify the administration of certain assets in different legal contexts:

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[812] Article 3 (1).

[813] See **Kolmann Stephan**, "*European International Insolvency Law - Council Regulation (EC) No. 1346/2000 on Insolvency Poceedings*", The European Legal Forum (E) 3-2002, 167 - 177, IPR Verlag GmbH München, (2002), at 170.

[814] See **Kastrinou Alexandra**, "*Interpretation and application of the COMI Definition by Domestic Courts*" in *'The European Insolvency Regulation: an update – Papers from the INSOL Europe Academic Forum Annual Conference, Stockholm, Sweden, 30 September – 1 October 2009'*, Eds.Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-5-9, (2010), at 4-17, discussing different cases and the interpretations and application of the concept of COMI. See also **Schmidt Jessica**, "*Eurofood three years on: the concept of COMI and Ordre Public revisited*" in *'The European Insolvency Regulation: an update – Papers from the INSOL Europe Academic Forum Annual Conference, Stockholm, Sweden, 30 September – 1 October 2009'*, Eds.Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-5-9, (2010).

> "(19) Secondary insolvency proceedings may serve different purposes, besides the protection of local interests. Cases may arise where the estate of the debtor is too complex to administer as a unit or where differences in the legal systems concerned are so great that difficulties may arise from the extension of effects deriving from the law of the State of the opening to the other States where the assets are located. For this reason the liquidator in the main proceedings may request the opening of secondary proceedings when the efficient administration of the estate so requests."

Several steps were taken in an attempt to ensure that the dominant role of the main proceeding would be respected. The Regulation limited (wherever possible) the number of such ancillary proceedings[815] and awarded ample powers to intervene in them to the insolvency administrators of main cases.[816]

In absence of a purely universalist framework, though, in order for the system to reach its goals, effective and efficient coordination and cooperation among the main and secondary proceedings was absolutely essential. The preamble, therefore, emphasized that all parties exchange information regularly in order to allow effective "teamwork":

> "(20) Main insolvency proceedings and secondary proceedings can, however contribute to the effective realization of the total assets only if all the concurrent proceedings pending are coordinated. The main condition here is that the various liquidators must cooperate closely, in particular by exchanging a sufficient amount of information. In order to ensure the dominant role of the main insolvency proceedings, the liquidator of such proceedings should be given several possibilities for intervening in secondary insolvency proceedings which are pending at the same time. For example, he should be able to propose a restructuring plan or composition or apply for realization to the assets in secondary insolvency proceedings to be suspended."

5.2.4 Recognition

One relevant effect of the enactment of the EU framework though a Regulation was the capacity to impose effective systems for the coordination, cooperation, and, in particular, the recognition of different proceedings. On this point, the preamble stated that:

> "22. This Regulation should provide for immediate recognition of judgments concerning the opening, conduct and closure of insolvency proceedings which come within its scope and of judgments handed down in direct connection with such insolvency proceedings. Automatic recognition should therefore mean that the effects attributed to the proceedings by the law of the State in which the proceedings were opened extend to all other Member States. Recognition of judgments delivered by the courts of the Member States should be based on the principle of mutual trust. To that end, grounds for non-recognition should be reduced to the minimum necessary. This is also the basis on which any dispute should be resolved where the courts of two Member States both claim competence to open the main insolvency proceedings. The decision of the first court to open the proceedings should be recognized in the other Member States without those Member States having the power to scrutinize the court's decision."

[815] See point (17) of the Preamble: "Prior to the opening of the main insolvency proceedings, the right to request the opening of insolvency proceedings in the Member State where the debtor has an establishment should be limited to local creditors and creditors of the local establishment or to cases where main proceedings cannot be opened under the law of the Member State where the debtor has the centre of his main interest. The reason for this restriction is that cases where territorial insolvency proceedings are requested before the main insolvency proceedings are intended to be limited to what is absolutely necessary. If the main insolvency proceedings are opened, the territorial proceedings become secondary."

[816] Point (20) of the Preamble.

Chapter II, entitled "Recognition of insolvency proceedings", listed the different actions that could be recognized automatically based on such "mutual trust" principle. Article 16 (1) stated that:

> "Any judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction pursuant to Article 3 shall be recognized in all the other Member States from the time that it becomes effective in the State of the opening of proceedings."

More actions were included in Article 25 (1):

> "Judgments handed down by a court whose judgment concerning the opening of proceedings is recognized in accordance with Article 16 and which concern the course and closure of insolvency proceedings, and compositions approved by that court shall also be recognized with no further formalities. Such judgments shall be enforced in accordance with Articles 31 to 51, with the exception of Article 34(2), of the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, as amended by the Conventions of Accession to this Convention."

The Regulation was concerned with the potentially disruptive effects of the alteration of pre-insolvency entitlements – a factor that could be highly detrimental, causing lack of transparency and predictability in the system. On this matter, the framework called for a "number of exceptions to the general rule"[817] allowing divergence from the law adopted in the opening State:

> (25) "There is a particular need for a special reference diverging from the law of the opening State in the case of rights in rem, since these are of considerable importance for the granting of credit. The basis, validity and extent of such right in rem should therefore normally be determined according to the lex situs and not be addicted by the opening of insolvency proceedings. The proprietor of the right in tem should therefore be able to continue to assert his right to segregation or separate settlement of the collateral security. Where assets are subject to rights collateral security. Where assets are subject to rights in rem under the lex situs in one Member State but the main proceedings are being carried out in another Member State, the liquidator in the main proceedings should be able to request the opening of secondary proceedings in the jurisdiction where the rights in rem arise I the debtor has an establishment in there. If a secondary proceeding is not opened, the surplus on sale of the asset covered by rights in rem must be paid to the liquidator in the main proceedings."

The Preamble also discussed set-offs at point 26 and position-closing and netting agreements at point 27. A very relevant remark was made at point 28:

> "In order to protect employees and jobs, the effects of insolvency proceedings on the continuation or termination of employment and on the rights and obligations of all parties to such employment must be determined by the law applicable to the agreement in accordance with the general rules on conflict of law. Any other insolvency-aw questions, such as whether the employee' claims are protected by preferential rights and what status such preferential rights may have, should be determined by the law of the opening State."

5.2.5 Access of foreign creditors to proceedings and communications

An interesting practical aspect of the Regulation was found in Articles 40-42. Creditors having their habitual residence, domicile, or registered office in the Community had the right to lodge a claim, in each of

[817] Point (24) of the Preamble: "Automatic recognition of insolvency proceedings to which the law of the opening State normally applies may interfere with the rules under which transactions are carried out in other Member States. To protect legitimate expectations and the certainty of transactions in Member States other than that in which proceedings are opened, provisions should be made for a number of exceptions to the general rule".

the local insolvency proceedings[818], by sending copies of supporting documents indicating the nature of the claim, the amount, and the date in which the claim arose.

Moreover, creditors could prove their rights to be secured or supported by priorities.

In order to have such a dialogue, though, information on eventual proceedings had to be amply available and easily accessible, or else it would be impossible for creditors to act. Article 40[819], therefore, required creditors to be informed as soon as proceedings were opened.

Providing information presented the same obstacles we have discussed in the previous sections. Article 41[820], entitled "Languages", attempted to provide the administrators with guidelines on how to solve language barriers.

5.3 (2012) COM 744 final, EUROPEAN COMMISSION Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings

The need for a revision to improve Council's Regulation No 1346/2000 on insolvency proceedings became pressing within ten years of its enactment due to the enduring effects of the market crisis.[821]

The dialogue among Member States was continuous and a public consultation was launched by the Commission on the 29th of March, 2012 to discuss the different issues that had arisen. Such consultation preceded the publication of a report on the application of Council Regulation (EC) No 1346/2000, which was adopted by the commission on December, 12th, 2012.

Ultimately, the European Commission published "COM 744 final, EUROPEAN COMMISSION Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings". The Communication addressed most of the issues and difficulties

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[818] Point (21) of the Preamble; Article 41: "Content of the lodgement of a claim: A creditor shall send copies of supporting documents, if any, and shall indicate the nature of the claim, the date on which it arose and its amount, as well as whether he alleges preference, security in rem or a reservation of title in respect of the claim and what assets are covered by the guarantee he is invoking."

[819] Article 40: "Duty to inform creditors 1. As soon as insolvency proceedings are opened in a Member State, the court of that State having jurisdiction or the liquidator appointed by it shall immediately inform known creditors who have their habitual residences, domiciles or registered offices in the other Member States. 2. That information, provided by an individual notice, shall in particular include time limits, the penalties laid down in regard to those time limits, the body or authority empowered to accept the lodgement of claims and the other measures laid down. Such notice shall also indicate whether creditors whose claims are preferential or secured in rem need lodge their claims."

[820] Article 41: "1. The information provided for in Article 40 shall be provided in the official language or one of the official languages of the State of the opening of proceedings. For that purpose a form shall be used bearing the heading "Invitation to lodge a claim. Time limits to be observed" in all the official languages of the institutions of the European Union. 2. Any creditor who has his habitual residence, domicile or registered office in a Member State other than the State of the opening of proceedings may lodge his claim in the official language or one of the official languages of that other State. In that event, however, the lodgement of his claim shall bear the heading "Lodgement of claim" in the official language or one of the official languages of the State of the opening of proceedings. In addition, he may be required to provide a translation into the official language or one of the official languages of the State of the opening of proceedings.

[821] **(2012) COM 744 Final**, "*European Commssion - Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings*", at 3. See also **McCormack Gerard**, "*Time to revise the European Insolvency Regulation*" in *'The European Insolvency Regulation: an update – Papers from the INSOL Europe Academic Forum Annual Conference, Stockholm, Sweden, 30 September – 1 October 2009'*, Eds. Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-5-9, (2010); **McCormack Gerard**, "*European conflicts and insolvency – Resolving uncertainties*" in *'European insolvency law: current issues and prospects for reform"*, Ed. Parry Rebecca, INSOL EUROPE, ISBN 978-0-9570761-6-7, (2014); Wessels Bob, "On the future of European insolvency law" in *'European insolvency law: current issues and prospects for reform"*, Ed. Parry Rebecca, INSOL EUROPE, ISBN 978-0-9570761-6-7, (2014); **Mac Namara Bernard**, "*Domestic and European perspectives on the reform proposa*l" in *'The grand project: reform of the European insolvency Regulation – Papers from the INSOL Europe Academic Forum and Academy of European Law Joint Insolvency Conference Trier, Germany, 18-19 March 2013 and the INSOL Europe Academic Forum Annual Conference Paris, France, 25-26 September 2013'*, Ed. Bariatti Stefania and Omar Paul J., INSOL EUROPE, ISBN 978-0-9570761-8-1, (2014).

that had been spotted over time and proposed improvements to the general insolvency framework of the Union.

The report concluded that the Regulation was functioning well, in general, but that it would be desirable to improve the application of certain provisions in order to enhance the effective administration of cross-border insolvency proceedings.[822] After several minor amendments, therefore, it was the time for a new draft to be prepared.[823]

The following five major shortcomings were identified:

1) The Regulation's scope does not cover national procedures that provide for the restructuring of a company at a pre-insolvency stage ("pre-insolvency proceedings") or proceedings that leave the existing management in place ("hybrid proceedings"). However, such proceedings have recently been introduced in many Member States and are considered to increase the chances of successful restructuring of businesses. In addition, a number of personal insolvency proceedings are currently outside the Regulation's scope.
2) There are difficulties in determining which Member State is competent to open insolvency proceedings. While there is wide support for granting jurisdiction for opening main insolvency proceedings to the Member State where the debtor's COMI is located, there have been difficulties in applying the concept in practice. The Regulation's jurisdiction rules have also been criticized for allowing forum shopping by companies and natural persons through abusive COMI-relocation.[824] [825]
3) Problems have also been identified with respect to secondary proceedings. The opening of secondary proceedings can hamper the efficient administration of the debtor's estate. With the opening of secondary proceedings, the liquidator in the main proceedings no longer has control over the assets located in the other Member State, which makes a sale of the debtor on a going concern basis more difficult. Moreover, secondary proceedings currently have to be winding-up proceedings, which constitutes an obstacle to the successful restructuring of a debtor.[826]
4) There are problems related to the rules on publicizing insolvency proceedings and lodging claims. It is not mandatory to publish or register decisions in the Member States where a proceeding is opened, nor in Member States where there is an establishment. There is also no European Insolvency Register which would permit searches in several national

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[822] See **Wessels Bob**, "*Amending the EU Insolvency Regulation: shaken or stirred?*" in *'The reform of international insolvency rules at European and national level – Papers from the INSOL Europe Academic Forum/Milan law school – Joint insolvency conference, Milan 31 March – 1 April 2011'*, Ed. Parry Rebecca, INSOL EUROPE, ISBN 978-0-9558364-9-7, (2011).

[823] The following Council Regulations had previously amended the EC n. 1346/2000 in the previous years: n. 603/2005 of the 12th of April 2005; n. 694/2006 of the 27th of April 2006; n. 1791/2006 of the 20th of November 2006; n. 681/2007 of the 13th of June 2007; n. 788/2008 of the 24th of July 2008; n. 583/2011 of the 9th of June 2011.

[824] "[…] the COMI concept is vague; uncertain; subject to manipulation and last minute changes", See **McCormack**, "*Time to revise the European Insolvency Regulation*" in *'The European Insolvency Regulation: an update – Papers from the INSOL Europe Academic Forum Annual Conference, Stockholm, Sweden, 30 September – 1 October 2009'*, Eds. Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-5-9, (2010), at 77-85. See also **Schmidt Jessica**, "*Eurofood three years on: the concept of COMI and Ordre Public revisited*" in *'The European Insolvency Regulation: an update – Papers from the INSOL Europe Academic Forum Annual Conference, Stockholm, Sweden, 30 September – 1 October 2009'*, Eds.Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-5-9, (2010), at 19-28.

[825] See **Moss Gabriel**, "*New world and old world symphony or cacophony*" in *'The European Insolvency Regulation: an update – Papers from the INSOL Europe Academic Forum Annual Conference, Stockholm, Sweden, 30 September – 1 October 2009'*, Eds. Wessels Bob and Omar Paul J., INSOL EUROPE, ISBN 978-0-9558364-5-9, (2010), at 145: "The concept of 'centre of main interests', or 'COMI' as it is known even in non-English speaking countries, is perhaps the most important undefined central concept in European or international insolvency law".

[826] See **Leandro Antonio**, "*Strenghtening the dominion of main proceedings: from Bank Handlowy to the revision of the European Insolvency Regulation*" in *'The grand project: reform of the European insolvency Regulation – Papers from the INSOL Europe Academic Forum and Academy of European Law Joint Insolvency Conference Trier, Germany, 18-19 March 2013 and the INSOL Europe Academic Forum Annual Conference Paris, France, 25-26 September 2013'*, Eds. Bariatti Stefania and Omar Paul J., INSOL EUROPE, ISBN 978-0-9570761-8-1, (2014).

registers. However, the good functioning of cross-border insolvency proceedings relies to a significant extent on the publication of the relevant decisions relating to an insolvency procedure. Judges need to be aware whether proceedings have already been opened in another Member State; creditors or potential creditors need to be aware that proceedings have commenced. In addition, creditors, particularly small creditors and SMEs, face difficulties and costs in lodging claims under the Insolvency Regulation.

5) Finally, the Regulation does not contain specific rules dealing with the insolvency of a multi-national enterprise group, although a large number of cross-border insolvencies involve groups of companies. The basic premise of the Insolvency Regulation is that separate proceedings must be opened for each individual member of the group and that these proceedings are entirely independent of each other. The lack of specific provisions for group insolvency often diminishes the prospects of successful restructuring of the group as a whole and may lead to a break-up of the group in its constituent parts.[827]

Moreover, the current structure of the Regulation did not reflect the development of European strategies and priorities in the process of refoundation of insolvency frameworks within the new ten-year plan. The lack of emphasis on reorganization proceedings, for example, was a clear sign of the inadequacy of the previous model.[828] Several relevant improvements were, therefore, urgently needed.

The steps to be taken in drafting the new framework were summarized in the following proposed actions:

1- "Scope of the insolvency Regulation

"The proposal extends the scope of the Regulation by revising the definition of insolvency proceedings to include hybrid and pre-insolvency proceedings as well as debt discharge proceedings and other insolvency proceedings for natural persons[829] who currently do not fit in the definition"

Jurisdiction

"The proposal clarifies the jurisdiction rules and improves the procedural framework for determining jurisdiction"

2- Secondary Proceedings

"The proposal provides for a more efficient administration of insolvency proceedings by enabling the court to refuse the opening of secondary proceedings if this is not necessary to protect the interests of local creditors, by abolishing the requirement that secondary proceedings must be winding-up proceedings and by improving the cooperation between main and secondary proceedings, in particular by extending the cooperation requirements to the courts involved"

3- Publicity and lodging of claims

"The proposal requires Member States to publish the relevant court decisions in cross-border insolvency cases in a publicly accessible electronic register and provides for the interconnection of national insolvency registers. It also introduces standard forms for the lodging of claims"

4- Groups of companies

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[827] *Id.,* at 2-3. See also: **Vallar Giulia**, "*The insolvency of Members of a group of companies in the proposal for amendment of the European Insolvency Regulation*" in *'The grand project: reform of the European insolvency Regulation – Papers from the INSOL Europe Academic Forum and Academy of European Law Joint Insolvency Conference Trier, Germany, 18-19 March 2013 and the INSOL Europe Academic Forum Annual Conference Paris, France, 25-26 September 2013'*, Eds. Bariatti Stefania and Omar Paul J., INSOL EUROPE, ISBN 978-0-9570761-8-1, (2014).

[828] *Id.,* at 2.

[829] On the topic of the inclusion of insolvency frameworks of natural persons within the European cross-border insolvency framework see **Hoffman Thomas**, "*Consumer insolvency tourism and the EIR – stuck between convergence needs and the Stockholm Action Plan?*" in *'The reform of international insolvency rules at European and national level – Papers from the INSOL Europe Academic Forum/Milan law school – Joint insolvency conference, Milan 31 March – 1 April 2011'*, Ed. Parry Rebecca, INSOL EUROPE, ISBN 978-0-9558364-9-7, (2011); **Wessels Bob**, "*On the future of European insolvency law*" in *'European insolvency law: current issues and prospects for reform"*, Ed. Parry Rebecca, INSOL EUROPE, ISBN 978-0-9570761-6-7, (2014), at 144-148.

> "The proposal provides for a coordination of the insolvency proceedings concerning different Members of the same group of companies by obliging the liquidators and courts involved in the different main proceedings to cooperate and communicate with each other; in addition, it gives the liquidators involved in such proceedings the procedural tools to request a stay of the respective other proceedings and to propose a rescue plan for the Members of the group subject to insolvency proceedings."

A new draft was enacted in an attempt to cure the previous shortcomings and to improve the effectiveness of the European cross-border insolvency framework, hence supporting European efforts to grow and stay competitive within the global market in the second decade of the new Millennium.

5.3.1 Regulation (EU) N. 2015/848 of the European Parliament and of the Council on insolvency proceedings - introduction

The new European Insolvency Regulation came to light after years of intense negotiation. The main body of rules included in the recast Regulation entered into force on the 26th of July, 2017 (Article 86 went into force on the 26th of June, 2016; Article 24 (1) entered into force on the 26th of June, 2018 and Article 25 entered into force on the 26th of June, 2019)[830]. Upon its enactment, the previous draft which had regulated the field for fifteen years was repealed.[831]

Not enough time has elapsed from the application of the new draft to make conclusive statements on the achievement of its targets; for sure, the updates are relevant and cover a variety of topics that were not addressed in the previous statute. In the next sections, we will examine its goals and structure so that it may be compared with the models that have been analyzed in the previous sections.

[A] Structure and goals

The structure of the recast Regulation did not suffer great modifications compared to the previous draft although it was expanded. The framework is now formed of seven chapters, 92 articles, and four annexes:

I. General provisions (Articles 1 to 18);
II. Recognition of insolvency proceedings (Articles 19 to 33);
III. Secondary insolvency proceedings (Articles 34 to 52);
IV. Provision of information for creditors and lodgment of their claims (Articles 53 to 55);
V. Insolvency proceedings of Members of a group of companies (Articles 56 to 77);
   - Section I: cooperation and communication (Articles 56 to 60)
   - Section II: coordination (Articles 61 to 77)
     - Subsection I: Procedure (Articles 61 to 70)
     - Subsection II: General Provisions (Articles 71 to 77)
VI. Data protection (Articles 78 to 83)
VII. Transitional and final provisions (84 to 92)

ANNEX A – listing insolvency proceedings referred to in point (4) of Article (2)
ANNEX B – listing insolvency practitioners referred to in point (5) of Article (2)
ANNEX C– listing repealed Regulations with list of the successive amendments thereto
ANNEX D – correlation table

The new cross-border model remained binding for all EU Members with the exception of Denmark[832] without requiring specific acts for its enactment. As such, the new formula does not remove one of the most relevant weaknesses or concerns of its predecessor: not being applicable to international cases involving non-EU countries.[833]

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[830] Article 92.
[831] **Wessels Bob**, "*The EU Regulation on Insolvency Proceedings (Recast)*", (2016), at 1 http://bobwessels.nl/site/assets/files/1856/eir-recast-aug-2015-technical-note.pdf
[832] Preamble point: (88).
[833] Preamble point 24: " This Regulation applies only to proceedings in respect of a debtor whose centre of main interests is located in the Union".

Goals also have remained mostly unvaried. The new draft continues to serve the purposes of contributing to the establishment of an area of freedom, security, and justice, while supporting the better functioning of the internal market, in contrast to the impact of forum shopping[834].

> Point 48: "[…] When cooperating, insolvency practitioners and courts should take into account best practices for cooperation in cross-border insolvency cases, as set out in principles and guidelines on communication and cooperation adopted by European and international organizations active within the area of insolvency law, and in particular the relevant guidelines prepared by the United Nations Commission on international Trade Law (UNCITRAL)".

Although, as we are about to discuss, its focus was expanded.

[B] Application of the framework

An attempt to cure one of the most relevant shortcomings listed in the 2012 report was made in the very first article of the recast Regulation:

CE 1346/00	*Article 1* **Scope** 1. This Regulation shall apply to collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator. 2. This Regulation shall not apply to insolvency proceedings concerning insurance undertakings, credit institutions, investment undertakings which provide services involving the holding of funds or securities for third parties, or to collective investment undertakings.
EU 848/15	*Article 1* **Scope** 1. This Regulation shall apply to public collective proceedings, including interim proceedings, which are based on laws relating to insolvency and in which, for the purpose of rescue, adjustment of debt, reorganisation or liquidation: (a) a debtor is totally or partially divested of its assets and an insolvency practitioner is appointed; (b) the assets and affairs of a debtor are subject to control or supervision by a court; or (c) a temporary stay of individual enforcement proceedings is granted by a court or by operation of law, in order to allow for negotiations between the debtor and its creditors, provided that the proceedings in which the stay is granted provide for suitable measures to protect the general body of creditors, and, where no agreement is reached, are preliminary to one of the proceedings referred to in point (a) or (b). Where the proceedings referred to in this paragraph may be commenced in situations where there is only a likelihood of insolvency, their purpose shall be to avoid the debtor's insolvency or the cessation of the debtor's business activities. The proceedings referred to in this paragraph are listed in Annex A. 2. This Regulation shall not apply to proceedings referred to in paragraph 1 that concern: (a) insurance undertakings; (b) credit institutions; (c) investment firms and other firms, institutions and undertakings to the extent that they are covered by Directive 2001/24/EC; or (d) collective investment undertakings.

As stated in the Preamble, in fact, the recast Regulation addresses all those proceedings that are concerned with debtors' rescue and reorganization and not just liquidations. The focus of the recast model

[834] Preamble points 2, 3, 4, and 29.

was expanded to include those proceedings that can be opened even in the absence of severe financial difficulties, or full-blown insolvency, so as to support the debtor's restructuring process[835] [836]:

> (10) "The scope of this Regulation should extend to proceedings which promote the rescue of economically viable but distressed businesses and which give a second chance to entrepreneurs. It should, in particular, extend to proceedings which provide for restructuring of a debtor at a stage where there is only a likelihood of insolvency, and to proceedings which leave the debtor fully or partially in control of its assets and affairs. It should also extend to proceedings providing for a debt discharge or a debt adjustment in relation to consumers and self- employed persons, for example by reducing the amount to be paid by the debtor or by extending the payment period granted to the debtor. Since such proceedings do not necessarily entail the appointment of an insolvency practitioner, they should be covered by this Regulation if they take place under the control or supervision of a court. In this context, the term 'control' should include situations where the court only intervenes on appeal by a creditor or other interested parties."
>
> (11) "This Regulation should also apply to procedures which grant a temporary stay on enforcement actions brought by individual creditors where such actions could adversely affect negotiations and hamper the prospects of a restructuring of the debtor's business. Such procedures should not be detrimental to the general body of creditors and, if no agreement on a restructuring plan can be reached, should be preliminary to other procedures covered by this Regulation."
>
> (15) "This Regulation should also apply to proceedings that, under the law of some Member States, are opened and conducted for a certain period of time on an interim or provisional basis before a court issues an order confirming the continuation of the proceedings on a non-interim basis. Although labeled as 'interim', such proceedings should meet all other requirements of this Regulation."

However, the Regulation applies to proceedings which are based on laws related to insolvency point 17, which states that the scope of the Regulation should be "ample":

> (17) "This Regulation's scope should extend to proceedings which are triggered by situations in which the debtor faces non-financial difficulties, provided that such difficulties give rise to a real and serious threat to the debtor's actual or future ability to pay its debts as they fall due. The time frame relevant for the determination of such threat may extend to a period of several months or even longer in order to account for cases in which the debtor is faced with non-financial difficulties threatening the status of its business as a going concern and, in the medium term, its liquidity. This may be the case, for example, where the debtor has lost a contract which is of key importance to it."

[835] For a discussion of pre-insolvency proceedings within the European cross-border framework see: **Omar Paul,** "*Upstreaming rescue: pre-insolvency proceedings in the European Insolvency Regulation*" in *'The grand project: reform of the European insolvency Regulation – Papers from the INSOL Europe Academic Forum and Academy of European Law Joint Insolvency Conference Trier, Germany, 18-19 March 2013 and the INSOL Europe Academic Forum Annual Conference Paris, France, 25-26 September 2013'*, Eds. Bariatti Stefania and Omar Paul J., INSOL EUROPE, ISBN 978-0-9570761-8-1, (2014); **Garcimartin Francisco**, "*Universal effects of European pre-insolvency proceedings: a case study*" in *'Reimagining rescue – Papers from the INSOL Europe Academic Forum and Academy of European Law Joint Insolvency Conference, Trier, Germany 19-20 March 2015 and the INSOL Europe Academic Forum and Nottingham Law School joint insolvency conference, Nottingham, United Kingdom, 25-26 June 2015'*, Eds. Parry Rebecca and Omar Paul J., INSOL EUROPE, ISBN 978-0-993-1897-3-9, (2016).

[836] **Volpe Vincenzo**, "*When is a company unable to pay its debts? An assessment of the tests for corporate insolvency*" in *'The grand project: reform of the European insolvency Regulation – Papers from the INSOL Europe Academic Forum and Academy of European Law Joint Insolvency Conference Trier, Germany, 18-19 March 2013 and the INSOL Europe Academic Forum Annual Conference Paris, France, 25-26 September 2013'*, Eds. Bariatti Stefania and Omar Paul J., INSOL EUROPE, ISBN 978-0-9570761-8-1, (2014), at 187-8.

Some exclusions still apply but they are limited and more carefully defined and tailored compared to the previous draft. The Preamble lists the following specific cases:

a- Confidential insolvency proceedings. This is in contrast with point D, on international cooperation, for while such proceedings may play an important role within a national setting, their confidentiality makes it difficult for them to have effects through the Union;[837]

b- Proceedings based on "general company law", not designed exclusively for insolvency situations, and proceedings that are specifically designed for the adjustment of debts of natural persons with very low income and very low asset value that do not include provisions for the payment of creditors[838];

c- Insolvency proceedings concerning the undertaking of credit institutions, investment firms, and other firms, institutions or undertakings covered by Directive (EC) No 24/2001 of the European Parliament and of the Council of 4 April, 2001, on the reorganization and winding up of credit institutions. They are all subject to special arrangements and national supervisory authorities have wide-ranging powers of intervention.[839]

The first major change was therefore made in extending the reach of the recast in accordance with new strategies supporting the reorganization of debtors.

[C] Universality, center of main interests and secondary proceedings

The second main shortcoming listed in the 2012 report regarded the intricate issue of applying a clear, practical definition of COMI. The Recast Regulation is drafted in an attempt to limit abuses and forum shopping or other fraudulent shortcuts. Several points in the Preamble address these issues:

> (29) "This Regulation should contain a number of safeguards aimed at preventing fraudulent or abusive forum shopping."
>
> (30) "Accordingly, the presumptions that the registered office, the principal place of business and the habitual residence are the centre of main interests should be rebuttable, and the relevant court of a Member State should carefully assess whether the centre of the debtor's main interests is genuinely located in that Member State. In the case of a company, it should be possible to rebut this presumption where the company's central administration is located in a Member State other than that of its registered office, and where a comprehensive assessment of all the relevant factors establishes, in a manner that is ascertainable by third parties, that the company's actual centre of management and supervision and of the management of its interests is located in that other Member State. In the case of an individual not exercising an independent business or professional activity, it should be possible to rebut this presumption, for example where the major part of the debtor's assets is located outside the Member State of the debtor's habitual residence, or where it can be established that the principal reason for moving was to file for insolvency proceedings in the new jurisdiction and where such filing would materially impair the interests of creditors whose dealings with the debtor took place prior to the relocation."
>
> (31) "With the same objective of preventing fraudulent or abusive forum shopping, the presumption that the centre of main interests is at the place of the registered office, at the individual's principal place of business or at the individual's habitual residence should not apply where, respectively, in the case of a company, legal person or individual exercising an independent business or professional activity, the debtor has relocated its registered office or principal place of business to another Member State within the 3-

[837] Preamble point (13).

[838] Preamble point (16).

[839] Preamble point (19); See **Teo Chindar**, "*The gap in the European Union legal framework addressing the subsidiaries of financial institutions*" in *'The grand project: reform of the European insolvency Regulation – Papers from the INSOL Europe Academic Forum and Academy of European Law Joint Insolvency Conference Trier, Germany, 18-19 March 2013 and the INSOL Europe Academic Forum Annual Conference Paris, France, 25-26 September 2013'*, Eds. Bariatti Stefania and Omar Paul J., INSOL EUROPE, ISBN 978-0-9570761-8-1, (2014).

month period prior to the request for opening insolvency proceedings, or, in the case of an individual not exercising an independent business or professional activity, the debtor has relocated his habitual residence to another Member State within the 6-month period prior to the request for opening insolvency proceedings."

(32) "In all cases, where the circumstances of the matter give rise to doubts about the court's jurisdiction, the court should require the debtor to submit additional evidence to support its assertions and, where the law applicable to the insolvency proceedings so allows, give the debtor's creditors the opportunity to present their views on the question of jurisdiction. (33) In the event that the court seized of the request to open insolvency proceedings finds that the centre of main interests is not located on its territory, it should not open main insolvency proceedings. (34) In addition, any creditor of the debtor should have an effective remedy against the decision to open insolvency proceedings. The consequences of any challenge to the decision to open insolvency proceedings should be governed by national law."

An improved definition of "center of main interest" is, therefore, provided:

CE 1346/00	*Article* ***3*** **International Jurisdiction** 1. The courts of the Member State within the territory of which the centre of a debtor's main interests is situated shall have jurisdiction to open insolvency proceedings. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in absence of proof of the contrary. 2. Where the centre of a debtor's main interests is situated within the territory of a Member State, the courts of another Member State shall have jurisdiction to open insolvency proceedings against the debtor only if he possesses and establishment within the territory of that other Member State. The effects of those proceedings shall be restricted to the assets of the debtor situated in the territory of the latter Member State. 3. Where insolvency proceedings have been opened under paragraph 1, any proceedings opened subsequently under paragraph 2 shall be secondary proceedings. These latter proceedings must be winding-up proceedings. 4. Territorial insolvency proceeding referred to in paragraph 2 may be opened prior to the opening of main insolvency proceedings in accordance with paragraph 1 only: (a) Where insolvency proceedings under paragraph 1 cannot be opened because of the conditions laid down by the law of the Member State within the territory of which the centre of the debtor's main interests is situated; or *(b)* Where the opening of territorial insolvency proceedings is requested by a creditor who has his domicile, habitual residence or registered office in the Member State within the territory of which the establishment is situated, or whose claim arises from the operation of that establishment.
EU 848/15	Article 3 International jurisdiction 1.The courts of the Member State within the territory of which the centre of the debtor's main interests is situated shall have jurisdiction to open insolvency proceedings ('main insolvency proceedings'). The centre of main interests shall be the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary. That presumption shall only apply if the registered office has not been moved to another Member State within the 3-month period prior to the request for the opening of insolvency proceedings. In the case of an individual exercising an independent business or professional activity, the centre of main interests shall be presumed to be that individual's principal place of business in the absence of proof to the contrary. That presumption shall only apply if the individual's principal place of business has not been moved to another Member

	State within the 3-month period prior to the request for the opening of insolvency proceedings. In the case of any other individual, the centre of main interests shall be presumed to be the place of the individual's habitual residence in the absence of proof to the contrary. This presumption shall only apply if the habitual residence has not been moved to another Member State within the 6-month period prior to the request for the opening of insolvency proceedings. 2.Where the centre of the debtor's main interests is situated within the territory of a Member State, the courts of another Member State shall have jurisdiction to open insolvency proceedings against that debtor only if it possesses an establishment within the territory of that other Member State. The effects of those proceedings shall be restricted to the assets of the debtor situated in the territory of the latter Member State. 3.Where insolvency proceedings have been opened in accordance with paragraph 1, any proceedings opened subsequently in accordance with paragraph 2 shall be secondary insolvency proceedings. 4. The territorial insolvency proceedings referred to in paragraph 2 may only be opened prior to the opening of main insolvency proceedings in accordance with paragraph 1 where (a) insolvency proceedings under paragraph 1 cannot be opened because of the conditions laid down by the law of the Member State within the territory of which the centre of the debtor's main interests is situated; or (b) the opening of territorial insolvency proceedings is requested by: (i) a creditor whose claim arises from or is in connection with the operation of an establishment situated within the territory of the Member State where the opening of territorial proceedings is requested; or (ii) a public authority which, under the law of the Member State within the territory of which the establishment is situated, has the right to request the opening of insolvency proceedings. When main insolvency proceedings are opened, the territorial insolvency proceedings shall become secondary insolvency proceedings.

A modified Article 3 in the Recast provides more detailed parameters that apply to both business entities and individual debtors. Difficulties, though, remain. Absent proof of the opposite (for example, the existence of a different center for the central administration of finances[840]), the center of main interest of a business debtor will be presumed to be the place of the registered office.[841] In the case of natural persons, the COMI will be located in the principal place of business for business-connected debtors, or, in the case of consumers, in the place of habitual residence. Such presumptions, though, are rebuttable.

A relevant modification to the approach of the previous Regulation was made, allowing courts to determine on their own motion if a case is a "main" or "secondary" proceeding:

> "*Article 4* **Examination as to jurisdiction** 1.A court seised of a request to open insolvency proceedings shall of its own motion examine whether it has jurisdiction pursuant to Article 3. The judgment opening insolvency proceedings shall specify the grounds on which the jurisdiction of the court is based, and, in particular, whether jurisdiction is based on Article 3(1) or (2).
> 2.Notwithstanding paragraph 1, where insolvency proceedings are opened in accordance with national law without a decision by a court, Member States may entrust the insolvency practitioner appointed in such proceedings to examine whether the Member State in which a request for the opening of proceedings is pending has jurisdiction pursuant to Article 3. Where this is the case, the insolvency practitioner shall specify in the decision opening the proceedings the grounds on which jurisdiction is based and, in particular, whether jurisdiction is based on Article 3(1) or (2)."

[840] Preamble point 27: "When determining whether the centre of the debtor's main interests is ascertainable by third parties, special consideration should be given to the creditors and to their perception as to where a debtor conducts the administration of its interests."
[841] See C-241/04 Eurofood IFSC ltd., (2006), in I-03813.

Secondary proceedings have remained a relevant component of the system and can be opened for a variety of reasons:

> Point (40) of the Preamble: "Secondary insolvency proceedings can serve different purposes, besides the protection of local interests. Cases may arise in which the insolvency estate of the debtor is too complex to administer as a unit, or the differences in the legal systems concerned are so great that difficulties may arise from the extension of the effects deriving from the law of the estate of the opening proceedings to the other Member States where the assets are locates. For that reason, the insolvency practitioner in the main insolvency proceedings may request the opening of secondary insolvency proceedings where the efficient administration of the insolvency estate so requires."

At the same time, their excessive use had to be discouraged, since it hampered:

> "the efficient administration of the insolvency estate. Therefore, this Regulation sets out two specific situations in which the court seised of a request to open secondary insolvency proceedings should be able, at the request of the insolvency practitioner in the main insolvency proceedings, to postpone or refuse the opening of such proceedings."[842]

Another relevant modification regarding secondary proceedings matches the changes in strategy of the Regulation. In the recast, in fact, they are not anymore limited to be liquidations; proceedings that attempt to support the debtor in restructuring operations are also allowed. The opening of a secondary proceeding may be requested by an insolvency practitioner of the main proceeding or by other empowered persons under Article 37:

> *"Article 37* **Right to request the opening of secondary insolvency proceedings**
> 1.The opening of secondary insolvency proceedings may be requested by: (a) the insolvency practitioner in the main insolvency proceedings; (b) any other person or authority empowered to request the opening of insolvency proceedings under the law of the Member State within the territory of which the opening of secondary insolvency proceedings is requested.
> 2.Where an undertaking has become binding in accordance with Article 36, the request for opening secondary insolvency proceedings shall be lodged within 30 days of having received notice of the approval of the undertaking."

Under Article 38[843], though, courts may refuse or postpone the opening of a secondary proceeding. The decision is taken based on a number of relevant factors:

[842] Point (41) of the Preamble.

[843] Article 38: "Decision to open secondary insolvency proceedings

1. A court seised of a request to open secondary insolvency proceedings shall immediately give notice to the insolvency practitioner or the debtor in possession in the main insolvency proceedings and give it an opportunity to be heard on the request.

2.Where the insolvency practitioner in the main insolvency proceedings has given an undertaking in accordance with Article 36, the court referred to in paragraph 1 of this Article shall, at the request of the insolvency practitioner, not open secondary insolvency proceedings if it is satisfied that the undertaking adequately protects the general interests of local creditors.

3.Where a temporary stay of individual enforcement proceedings has been granted in order to allow for negotiations between the debtor and its creditors, the court, at the request of the insolvency practitioner or the debtor in possession, may stay the opening of secondary insolvency proceedings for a period not exceeding 3 months, provided that suitable measures are in place to protect the interests of local creditors. The court referred to in paragraph 1 may order protective measures to protect the interests of local creditors by requiring the insolvency practitioner or the debtor in possession not to remove or dispose of any assets which are located in the Member State where its establishment is located unless this is done in the ordinary course of business. The court may also order other

(45) "[…] this Regulation should provide for the possibility that the court temporarily stays the opening of secondary insolvency proceedings, when a temporary stay of individual enforcement proceedings has been granted in the main insolvency proceedings, in order to preserve the efficiency of the stay granted in the main insolvency proceedings. The court should be able to grant the temporary stay if it is satisfied that suitable measures are in place to protect the general interest of local creditors. In such a case, all creditors that could be affected by the outcome of the negotiations on a restructuring plan should be informed of the negotiations and be allowed to participate in them."

[D] International cooperation: Registers of insolvency proceedings[844]

The recast Regulation attempts to increase the level of efficiency of the framework through the introduction of public register.[845] Such register would be a tool to grant greater and easier access to relevant information on debtors and local proceedings.[846] As stated in the Preamble, they would be a key tool, for example, in supporting creditors in lodging claims in foreign proceedings:

(48) "Main insolvency proceedings and secondary insolvency proceedings can contribute to the efficient administration of the debtor's insolvency estate or to the effective realisation of the total assets if there is proper cooperation between the actors involved in all the concurrent proceedings. Proper cooperation implies the various insolvency practitioners and the courts involved cooperating closely, in particular by exchanging a sufficient amount of information. In order to ensure the dominant role of the main insolvency proceedings, the insolvency practitioner in such proceedings should be given several possibilities for intervening in secondary insolvency proceedings which are pending at the same time. In particular, the insolvency practitioner should be able to propose a restructuring plan or composition or apply for a suspension of the realisation of the assets in the secondary insolvency proceedings. When cooperating, insolvency practitioners and courts should take into account best practices for cooperation in cross-border insolvency cases, as set out in principles and guidelines on communication and cooperation adopted by European and international organisations active in the area of insolvency law, and in particular the relevant guidelines prepared by the United Nations Commission on International Trade Law (Uncitral)."

(76) "In order to improve the provision of information to relevant creditors and courts and to prevent the opening of parallel insolvency proceedings, Member States should be

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measures to protect the interest of local creditors during a stay, unless this is incompatible with the national rules on civil procedure. The stay of the opening of secondary insolvency proceedings shall be lifted by the court of its own motion or at the request of any creditor if, during the stay, an agreement in the negotiations referred to in the first subparagraph has been concluded. The stay may be lifted by the court of its own motion or at the request of any creditor if the continuation of the stay is detrimental to the creditor's rights, in particular if the negotiations have been disrupted or it has become evident that they are unlikely to be concluded, or if the insolvency practitioner or the debtor in possession has infringed the prohibition on disposal of its assets or on removal of them from the territory of the Member State where the establishment is located.
4.At the request of the insolvency practitioner in the main insolvency proceedings, the court referred to in paragraph 1 may open a type of insolvency proceedings as listed in Annex A other than the type initially requested, provided that the conditions for opening that type of proceedings under national law are fulfilled and that that type of proceedings is the most appropriate as regards the interests of the local creditors and coherence between the main and secondary insolvency proceedings. The second sentence of Article 34 shall apply."

[844] See https://e-justice.europa.eu/content_insolvency_registers-110-en.do

[845] See **Inacio Emmanuelle**, "*Insolvency Regosters in the Recast European Insolvency Regulation*", Eurofenix - The Journal of INSOL Europe-, Autumn 2017, Issue 69, at 12-13.

[846] See **Szìranyi Pàl**, "EU-wide Interconnection of insolvency registers" in *'Reimagining rescue – Papers from the INSOL Europe Academic Forum and Academy of European Law Joint Insolvency Conference, Trier, Germany 19-20 March 2015 and the INSOL Europe Academic Forum and Nottingham Law School joint insolvency conference, Nottingham, United Kingdom, 25-26 June 2015'*, Eds. Parry Rebecca and Omar Paul J., INSOL EUROPE, ISBN 978-0-993-1897-3-9, (2016).

> required to publish relevant information in cross- border insolvency cases in a publicly accessible electronic register. In order to facilitate access to that information for creditors and courts domiciled or located in other Member States, this Regulation should provide for the interconnection of such insolvency registers via the European e-Justice Portal. Member States should be free to publish relevant information in several registers and it should be possible to interconnect more than one register per Member State."
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> (78) "Information on certain aspects of insolvency proceedings is essential for creditors, such as time limits for lodging claims or for challenging decisions. This Regulation should, however, not require Member States to calculate those time-limits on a case-by-case basis. Member States should be able to fulfil their obligations by adding hyperlinks to the European e-Justice Portal, where self-explanatory information on the criteria for calculating those time-limits is to be provided."

However, determining the quantity and quality of such information, as often discussed in the previous pages, is not an easy task. Different approaches have been planned for individuals to avoid promoting stigma of bankrupts in the new framework:

> (77) "This Regulation should determine the minimum amount of information to be published in the insolvency registers. Member States should not be precluded from including additional information. Where the debtor is an individual, the insolvency registers should only have to indicate a registration number if the debtor is exercising an independent business or professional activity. That registration number should be understood to be the unique registration number of the debtor's independent business or professional activity published in the trade register, if any."
>
> (79) "In order to grant sufficient protection to information relating to individuals not exercising an independent business or professional activity, Member States should be able to make access to that information subject to supplementary search criteria such as the debtor's personal identification number, address, date of birth or the district of the competent court, or to make access conditional upon a request to a competent authority or upon the verification of a legitimate interest."
>
> (80) "Member States should also be able not to include in their insolvency registers information on individuals not exercising an independent business or professional activity. In such cases, Member States should ensure that the relevant information is given to the creditors by individual notice, and that claims of creditors who have not received the information are not affected by the proceedings."

But the struggle to find an effective and efficient balance in this area involves all debtors.

[E] The insolvency of groups of companies[847]

The recast Regulation attempts to cure another shortcoming listed in the 2012 report in Part V, which addresses the issue of proceedings opened to deal with the financial difficulties of groups of companies.[848] UNCITRAL also studied this matter recently:

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[847] Preamble point (51); see **Van Galen Robert**, "*The recast Insolvency Regulation and groups of companies*" in *'Reimagining rescue – Papers from the INSOL Europe Academic Forum and Academy of European Law Joint Insolvency Conference, Trier, Germany 19-20 March 2015 and the INSOL Europe Academic Forum and Nottingham Law School joint insolvency conference, Nottingham, United Kingdom, 25-26 June 2015'*, Eds. Parry Rebecca and Omar Paul J., INSOL EUROPE, ISBN 978-0-993-1897-3-9, (2016); **McCormack Gerard**, "*Groups of companies and the "recast" European Insolvency Regulation*" in *'Reimagining rescue – Papers from the INSOL Europe Academic Forum and Academy of European Law Joint Insolvency Conference, Trier, Germany 19-20 March 2015 and the INSOL Europe Academic Forum and Nottingham Law School joint insolvency conference, Nottingham, United Kingdom, 25-26 June 2015'*, Eds. Parry Rebecca and Omar Paul J., INSOL EUROPE, ISBN 978-0-993-1897-3-9, (2016).

[848] See definitions at Article 2 (13) and (14): "

(13) 'group of companies' means a parent undertaking and all its subsidiary undertakings;

"It is increasingly recognized that strong and effective insolvency regimes are important for all States as a means of preventing or limiting financial crises and facilitating rapid and orderly workouts from excessive indebtedness. Such regimes can facilitate the orderly reallocation of economic resources from businesses that are not viable to more efficient and profitable activities; provide incentives that not only encourage entrepreneurs to undertake investment, but also encourage managers of failing businesses to take early steps to address that failure and preserve employment; reduce the costs of business; and increase the availability of credit. Comparative analysis of the effectiveness of insolvency systems has become both common and essential for lending purposes, affecting States at all levels of economic development. Much of the legislation relating to corporations and particularly to their treatment in insolvency deals with the single corporate entity, notwithstanding that the business of corporations is increasingly being conducted, both nationally and internationally, through enterprise groups - groups of corporations, sometimes very large, that are interconnected by various forms of ownership and control. These groups, found extensively in both emerging and developed markets, are a common vehicle for conducting international trade and finance. When some or all of the constituent parts of such groups become insolvent, there are currently very few domestic law regimes and no international or regional legal regimes that can effectively coordinate the conduct of the resulting insolvency proceedings, often involving multiple jurisdictions."[849]

The Preamble discusses this relevant topic in a number of points:

(57) "Group coordination proceedings should always strive to facilitate the effective administration of the insolvency proceedings of the group Members, and to have a generally positive impact for the creditors. This Regulation should therefore ensure that the court with which a request for group coordination proceedings has been filed makes an assessment of those criteria prior to opening group coordination proceedings."

(58) "The advantages of group coordination proceedings should not be outweighed by the costs of those proceedings. Therefore, it is necessary to ensure that the costs of the coordination, and the share of those costs that each group member will bear, are adequate, proportionate and reasonable, and are determined in accordance with the national law of the Member State in which group coordination proceedings have been opened. The insolvency practitioners involved should also have the possibility of controlling those costs from an early stage of the proceedings. Where the national law so requires, controlling costs from an early stage of proceedings could involve the insolvency practitioner seeking the approval of a court or creditors' committee."

(59) "Where the coordinator considers that the fulfilment of his or her tasks requires a significant increase in costs compared to the initially estimated costs and, in any case, where the costs exceed 10% of the estimated costs, the coordinator should be authorised by the court which has opened the group coordination proceedings to exceed such costs. Before taking its decision, the court which has opened the group coordination proceedings should give the possibility to the participating insolvency practitioners to be heard before it in order to allow them to communicate their observations on the appropriateness of the coordinator's request."

(60) "For Members of a group of companies which are not participating in group coordination proceedings, this Regulation should also provide for an alternative mechanism to achieve a coordinated restructuring of the group. An insolvency practitioner appointed in proceedings relating to a member of a group of companies should have standing to request a stay of any

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(14) 'parent undertaking' means an undertaking which controls, either directly or indirectly, one or more subsidiary undertakings. An undertaking which prepares consolidated financial statements in accordance with Directive 2013/34/EU of the European Parliament and of the Council (1) shall be deemed to be a parent undertaking."

[849] http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html

measure related to the realisation of the assets in the proceedings opened with respect to other Members of the group which are not subject to group coordination proceedings. It should only be possible to request such a stay if a restructuring plan is presented for the Members of the group concerned, if the plan is to the benefit of the creditors in the proceedings in respect of which the stay is requested, and if the stay is necessary to ensure that the plan can be properly implemented."

(61) "This Regulation should not prevent Member States from establishing national rules which would supplement the rules on cooperation, communication and coordination with regard to the insolvency of Members of groups of companies set out in this Regulation, provided that the scope of application of those national rules is limited to the national jurisdiction and that their application would not impair the efficiency of the rules laid down by this Regulation."

The ultimate goal pursued by the Regulation is to increase efficiency, preventing growth in costs and the unfair distribution of proceeds.

5.4 Recent updates: the proposal for a Directive on the topic of cross-border insolvency law

We have briefly discussed the main characteristics of the process of refounding European regulations on cross-border insolvency. We have listed some relevant weaknesses but, overall, the progress made by the Union in this field in the past few years has been excellent. There is more to be done, though, especially to coordinate growth in this area with the general strategies and the process of refounding insolvency regulations.

One main barrier that prevents Europe from taking full advantage of the steps forward that were made is the struggle to harmonize local frameworks, a factor that forces the cross-border Regulation to remain variable and to cover mostly procedural aspects. The persistent effects of the crisis, though, require swift improvements.

In order to promote the continuation of the process, Article 89 of the recast Regulation mandates for its review on a regular basis. Every five years, the draft is to be placed under revision and verification to ensure that it remains updated and effective. This is a very positive approach which has been proven successful by the World Bank in the past two decades

In an attempt to directly tackle barriers, the Union has recently arrived to a sort of "mediation". It appears to have realized that the crucial issue of "flexibility" is a main weakness of all international models and there is no shortcut to solve it. The use of Regulations has proven successful to bind Member States, but only in procedural aspects; it does not appear capable of effectively modifying more substantive aspects. Recently, therefore, a proposal has been made to come to a smart middle ground.

As mentioned in Chapter I, a proposal has been made, to lead Member States toward the adoption of common (although not completely uniform) parameters through a Directive on the topic of cross-border insolvency. Directives are less binding tools; they let the Union establish the goals that Member States have to reach but but allow them to choose how to do it:

"A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods."[850]

By using a less rigorous tool, the Union would attempt to achieve the important result of bringing the different approaches deployed among Member States closer:

"More specifically, such frameworks aim to help increase investment and job opportunities in the single market, reduce unnecessary liquidation of viable companies, avoid unnecessary job losses, prevent the build-up of non-performing loans, facilitate

[850] Treaty on the Functioning of the European Union, Article 288.

cross-border restructurings, and reduce costs and increase opportunities for honest entrepreneurs to be given a fresh start."[851]

The new framework would move awa from what recast Regulation stated at point 8 of the Preamble:

> "In order to achieve the aim of improving the efficiency and effectiveness of insolvency proceedings having cross-border effects, it is necessary, and appropriate, that the provisions on jurisdiction, recognition and applicable law in this area should be contained in a Union measure which is binding and directly applicable in Member States."

This new step-by-step approach appears to be a concrete response to the difficulties faced in the past:

> "The proposal's key objective is to reduce the most significant barriers to the free flow of capital stemming from differences in Member State's restructuring and insolvency frameworks. The aim is for all Member States to have in place key principles on effective preventive restructuring and second chance frameworks, and measures to make all types of insolvency procedures more efficient by reducing their length and associated costs and improving their quality."[852]

Minimum standards would be uniformly imposed to: a) allow early filing for restructuring proceedings, hence preventing the negative effects of insolvency; and b) support honest debtors with the discharge of their debts and in obtaining an effective fresh start.

Moreover, as mentioned in Chapter I, reorganizations would become the preferred option in the insolvency setting. The Directive would attempt to guarantee:

(i) efficient possibilities for early restructuring;

(ii) greater room for negotiation through moratoriums of individual enforcement actions;

(iii) the continuation of a debtor's business while restructuring it effectively;

(iv) that a dissenting minority of creditors and shareholders could not jeopardize restructuring efforts (although their interests would be still be protected);

(v) an increase in a plan's chances of success;

(vi) the reduction of costs and length of restructuring procedures;

(vii) the availability of discharge for over-indebted entrepreneurs in a reasonable timeframe (three years).[853]

Nevertheless, leaving the proposed draft as it is would mean that several core aspects would still remain inadequately addressed:

> "The proposal does not harmonise core aspects of insolvency such as rules on conditions for opening of proceedings, a common definition of insolvency, ranking of claims and avoidance actions broadly speaking."[854]
>
> "Although such rules would be useful for achieving full cross-border legal certainty, as confirmed by many stakeholders in the public consultation."[855]

Although almost twenty years have been spent in the process of refounding European insolvency laws, the divergence on substantive topics is still considered too wide to be bridged. A Directive on some of

[851] **(2016) COM 723 Final**, "*Proposal for a Directive of the European Parliament and of the Council on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency and Discharge Procedures and Amending Directive 2012/30/EU*", at 5-6.

[852] *Id.,* at 5.

[853] *Id.,* 18.

[854] *Id*., 6.

[855] *Id.*

the key principles, though, could still lead to important improvements, since it could prove this step-by-step approach correct and, eventually, support progress over time:

> "Prescriptive harmonization could require far-reaching changes to commercial law, civil law and company law, whereas flexible provisions risk not bringing about desired changes."[856]

> "Instead the focus of this proposal it on addressing the most important problems that could be feasibly addressed by harmonization. As such the proposal would complement Regulation 848/2015 requiring Member States to ensure that their national preventive restructuring procedures comply with certain minimum principles of effectiveness."[857]

6. Analysis of Chapters II and III

In Chapter III, we discussed relevant aspects of international bankruptcy law. Cross-border insolvency is the second front on which the process of refounding European frameworks is trying to bring major improvements. In order to achieve its goals and maximize the competitiveness of its markets, the Union needs to create a system that can incentivize and support entrepreneurs in their activities across Member States and not just at a local level.

Despite the importance of this topic, it took decades of negotiations to enact the first Regulation.

Structuring an effective and efficient cross-border insolvency framework is a great challenge. In the previous pages, we mentioned several models that have been applied over the centuries; most were operative within small geographic areas and bound similar societies and economies. Such tools could not support a large and expanding Union sailing upon the waters of a turbulent globalized market.

Several new formulas have been proposed in the past few decades. Some have been structured in the form of principles; others consist of full models which to provide flexible systems that can adapt to different local laws in an attempt to bring higher levels of coordination. After fifty years of negotiations, the European Union enacted a binding Regulation which imposed a fixed and mandatory process of cooperation on Member States; this form was chosen in an attempt to promote swift and uniform progress in this complex field of law.

All these approaches address common key issues and principles, but also present a common weakness (even the European one, which is the most inflexibility of them all): variability. Flexible models are valuable; they allow principles of international bankruptcy law to be active within international markets. Nevertheless, the lack of harmonization between substantive rules limits their impact greatly.

Despite the negative effects which are connected to high levels of variability, this element may be impossible to remove at the moment. As discussed in Chapter II, to be effective and efficient, local frameworks must match the society they are enacted within, and societies still present great differences among each other. Hence problems would not be solved even if we were to impose common rules on all aspects of insolvency laws from the top-down, for such process would bring great inefficiencies at a national level.

The current status quo, therefore, leads to a riddle, which explains why we have decided to analyze Chapters II and III together: how do we create, just like the European Union has aimed to do in the past decades through the process of refoundation, a feasible insolvency framework both at the local and cross-border level, when local systems need to match the diverging principles of several societies and economies, and cross-border ones, on the other hand, need high degrees of uniformity among all of the national settings involved?

The two elements seem to be absolutely irreconcilable, at the least in the current international scenario. The inability to harmonize them becomes a great barrier and a major cause of the current impasse that prevents the refoundation of European insolvency frameworks from making the progress that is urgently needed.

The European Union has, therefore, recently discussed new paths.

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[856] *Id.*

[857] *Id.,* at 9.

While the Union has obtained important results in the new millennium by deploying, through decades of mediations, a cross-border insolvency Regulation and then an improved recast Regulation (which ensured immediate improvements to the original draft), it appears evident today that this measure alone could not suffice. “Rigid” Regulations appear to be inadequate to solve the riddle and to guide Member States toward those changes in local approaches and policies that would achieve the levels of uniformity necessary to attain the ambitious goals that were set. The steps taken toward deploying a Directive in the field of cross-border insolvency may, therefore be crucial.

A Directive could effectively support the coordinated development of local frameworks. With time it could achieve the target of increasing the levels of harmonization to such a point that a more detailed Regulations could then be successfully enacted. In the future, in fact, Regulations should begin to provide also common substantive rules of bankruptcy and not just procedural ones.

This process, of course, would have to be subdivided into phases, and it is difficult to imagine that it could be developed as swiftly as the Union has hoped. Time is a relevant factor in the process of refounding our insolvency systems. It appears, from the documents which we have examined up to now, that Europe has made a bold move toward increasing its economic competitiveness, but based on strategies that did not account for the complexity of the legal reforms that had to be made.

7. Conclusion

In this chapter, we discussed relevant aspects of international bankruptcy laws and of cross-border frameworks. We have analyzed how influent international organizations are attempting to structure models that can support the development of transnational business within a complex globalized market. The European Union has spent decades negotiating and structuring systems which could coordinate and assist the Members in their social and economic efforts.

When Regulations were finally deployed, though, they did not achieve the targets that were set and the refoundation of insolvency frameworks could not move decisive steps forward. The results obtained from 2002 have been promising and led to relevant improvements. But much remains to be done.

An impasse appears to have doomed current plans, and the path that should be taken to better the current situation is not clear.

What is wrong with current European strategies?

Is the source of Europe’s difficulties to be found in external elements such as the financial crisis, or is the impasse caused by specific bankruptcy elements?

Chapters II and III, together, have shed some light on relevant difficulties met in the international scenario in reforming bankruptcy systems. Adapting modern laws to the current economic scenario is a challenge and several best practices have been suggested to enact effective and efficient models both at a local and transnational level. The riddle which we have discussed in our analysis, though, shows specific aspects of the impasse which are bound to the very the matrix of the process of refounding European insolvency frameworks.

It appears that structuring an efficient and effective, substantive and procedural, cross-border European insolvency scenario may not be possible until local systems reach higher levels of uniformity. More needs to be said, therefore, on this relevant element: uniformity.

Following its strategies for the new millennium, the European Union has developed a new insolvency structure based on several specific key pillars to bring its insolvency systems closer. The most relevant of such key pillars are:

- the deployment of reorganization as the main proceeding to solve cases, hence reducing the role of liquidations;
- an increase in the availability of the bankruptcy tool for non-business debtors (such tools are aimed at reorganizing the debtor in all those instances in which it is possible and reducing liquidations);
- the availability of quick discharge rules;
- the promise of meaningful fresh starts for honest debtors;
- a decrease of the impact of bankruptcy stigma on entrepreneurs and bankrupts in general.

Most aspects of these fundamental elements are somewhat new. As discussed in Chapter I, they often enter into conflict with the European insolvency scenario which was present until the very end of the

previous millennium. This is the exact reason why we talk about the refoundation of Europe's insolvency frameworks.

The European insolvency scenario, before this ambitious process of reform started, indeed presented more uniform matrix which could have been easier to adapt to the development of transnational regulations. The choice, however, was to opt for radical changes which could ensure great economic prosperity.

It has to be accepted that the results achieved up to now are far from the ones wished or planned for. Hence, it is necessary to understand if mistakes were made, and what kind. We will try to do so by gaining a better understanding of the key pillars of the process of reform, which constituted the "riddle" we are confronted with and the impasse that is slowing us down.

In the next pages we will discuss of the evolution of European insolvency frameworks in the past centuries; stigma against bankrupts; the balance between liquidations and reorganizations; and crimes and punishments. We will do so by examining several different systems.

We will commence this part of our analysis in Chapter IV, discussing medieval models in Italy and England. In Chapter V, we will discuss the American Bankruptcy Code and American insolvency models from their origins till today. In Chapter VI, we will use the Italian bankruptcy system as a case study, focusing on the modifications that have occurred in the past one hundred years.

The ultimate goal of our discussion will be to show how local systems evolve over time and what happens when swift changes are sought through the ample use of legal transplants.

CHAPTER IV.
BANKRUPTCY IN THE MIDDLE AGES: THE EVOLUTION OF EARLY FRAMEWORKS AND THE SO-CALLED "STIGMA OF FAILURE"

1. Introduction

We could divide the previous three Chapters into two different parts. In Chapter I, the first part, we discussed the goals of modern Europe and what role the refoundation of European insolvency systems played within its strategies for the new millennium. In Chapters II and III, the second part, we discussed those best practices that are adopted to structure reforms and to support systems in bringing the improvements necessary to reach higher levels of efficiency and effectiveness and compete in the modern economic scenario.

Chapters IV, V, and VI, we will start a new part. We will analyze several insolvency systems that have been enacted over time in different geographic areas. Our path will show a common pattern connecting all of them:

- in Chapter IV, we will discuss ancient and medieval models that were developed in the Italian Peninsula and England;
- in Chapter V, we will discuss U.S. frameworks from colonial to modern times;
- in Chapter VI, we will discuss modern Italian systems from the late eighteenth century till today.

Our discussion of such different frameworks will allow us to gain important data on the current international insolvency scenario and on the impasse affecting the process of refounding European insolvency frameworks at the local and cross-border level.

In this chapter in particular, we will obtain relevant information on the matrix of insolvency laws in Europe and the two great barriers that seem to have paralyzed recent reforms: the lack of uniformity among local statutes and the stigma of failure.[858]

Before we move forward, though, some clarifications are necessary.

First of all, it is necessary to mention that this is not a history manual. This section will therefore have to be limited compared to the vast amount of information that could be discussed. Choices had to be made to ensure that we can move forward toward our conclusions. We will, therefore, limit ourselves to discussing salient aspects of medieval bankruptcy models from the Italian Peninsula and England only, due to their relevance and the connection with Chapters V and IV. Two successive historical sections placed in the beginning of each of the following chapters will then analyze the development of American systems in Chapter V and of modern Italian ones in Chapter VI. The reasons that brought us to choose these systems are explained in each section and will prove supportive of our conclusions.

Second, it is necessary to mention that in writing the medieval Italian part of this chapter, we are greatly indebted to Professor Umberto Santarelli, who in 1964 published a book entitled "*Per la storia del fallimento nelle legislazioni dell' età intermedia*"[859]. His leading study, which analyses early Italian systems,

[858] For an overview of the evolution of European laws from the medieval ages see **Padoa Schioppa Antonio**, "*Storia del diritto in Europa – dal medioevo all' età contemporanea*", Collezione testi e studi, Il Mulino, Bologna, ISBN 9788815119353, (2007); **Calasso Francesco**, "*Medioevo del diritto – I Le Fonti*", Casa Editrice Giuffrè Editore, Milan, Italy, (1954).

[859] **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, 1964.

is the key that allowed us to develop our reasoning in this area and to reach our goals. We mean to take no credit for his vast research and incredible work.

Third, we need to briefly discuss the use of the term "medieval", as we will use it in analyzing the insolvency systems included in the next pages. On this point, it is worth mentioning that we do not mean to engage a lengthy discussion on the understanding of the exact time period that comprises the Middles Ages from an historical point of view. The term "medieval" is useful to our discussion since:

a) It generally covers the centuries we will analyze - most statutes were enacted between the twelfth and the seventeenth century.[860]
b) This period was filled stigma, a dark age for our legal systems in which debtors were greatly antagonized and suffered harsh punishments. This is important, for in Chapter V we will discuss the American system, which was rooted in a stigmatizing system but ultimately developed over the centuries what we may define as a "debtor-friendly" framework. This model and its new approach to bankruptcy is inspiring reforms within the Union and at the international level. In order to understand the social conflicts we are facing in modern Europe and the difficulties that are connected with the stigma of failure and the impasse in the refoundation of insolvency systems, we need to keep these two different approaches (the "stigmatizing" and the "debtor-friendly" one) well in mind. Upon analyzing different scenarios, it will be important to observe the different structure of rules and principles which derive from each approach.

One last relevant element regards the discussion of ancient models in comparison with modern ones. In our discussion, we will often make reference to the World Bank's Principles. Our goal will be to compare systems and understand how they evolved. In the end, the matrix that was developed hundreds of years ago is still an important part of modern models.

In such instances we will use the first list of the Principles, the one of 2001; unless there is a need to make a comparison with a more recent draft, it would not be useful to use the latest ones. As discussed in Chapter II, new drafts included changes connected to very recent evolutions of the modern scenario, and are therefore less relevant to the current stage of our analysis.

1.1 An analysis of bankruptcy statutes in medieval Italy

Our analysis in this section will concern statutes enacted between the twelfth and seventeenth century within the borders of several city-states or local governments on the Italian Peninsula, as well as territories under their influence and control. It is important to remember that several Italian city-states such as Pisa, Genova, Venice or Amalfi (just to mention a few) were commercial superpowers of the time and held possessions well outside the Italian "boot". The choice of discussing the medieval Italian scenario in our historical overview is supported by several factors:

- **The origin of bankruptcy laws** – medieval Italy is often argued to be the place where bankruptcy regulations originated. The term "bankruptcy" can be traced back to the Italian phrase *banca rotta*, which defined the breaking of an insolvent debtor's table in the public square in the city-state as a sign of exclusion from a specific guild and from the economy of the town in general.
- **Structure and heritage** – we will discuss how the structure and approaches of medieval Italian frameworks greatly resemble modern ones. We will analyze some of the most relevant elements in depth, with a specific focus on their evolution over time. We will attempt to obtain useful information on the process that has shaped the modern insolvency scenario, and on the origins and causes of the stigma of failure[861];
- **Numerosity and variety** – the Italian territory in the Middle Ages was constellated by a multitude of city-states, territories, and administrations. Such variety will grant us an opportunity to compare several different (at times diametrically opposite) approaches to relevant insolvency issues and their interaction among each other under what we may define today as a "cross-border" point of view. Every single government, despite relative geographical proximity, applied

[860] See http://www.treccani.it/enciclopedia/medioevo/ ; https://www.britannica.com/event/Middle-Ages

[861] Moreover, in Chapter VI, we will discuss modern Italian bankruptcy frameworks; their evolution from the late eighteen hundreds will show the impact of their Medieval origins and the interaction with the process of refounding European insolvency regulations.

its own unique bankruptcy formula over the centuries to address the threats posed to its society by financial defaults within its borders. We will have a chance, for example, to discuss the different systems enacted in Milan, Venice, and the cities under their influence and control. The two neighboring rivals applied opposite strategies: Milano incentivized liquidations and punished insolvent debtors heavily, while the majority of proceedings in Venice were reorganizations with an ample use of moratoriums;

- **International aspects** – this point presents strong connections with the previous one. Different laws, approaches, and policies often happened to collide in such an unstable geopolitical scenario. Several Italian towns were flourishing economies, not to say superpowers of the time, and extended their influence across the Mediterranean Sea and Europe. Conflicts deriving from cross-border or international bankruptcies were not uncommon and held a great social and political impact. Towns attempted, therefore, to regulate them with specific international agreements.[862]

Since this is not a medieval bankruptcy law manual, we will not develop an in-depth study on all of the different statutes, rules, and elements of the insolvency process in these centuries. We will cherry-pick those elements most useful to our goals and our discussion. We will show how each framework, although characterized by unique features, shared several basic elements and principles, which show clear analogies with the ones contained in contemporary systems. We will also examine stigma and the reason for the enactment of such harsh punishments, which were not solely because of the general severity of legal frameworks of the time.

1.2 About the analysis of early bankruptcy statues in medieval England

In the second part of this chapter, we will discuss the development of early English bankruptcy statutes. This section will allow us a) to compare and examine a different medieval insolvency scenario, and b) discuss the origins of "discharge rules", an element of bankruptcy models which, as mentioned in Chapter I, has gained key relevance in modern models.

Moreover, it will allow us to follow the development of insolvency rules in the New World, a topic that will be discussed in greater depth in Chapter V.

The development of bankruptcy statutes in England was slower compared to the Italian Peninsula. With time, though, just as it happened with the Italian city-states, England expanded its borders and trade to other territories and felt, therefore, the need to enact specific regulations which were the exported to new territories.

If, therefore, the first part of this chapter will be more focused on understanding stigma and the original structure of modern European systems, the second will analyze the earliest steps of the process that led to the great changes we are studying today.

2. Bankruptcy in medieval Italy

Before we embark in our analysis of individual elements and models, it is important to restate a crucial point: the history of medieval bankruptcy models (or of bankruptcy in general) within the Italian Peninsula involves heavy stigma against failure[863]; countless statutes bluntly equated insolvency (and therefore bankruptcy) with theft, punishing debtors with the death penalty or imprisonment for life.[864] Bankruptcy law, at the time, was a field of criminal law, and bankrupts were considered criminals within societies; they were heavily punished and banned from the city-states they lived and worked in.

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[862] In this particular case, "International" has a wider meaning than the one we may tend to infer today. The bankruptcy case of an insolvent merchant owning properties in nearby cities like Crema and Cremona was international, as would be a case involving a German trader conducting operations from a commercial base of the maritime power of Genoa, such as Sardinia, Turkey, or Northern Africa.

[863] **Galgano Francesco**, "*Lex mercatoria*", Quinta edizione, Società Editrice il Mulino, Bologna, ISBN 9788815264664, (2010), at 54.

[864] **Santarelli Umberto**, "*Mercanti e società tra mercanti*", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 75.

Many of the parameters applied by modern best practices and discussed in Chapter I to III were already applied within medieval systems. At the time there was no discharge; bankrupts often had no right to avail themselves of legal assistance and enjoyed little protections against petitioners in involuntary cases.[865] They were ruined for life unless they managed, somehow, to pay their debts in full.

Bankruptcy was a life-changing factor which often caused the complete ruin of the debtor, of his family and heirs, and of a variety of other connected individuals such as coworkers, partners, or employees; the devastating consequences that derived from the opening of a case were often permanent and irreversible.[866]

2.1 The structure of early bankruptcy laws in medieval Italy

The process that led to the enactment of specific bankruptcy frameworks in the Middle Ages aimed to provide effective and efficient public proceedings to protect societies from the damages stemming from insolvency in all those situations in which a debtor was indebted to a multitude of creditors.[867] The numerous different statutes we will discuss in this section were structured and conceived to achieve this specific goal.

In the beginning, lawmakers did not structure independent bodies of law; most principles on this topic were embodied within the general legal framework of a city-state. The first seeds of more complex statutes in the field of bankruptcy were planted in the Italian Peninsula between the twelfth and the thirteenth century. Early traces of rules on the topic of bankruptcy can be found already in 1161 among the Laws of Pisa, called *Constitutum usus Pisanae civitatis*.[868]

This statute which, again, was not drafted with the exclusive goal to regulate insolvencies, included specific sections addressing the issues posed within society by those debtors that had become unable to repay their creditors (*creditoribus*). The framework regulated:

- **The process by which the debtor would be dispossessed of his assets** - in case of default, the debtor was dispossessed of all of his remaining assets, which would be promptly liquidated (*cessio bonorum*).[869] The ultimate goal of this process was to ensure the repayment of the highest possible percentage of debts.
- **The distribution process** – an organized public proceeding would ensure fairness in the distribution of the proceeds obtained through the liquidation of the debtor’s assets. Debtors would remain liable for all outstanding debts and the burden could then be extended to the heirs.[870]
- **The ranking of claims, with priority awarded to some creditors over others** - in most early systems all creditors were equal. The distribution process occurred *per libram,* not *pari passu*. As a hint of the first priority rankings, some rules protected those traders who could find among the debtor's residual belongings assets that had been sold but not paid for. If the

[865] *Id.,* at 76.

[866] **Santarelli Umberto**, “*Per la storia del fallimento nelle Legislazioni Italiane dell’ Età Intermedia*”, CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 95-96: some statutes would forbid to file an opposition to challenge the opening of the proceeding.

[867] **Galgano Francesco**, “*Lex mercatoria*”, Quinta edizione, Società Editrice il Mulino, Bologna, ISBN 9788815264664, (2010), at 55; **Santarelli Umberto**, “*Per la storia del fallimento nelle Legislazioni Italiane dell’ Età Intermedia*”, CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 26.

[868] Year 1116.

[869] The debtor had to devolve all of his patrimony owned at the moment of insolvency and all subsequent sources of value or income acquired successively until he could fully repay of all his debts. **Santarelli Umberto**, “*Per la storia del fallimento nelle Legislazioni Italiane dell’ Età Intermedia*”, CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 25.

[870] In this case, it is worth mentioning that the debt was transferred to the “sons” as heirs – *jure successionis* – thus constituting an avoidable duty through renunciation of the bequest. While the hereditary consequences of insolvency were a burden on debtors under a number of statutes, not all of them allowed such a way out; some even go as far as holding responsible not just heirs or family members but also partners or employees. Some statutes would actually commence the bankruptcy proceeding against the heirs of a debtor whom had died before being found insolvent, hence declaring them bankrupt even they would not have been so had the succession not taken place! *Id.*, at 79.

transaction could be proven and the claim against the estate was valid, such creditors would obtain a priority status over others; the items would be considered collateral and could be retrieved from the estate.[871]

One of the first well-structured models enacted solely to address insolvency issues can be found among the laws of Verona of 1228. The architecture of a such body of laws share much with more modern insolvency frameworks:

- It regulated the procedure that public officials had to follow to sell the assets recovered from a debtor – it was, therefore, a fully regulated **public proceeding**.
- It embodied an early form of **moratorium, or stay,** through which a creditor's individual enforcement action would be suspended upon commencement of a case.
- It provided specific **rules addressing the issue of seniority** among claims while ordering that proceeds resulting from the liquidation of the estate had to distributed among all creditors.[872]
- It ordered that any creditor who had in custody, or entered through any other means in possession of items of property of the debtor, had to return them to the proceeding so that they could be part of the distribution process.
- It contained specific rules to **punish** insolvent debtors.

Ever since the thirteenth century, therefore, complex insolvency frameworks had been drafted to support the efforts of local governments in their struggle against insolvency (we will discuss the definition of insolvency adopted at the time and how it successively evolved in the next pages).

2.2 The structure and evolution of Italian medieval bankruptcy frameworks

2.2.1 Introduction to medieval approaches and to the commencement of cases

We discussed in Chapters I and II how best practices today incentivize ample, voluntary access to proceedings, mainly reorganizations, for a great variety of debtors, even non-business ones; a process that has become even more evident in the latest draft of the World Bank's Principles and in the recent documents that are being published by the European Union.

Medieval frameworks applied a different approach. The debtor was perceived as a dangerous criminal and immediately stigmatized. Economic defaults could spread like a virus and cause great damage within such limited economies. Heavy criminal punishments, therefore, were a key element of early models and were structured in an attempt to limit the number of defaults and to deter people from taking risks.

It is a common assumption that Italian medieval bankruptcy statutes were concerned exclusively with business debtors such as merchants, a flourishing middle class who had amassed great wealth, power and influence by trading and exploiting borrowed capital.[873] Their capacity to access loans and make enormous profits, in the end, was often mirrored by an equal or even greater ability to dissipate them, causing quakes within the fragile economies of the city-states.[874] Nevertheless ,such regulations often did not make any direct reference to business debtors, and specifically to "merchants" or "traders", as the exclusive subjects of insolvency regulations. They rather referred to "insolvent individuals" in general.[875] Anybody could, therefore, potentially become a debtor in a bankruptcy case, although it is a fact that cases involving individuals that were not involved in business activities were a statistical minority.[876]

[871] *Id.,* at 28.

[872] A similar rule was contained in another more complex statute that is worth mentioning, the one applied in 1241 in Vercelli, under which, in case a debtor was incapable to fully repay debts even through the sale of all of his assets, public officials declare him bankrupt. *Id.,* at 30.

[873] See **Francesco Galgano**, "*Lex Mercatoria*", Casa Editrice Il Mulino, Bologna, ISBN 978-88-15-26466-4, (2016).

[874] **Santarelli Umberto**, "*Mercanti e società tra mercanti*", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 65.

[875] See Lattes, making the example of Venice, although it is true that in many city-states insolvency frameworks were contained in their Code of Commerce and Mercantile statutes. **Lattes Alessandro** , "*Il fallimento nel diritto comune e nella legislazione bancaria della Repubblica di Venezia*", Nobu public domain reprints, printed in the US, at footnote 16.

[876] Some statutes do make a precise limitation to the "members of some arts".

Most early insolvency frameworks privileged swift liquidations[877] and involuntary mechanisms to access proceedings. They allowed ample powers to creditors and authorities; little could be done to stop the "wheel" of the public proceeding once it had started spinning. Statutes often did not even include rules to allow bankrupts to challenge the evidence that justified the opening of a proceeding.

Voluntary petitions were allowed and, of course, even encouraged by local authorities.

The high levels of stigma surrounding bankruptcy proceedings, though, acted as a powerful deterrent. Some statutes did attempt to provide incentives so that debtors could take early action, just as modern legislators have encouraged. Such "incentives", though, were not as supportive as modern ones. While, as discussed in the previous chapters, modern models attempt to provide honest, collaborative debtors with discharges and meaningful fresh starts, such elements were not available in medieval times.

Medieval "incentives" were of different nature. In Genoa, for example, upon becoming insolvent, a debtor who:

- acted without undue delays that would harm creditors;
- handed over all his books and records;
- kept all such books and records regularly and orderly;
- was found to have avoided committing any frauds or actions against the creditors;

could be "awarded" *domicilio coatto* (home detention).

In general, medieval systems adopted a diametrically opposite approach compared to modern best practices, although they shared the same ultimate goals. They both attempted to support local economies and societies. Medieval frameworks, though, did not trust in the fact that lenient models could lead individuals to honesty; they preferred to deploy harsh punishments to inculcate responsible behaviors.

The heavy criminal and civil burdens, which ultimately were the root of the stigma that still impacts the modern insolvency scenario, were structured as tools to increase the effectiveness and efficiency of the bankruptcy process of the time.

Just as more "benevolent" frameworks may make debtors reckless and push some to attempt to take advantage of the protections included in the system, though, the strategy deployed by medieval models also had relevant side effects. Medieval systems did not make debtors cooperative. Bankrupts would rather hide their financial difficulties for as long as possible, hoping to make a miraculous recovery before a case could be commenced instead of choosing to be tortured and imprisoned.

Upon facing such irreparable consequences, many would also try to hide their assets and to escape from the city. If they managed to cure their default before it became public or to hide assets and escape before it was too late, they could obtain great benefits.[878] [879] [880] In response to such behaviors, the system became even more repressive to ensure that authorities could gain early control over insolvent debtors and their assets before frauds could occur.

It is in this scenario, as we are about to discuss, that the act of escaping gained great relevance within bankruptcy frameworks. Curing this attitude and forcing the debtor to take part in the proceeding became a key priority for city-states. This is the origin of insolvency as access criteria in bankruptcy.

2.2.2 The evolution of the concept of insolvency[881]

In the past chapters we have discussed insolvency extensively.

In particular, we have observed how modern frameworks do not apply a uniform definition of it; the most common tests applied are the "liquidity" and the "balance sheet" ones[882], which revolve around purely economic factors such as:

[877] **Santarelli Umberto**, "*Mercanti e società tra mercanti*", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 67.

[878] **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 140.

[879] *Id.,* at 143.

[880] See the discussion on imprisonment for debts in Chapter V.

[881] **Santarelli Umberto**, *"Mercanti e società tra mercanti*", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 71-74.

[882] See principle "9C" of the World Bank's List of 2001.

a) establishing the actual capacity of a debtor to repay its outstanding obligations;
b) studying the debtor's accounting to assess if a financial default has reached incurable proportions.

The origins of the concept of insolvency, though, stem from surprisingly remote roots. In past centuries insolvency was a synonym of "fugitive".[883]

As mentioned in the previous sections, in fact, the consequences of financial default of wealthy and powerful merchants were a deeply feared threat to medieval societies.[884] Bankruptcy was perceived as a dishonor. By not paying his debts, the debtor would not just cause difficulties to the creditors, but he would break a promise and sow distrust. In a mercantile environment which was indissolubly bound to a man's reputation, bankruptcy was perceived as an unlawful act against society[885] which led communities all over the Italian Peninsula to react by enacting complex statutes to prevent individuals from taking excessive financial risks.

In general, debtors were considered infamous people.[886]

The key to the success of public proceedings in such emergency situations was the swift protection of a debtor's (remaining) assets against frauds and dissipation; to ensure that all resources could be catalogued, collected, and made available for distribution. Hence, local goverments developed ways to maintain control over their citizens and their property. They did so by:

a) designing tools to swiftly open proceedings in case where debtors had fled[887] (bankrupts were also defined as "fugitives" and fleeing was considered an act in violation of the laws of a city-state[888]) – in order to prevent unlawful escapes, creditors were awarded special powers to ask for the commencement of cases based on the mere suspicion of bankruptcy. They would be asked to take an oath affirming that the debtor was on the point of escaping from the city-state due to his financial difficulties;
b) structuring harsh emergency[889] rules to ensure that bankrupts could be captured and handed over to local authorities – in those cases in which the debtor had already escaped, creditors would often be awarded the power to chase and apprehend him.

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[883] Debtors were also defined as *debitor fugitivus*; see **Galgano Francesco**, "*Lex mercatoria*", Quinta edizione, Società Editrice il Mulino, Bologna, ISBN 9788815264664, (2010), at 55.

[884] It is difficult to emphasize enough the importance of the act of running from the community and the fraudulent connotations envisioned with it. Definitions of escaped bankrupts varied among Medieval statutes: "fugitive, cessantes, rupti, fallentes". See **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 47. Medieval legislatures with time seem to have obsessed with finding measures to prevent debtors from becoming fugitives, and while pure and simple hiding and fleeing were, of course, clearer expressions of a debtor's guilt, the definition of "escape" and its inner meaning was gradually extended reaching very remote boarders. See the statute of Bologna of 1509 mentioned by Santarelli at 53-54. See also **Mann Bruce H.,** "*Bankruptcy in the Age of American Independence*", Harvard University Press, London, ISBN 9780674032415, (2002), at 212.

[885] **Santarelli Umberto**, "*Mercanti e società tra mercanti*", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 67. At this page, Professor Santarelli also quotes Baldo degli Ubaldi, a well known jurist of the fourteenth century, stating that usually bankrupts were crooks and cheaters and even in those few cases in which they were not they could not be expected to be forgiven for their sudden misfortunes.

[886] *Id.,* at 68.

[887] Laws of Como, 1473. In the Laws of Venice in 1244, no particular relevance is given to the act per se, while in a statute of 1464, the situation is almost inverted and even just "hiding" within the city walls is punished. **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 51.

[888] Santarelli Umberto, "Mercanti e società tra mercanti", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 69.

[889] In the beginning, by adding key principles of bankruptcy law to already enacted body of laws; with time, specific insolvency regulations became a necessary part of the legal framework of nations, although examples of nations that did not have a specific code on the topic can be found up to modern times and there is fervent discussion on whether systems should rely exclusively on contract laws.

"Fleeing" (or insolvency) at that time was interpreted broadly.[890] It did not, for example, require intent. An individual could be declared to have "escaped" (and therefore be bankrupt) without even knowing it, or without knowing he had incurred irreparable levels of debt; which is, to a certain extent, ironic.[891]

An example will be useful to show the medieval point of view on this point: let's think of the case of a wealthy merchant, an influential citizen of a major maritime power of the time such as Pisa. Upon leaving the city to acquire precious goods for trade in the Middle East, he would not be engaging in extraordinary or dangerous behavior; it would be a routine operation to support his trades. The voyage by sea or land, at the time, could take weeks and while away his possessions in the city could be depleted by a variety of unforeseeable calamities, such as fire; foreign attacks or sieges; floods caused by the river Arno; or plagues. The merchant might be unable to learn of the disaster and, even if he had received news from the mainland, he could have ultimately been unable to recover financially from it once he returned. In the meanwhile, creditors could commence an involuntary bankruptcy case assuming his absence from the territory of the city meant he had fled.

Early insolvency was, therefore, an extremely broad and blurry access requirement which gave rise to several, often extreme, interpretations.

By some statutes, in fact, under the circumstances presented in our example, the very same merchant could have been declared bankrupt even if he did own enough assets to repay his debts, as long as such assets were not present within the territory of the city-state (they could be, for example, located in a colony, commercial base, or foreign territory such as the Middle East or Northern Africa) and, therefore, as long as they were not readily available.[892]

Under other statutes, the death of a debtor became, to a certain extent, the most advanced form of insolvency. By dying, the debtor would escape to a place where nobody could reach him. Frustrated by such conditions, authorities enacted rules to ensure that obligations would be repaid by the debtor's heirs, who would suffer and would not be freed until they had paid all debts, or until an agreement, if the law allowed such option, had been reached with the creditors.[893]

With time, the original interpretation of insolvency as a synonym for fugitive was mitigated by other priorities. Administrations realized that the prevailing interest of creditors was to recover from financial losses. Town governments and creditors had no desire to open a complex, expensive, formal proceeding in those cases in which a debtor had the resources to pay.

Gradually, therefore, debtors became "insolvent" upon lacking sufficient assets to repay their debts. This process, though, took time.

In Bologna, the definition of insolvency as synonym for fugitive was broadened to the point that a case could be commenced upon a debtor's halting of economic activity or upon conducting "abnormal" business operations. Under other statutes, a debtor could be considered a fugitive even if he had not physically escaped from the city-state. Hiding, in fact, became in some jurisdictions equally sanctioned as running away and the refusal to submit oneself to the control of public authorities acquired relevance under bankruptcy statutes.

Yet, ironically, even being present within the town's walls, in a well-known location and under control of the authorities, became, with time, insufficient to protect the debtor from the consequences of his default. A debtor could be designated a fugitive for not attening the public hearing to object to the allegations of the creditors.

In Lombardy, a land where bankruptcy was taken particularly seriously and punishments were harsh, we can observe the last steps in this evolutionary path. Lombard statues commenced to extended the meaning of fugitive to a point that an individual could be declared bankrupt despite his physical presence in front of the bankruptcy judge during a scheduled hearing, as long as he could not prove that he owned

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[890] **Santarelli Umberto**, "*Mercanti e società tra mercanti*", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 68-71.

[891] Some cities did require a minimum amount of debts to be proven for a debtor to be insolvent see the laws of Genova in 1589: 1.000 lire or more.

[892] Laws of Padova, 1384.

[893] **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 77-78.

enough available assets to repay all his outstanding debts.[894] A fair match to the concepts applied in modern frameworks.

2.2.3 Bankruptcy estates and avoidance of transactions

Bankruptcy is intrinsically bound to great scarcity of assets. As shown by the evolution of the concept of insolvency, medieval societies attempted to structure procedures that could allow for the swift commencement of cases, to ensure higher chances of recovering the debtor's property and limit the chain effects of his financial default. Statutes had, therefore, to collect, protect, and put to good use all the remaining assets.

Medieval estates resembled modern ones under several aspects. In the Middle Ages, all of the debtor's properties would become part of the estate and had to be handed over swiftly to the insolvency administrator upon commencement of the bankruptcy case.[895] [896] The very concept of protecting or exempting certain items of property was, of course, alien to early systems. The bankrupt would be dispossessed of all belongings, which would be sold and used for to pay his debts; exceptions were very rare and limited.

As we will discuss in greater depth in the next sections, statutes would grant authorities ample powers to:

1) punish the debtor or third parties if they removed items from the estate or withheld relevant information on their location[897];
2) ensure that the case would pay the highest possible shares;
3) protect the interests of creditors in the preservation of the estate, avoiding transactions and preventing frauds.

Medieval frameworks were deeply concerned with the dissipation of assets and with frauds. Therefore, they enacted specific tools to avoid all those transactions that had the effect of depleting the patrimony of an insolvent debtor.[898] The reasoning was that a bankrupt did not have a right to worsen his finances when he was already unable to repay his debts (or was about to become it).[899]

All transactions or donations that could damage the estate were place under the court's scrutiny and could be avoided.[900] Since proving frauds could be a burden on insolvency administrators, most statutes started delineating the concept of "suspect period"; time lapses before the commencement of the proceeding, in which debtors were presumed to be insolvent. Under such a presumption, all transactions or donations could be revoked. The burden to prove the legality of the transfer was placed on the party benefitting from it.[901]

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[894] Evidence of this reasoning can be found in earlier statutes. In Florence, for example, in 1299 insolvency was defined as the incapacity of determined subjects to repay their debts (a definition which could prove to be "modern" under several contemporaneous statutes). Nevertheless, the law continued to refer to bankrupts as *cessantes* and *fugitivi*, hence maintaining a connection with the concept of "escaping".

[895] **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 193.

[896] The interest of the creditors was protected by medieval statutes and kept in high consideration. Lesser or no protections at all were awarded to the interests of third parties. An exception can be found in the statute of Bologna of 1509, in which the holder of property of the debtor could give proof of his right to keep it. Courts, though, had wide discretion in denying such a right. **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 195-6.

[897] *Id.,* at 194-195.

[898] *Id.,* at 199.

[899] *Id.,* at 204.

[900] *Id.,* at 209.

[901] *Id.,* at 201; some statutes extended the "suspect period" for movable assets, *Id.* at 203.

2.2.4 Claims and distribution process[902]

The organization of formal public proceedings and the ample powers awarded to courts, creditors, and insolvency administrators aimed to bring swiftness and efficiency to bankruptcies. Financial defaults had to be cured rapidly. It was therefore necessary not just to collect the debtor's assets to make them available for liquidation but also to inform the creditors, to learn of their number and of the kind and value of their claims.

Medieval proceedings applied quick procedures for the verifications of claims.[903] Bankruptcy administrators were often able to reach a number of creditors upon verifying the debtor's accounting; but documents were not always accurate or available. Bankruptcies were also made public knowledge to ensure that creditors could spontaneously ask to take part in it.[904] Simplified procedures were enacted in these cases. In most instances, for example, an oath would be sufficient to prove a credit.[905]

Models were not built with the exclusive goal to support creditors, though. Deadlines were often mandatory and if not met, creditors could be barred from lodging their claims. Steps were taken, moreover, to prevent claims from being forged or oaths from being given lightly, a great threat to the fairness of proceedings. With the passing of time two main approaches developed:

- In Piedmont, creditors had to go through a specific judgment within the bankruptcy proceeding to prove the existence of their claim.
- In Lombardy, in order to preserve the original goal of a swift proceeding, the credit could be proven exclusively by exhibiting a public document which, if available, could not be contested. Lack of it, though, would make it impossible to be part of the proceeding.

With time, most statutes followed in the Piedmontese model while applying strict tests to evaluate claims and all supporting documentation.[906]

The ultimate challenge of a bankruptcy proceeding is to design a system for the effective and fair distribution among creditors of the (often extremely scarce) available resources. Modern systems are greatly concerned with rankings among claimants and with discerning, among a myriad of different policies, which should be paid first (which is to say, who should not be paid at all). Early frameworks took time in developing rules on this topic.

For over five centuries, all creditors would be satisfied through a *pro rata* distribution[907] following the general rule of absolute equality among all creditors.[908] Few exceptions[909] applied, meaning that few claims enjoyed some sort of priority. A common protection was reserved to dowries. A number of statutes allowed the debtor's wife and her family to recover items that had been donated at the time of marriage.[910] Another common exception (which was already mentioned in earlier pages) protected those creditors that could find, among the remaining assets of a bankrupt, items that had been sold and delivered but not paid; such items could be returned to them directly, saving them from the distribution process.

With time, societies and proceedings evolved. Priorities grew in number to protect a great variety of interests; the approach to the distribution process, therefore, also changed. It is in the sixteenth century, more classes of claims become "unequal". Statutes started affirming that some deserved higher protections and a greater chance to be successful in the distribution process compared to others. Earlier examples of priorities protected interests under the *prior in tempore potior in jure* principle, which can be

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[902] **Santarelli Umberto**, "*Mercanti e società tra mercanti*", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), 84-101.

[903] **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 193.

[904] *Id.,* 226.

[905] In Bologna an oath with witnesses. *Id.* at 228-230.

[906] Laws of Siena 1585; Id., at 231.

[907] *Id.* at 238-242.

[908] Laws of Florence, *Id.* at 253.

[909] For centuries there would be no alternative rules the few variations allowed would be strictly construed exceptions. *Id.,* at 257.

[910] *Id.,* at 243-251.

translated with the analogous expression, common to U.S. law: “first in time, first in right.”[911] At the same time, other claims were excluded, such as the ones deriving from usury or frauds.

2.3 The origins of the stigma of failure in Italian medieval bankruptcy laws

The World Bank’s Principles do not specifically address the issues connected to the stigmatization of bankruptcy systems or of bankruptcy crimes, which is congruent with the modern approach characterized by the “rescue culture” discussed in Chapter I. Modern frameworks attempt to support honest debtors in reorganizing and obtaining a fresh start, and therefore burdens.

The debate on the stigma of failure, though, is ample and relevant; it constitutes one of the most incredible barriers weakening the refoundation of European insolvency frameworks today. As discussed in Chapters I and II (and we will see more examples upon analyzing more modern Italian frameworks in Chapter VI), stigma is caused by a variety of factors, such as:

- negative social behaviors (lasting even after the closure of proceedings),
- specific bankruptcy crimes;
- limitations on personal rights, such as voting or travelling;
- limitations on the appointment for job positions or the obtainment of licenses.

Yet, as we are about to discuss, far more troublesome elements were embodied in medieval statutes.

It is an undeniable, in fact, that bankrupts never had an easy life; they have always had to pay a very high price due to their condition. A wide range of punishments has been enacted against them over time by all sorts of regimes. Even before the specific field of bankruptcy law was born, bankrupts were publicly humiliated, deprived of their assets, and sold as slaves. As we are about to discuss in greater depth, bankruptcy did arise as a field of law; it provided criminal rules that were grounds for exile, imprisonment for life, torture[912], and all sorts of other, often incredibly cruel, punishments[913], as if their misfortunes were not already enough.[914]

In this section, we will discuss some of those factors that contributed to make stigma powerful enough to constitute a weight on modern systems and economies. First of all, though, it is important to mention that the intent of medieval systems was not punish debtors *tout court*. Stigma derived from a specific strategy. It aimed to:

a) protect medieval societies and economies;
b) limit the duration and costs of proceedings;
c) force cooperation and incentivize the availability of information.

It is interesting to point out, therefore, how stigma ultimately is the product of effective and efficient strategies developed to achieve the same goals targeted by modern systems. Of course, the medieval approach would not be acceptable today. It is nevertheless important to understand that the stigma comes from a reasoned approach.

2.3.1 An overview of stigmatizing factors in medieval statutes

Although, today, we tend to think of insolvency as a field connected to civil or business law, bankruptcy in the medieval ages was rooted in criminal law.[915]

The Governments of the various city-states and territories attempted to be efficient and effective in their administration of economic defaults by making bankruptcy a crime. They worked tirelessly to limit the number of insolvencies to a minimum, since each single default posed great threat to the solidity of a small town’s economy.[916] Fear operated as a barrier to the opening of risky business activities. A system of

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[911] *Id.,* at 265-269.
[912] **Santarelli Umberto**, “*Mercanti e società tra mercanti*”, Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 70.
[913] See **Rafael Efrat**, “*Personal Bankruptcy in the 21st Century: Emerging Trends and New Challenges. The Evolution Of Bankruptcy Stigma”*, 7 Theoretical Inquiries L, 365, 369 (2006).
[914] *Id.*
[915] **Santarelli Umberto**, “*Per la storia del fallimento nelle Legislazioni Italiane dell’ Età Intermedia*”, CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 118.
[916] Id., at 95.

dreadful civil limitations and criminal punishments aimed to dissuade citizens from taking risks and, in case of economic default, to limit or possibly nullify the capacity of the debtor to take further actions, not just in the business environment but also within society as a whole.

Statutes deployed several common elements which were key in strengthening stigma and its effects. The most relevant ones were:

a) the presumption of insolvency (which served to guarantee swiftness in proceedings but had a heavy stigmatizing effect);
b) torture (which served not just as a punishment but also to guarantee swiftness in proceedings);
c) exile (which could be for life or limited to a certain duration);
d) disqualification from employment;
e) deprivation of titles and property;
f) exclusion from a commercial guild;
g) inclusion in public bankruptcy registers;
h) extension of the effects of punishments to family members and other parties;
i) imprisonment for debts (which will be also discussed in Chapter V, within the American system).

2.3.2 The presumption of insolvency

Several frameworks, such as those from Milano, Bologna, Parma, Ancona, Fermo, and Arezzo (just to mention some north to south), were concerned with the difficulties the city-states faced in isolating and apprehending debtors before they could make themselves unreachable. In order to provide an effective solution to the issue, lawmakers authorized creditors to testify in front of a public court that a debtor may have been on the verge, of fleeing.[917] Such oaths became, under a "presumption of insolvency", sufficient to trigger the immediate commencement of the case. If courts deemed it necessary, creditors would be immediately awarded special powers to capture the debtor and hand him over to the town's authorities (as unharmed as possible, whatever that may have meant at that time)[918] before he escaped.

The solution was, indeed, effective and efficient, for it solved the problem it was called to solve and sped up the commencement of cases, preventing the worsening of the financial conditions of the debtor. On the other hand, though, consequences could be unjustified and irreparable. Acrimonious creditors could, in fact, commit abuses by applying such ample powers.

2.3.3 The use of torture[919]

Another often-mentioned, gruesome consequence of bankruptcy was the use of torture.

As bankruptcy was considered a field connected to criminal law[920], insolvency statutes become accustomed to disciplining through the ample use of this tool.[921] Rules often refused to limit the application of such a horrific practice to the bankrupt himself and extended it, as long as it was deemed necessary to acquire information, to all sorts of interested parties, such as:

- relatives;
- coworkers and business partners[922];
- anyone else whom would aid, abet, or hide the fugitive[923];

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[917] Some statutes were procedurally more complex and would grant terms to prove the origins of the credits or the capacity to repay debts.

[918] Most (but not all) statutes explicitly forbade murdering the bankrupt.

[919] See on this topic: **Durand B., Otis-Cour L.,** "*La torture judiciaire 2 volumes. Approches historiques et juridiques*", Centre d' histoire judiciaire, ISBN 978-2910114060, (2002); **Fiorelli Piero**, "*La tortura giudiziaria nel diritto comune – Volume I*", Giuffrè Editore, Milano, (1953).

[920] Milano Mercanti, 1330.

[921] **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 163-164.

[922] Laws of Como, 1336.

[923] Laws of Lucca, 1376.

- those that would be suspectef of hiding or keeping some of the debtor's assets[924].

Yet again, the application of torture within the bankruptcy setting was not just a punishment. Medieval lawmakers had a well-defined strategy in mind. In using this tool they attempted to:

a) deter frauds;

b) facilitate access to all relevant information (to locate assets, for example);

c) reduce the length and costs of proceedings, hence increasing the benefits for the creditors and society at large.

As for the first point there is not much to add; the atrocities[925] that were of common use in those dark days worked as a fine tool to inculcate some honesty in most people. As to the second, torture was widely in use as a mean to obtain a variety of information. Presumably, as a consequence, proceedings would be of shorter duration and, therefore, less costly.

2.3.4 Exile[926]

Exile a great burden on all citizens and not just bankrupts.

While timely escape from the territory of the city often allowed the debtor organize himself, to retain or hide assets, or to bargain for protection with other governments, being exiled caused bankrupts to be abandoned in foreign lands, deprived of all properties, rights, and of the protections ensured by their citizenship in an era of great political instability, including rampant brigandage and recurrent wars.

Exile was not always perpetual and some debtors did enjoy hopes to be allowed to eventually return to their hometown.

2.3.5 Disqualifications from employment and from holding public offices

The disqualification from public charges and employment, and the deprivation of the right to vote[927], were common civil consequences of bankruptcy and, to a certain extent, a concomitant consequence of the imposition of exile. They were imposed as a punishment to ensure the eviction of the debtor from the political life of the city-state. All debtors in bankruptcy were considered thieves; as such, they were ousted from public life.

2.3.6 Exclusion from guilds

We have already discussed the connection between the words *banca rotta* and bankruptcy laws. Since most insolvency cases concerned business debtors, a typical punishment saw merchants excluded from their guilds, often for life.[928] Such disqualification served several purposes:

- it caused the debtor to lose trading privileges;
- it supported the process of exclusion and alienation from society (and the market) of bankrupts.

Fear of a punishment which would often extend to a debtor's family members and heirs, pushing merchants to be very careful in their trades and to pay their debts as regularly as possible.

2.3.7 Bankruptcy registers and public shaming

Shame on the person of the bankrupt and his heirs was also achieved by publicity in special registrars. The names of bankrupts would be affixed to the doors of public buildings to allow the community to learn

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[924] Laws of Bologna, 1509.

[925] In Florence statutes that entered into force between 1322 and 1415 required the bankrupt to be tortured and mandated that he may not be killed only if younger than fifteen years old. **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 165.

[926] **Santarelli Umberto**, "*Mercanti e società tra mercanti*", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 76-7.

[927] Appears first in a statute of Florence enacted on January 1st, 1289.

[928] In Siena the radiation was extended also to the heirs and descendants.

of the commencement of a procedure, not just so that creditors could effectively lodge claims but[929] "*per maggior sfregio e castigo*"[930]. But many were illiterate at the time.

In Florence, it was common to increase the effects of the stigma by painting caricatures of bankrupts, so that the whole population could learn about their status and their actions. Through this tool, information could spread swiftly within all layers of society with greater mortification.[931]

The medieval attitude was that bankrupts deserved to be punished severely, since they had broken their promises and the bond of trust connecting them to the other members of the guild and of society. They deserved to be deprived of their status, to lose all of their privileges, and to be ousted from the community, not just through physical bans but also due to the stigma that would surround them.[932]

2.3.8 The extension of the effects of punishments to family members and other parties

The criminal effects of bankruptcy were often not limited to the debtor but extended to other family members[933] [934] (parents, siblings[935], male descendents[936]), his heirs, and even to people that enjoyed more remote connections, such as employers, coworkers, business partners[937], or employees. The reasoning was that all such people could harm the creditors, either by helping the debtor conceal assets or withholding essential information; efficiency demanded, therefore, that actions were taken also against them.

Entrepreneurs were not, therefore, the only ones that had to fear insolvency. The default of one could cause the ruin of many innocent ones; one of the elements that probably contributed the most to the entrenchment of stigma within our societies till modern days. As discussed in the previous sections, related persons could incur punishments for helping bankrupts to escape[938] [939] or even for employing a bankrupt.[940] Torture and incarceration would be imposed until it was ensured that all relevant information about the bankrupt and his assets were disclosed.[941]

The loss of noble titles and privileges was yet another heavy civil consequence affecting the debtor and the member of his family. It deprived them of their role and rank in society. The punishment was usually joined by the prohibition of wearing symbols of power, such as silk, in public. The wives of bankrupts were also usually not permitted to show themselves in town wearing expensive jewels. Such limitations were somewhat logical, though, since showing wealth through expensive clothing or accessories would be

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[929] See the statute of Florence of 1585. Yet this practice would be followed until recent times by numerous regimes; we will discuss this point further in Chapter VI. See **Ortalli Gherardo**, "*La pittura infamante; Secoli XIII – XVI*", Casa Editrice Viella Libreria Editrice, Roma, (2015).

[930] **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 133.

[931] *Id.*

[932] **Santarelli Umberto**, "*Mercanti e società tra mercanti*", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 78.

[933] The insolvency of a son or grandson spread and affected the patrimony of the parents. The family was considered a unique entity and confusion of the patrimonies of the single assets, especially when living all together in the same household, was binding all of the members. See **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 170-171.

[934] The wife being an exception. The wife of a bankrupt was, in numerous statutes, awarded a priority for her dowry given the peculiar value given by the medieval society to that kind of assets. *Id.,* at 182.

[935] In general, the bond among siblings is extremely ample, including minors and excluding any exceptions that may prevent them liability. Some statutes limit the duties to co-working siblings or siblings living in the same household. *Id*., at 177-178.

[936] Depending on statutes, their responsibility could be general, as people detaining property that should be conferred to the estate, or specific, as individuals coming from the same blood line of the debtor and hence bound to answer for the debts he may have incurred. *Id*., at 179.

[937] Most statutes did not include specific rules for the bankruptcy of businesses; yet the fact that business was run on a partnership made every partner equally responsible for default of the enterprise. If one partner was insolvent all of them were held equally liable. *Id.,* at 185-7.

[938] An exception was made in Genoa protecting family members that were particularly close to the debtor. *Id.,* at 190.

[939] *Id.,* at 189.

[940] See Statuto Mercantile Romano 1317; Laws of Milan, 1330 as examples.

[941] Statutes of Toscana, 1582.

in contrast with the goals of an effective proceeding. But it is worth mentioning also that that the wife of a *fugitivi* did enjoy some protections under several statutes; a common one that has already been discussed shielded them having assets that constituted a dowry seized.

2.4 Medieval reorganizations: *salvacondotto* (safe conduct) and *concordati*[942]

With differing levels of success, city-states and territories attempted to design frameworks for negotiation that would provide bankrupts with the opportunity to reach agreements with their creditors. Such proceedings were called *concordati* or *della concordia*[943] (about harmony); the ancestors of modern reorganizations. Although models differed greatly between territories, it can be generally affirmed that, in these centuries, with few exceptions, rehabilitations did not constitute a true alternative to liquidations; the approaches and policies that were developed, though, are interesting and constitute the roots of modern models.

In this section, we will discuss three different elements which are relevant to understand the evolution of these proceedings up to modern times:

- "*salvacondotto*" (safe conduct);
- "*concordato fallimentare*";
- "*concordato preventivo*".

The salvacondotto was a tool granting special protections to debtors. Creditors or authorities could stay actions for a certain amount of time, allowing the debtor to return safely to town and negotiate a solution to his default. As such, the salvacondotto acted to support voluntary settlements which would have been impossible to discuss if the debtor escaped abroad and made no return or kept his location secret to avoid punishment.

Medieval systems allowed two kinds of "*concordato*", or formal agreements between debtor and creditors. The first, which we will call "*concordato fallimentare*" (under a more modern terminology that will resemble the one used in Chapter VI), was a tool used to close liquidations. Once bankruptcy occurred, in fact, it was difficult but not impossible for a debtor to successfully communicate with the creditors. If he could find an agreement that matched the requirements of the enacted framework, the liquidation could be closed and the debtor could avoid some of the effects of stigma. This tool proved relevant among several medieval insolvency frameworks and survived up to modern day.

The second form of concordato, called "*preventivo*", pursued different goals. It was structured as a tool to prevent the opening of a liquidation through a proceeding, incentivizing an agreement between the debtor and his creditors.

2.4.1 Safe conducts

Reaching an agreement after the commencement of a liquidation proceeding, in systems that incentivized early imprisonment and almost unregulated pursuit of debtors, was difficult. Rehabilitations were, therefore, supported by safe conducts (called *fida* in Venice). Safe conducts were awarded in the form of public documents that allowed special protections to the person of the debtor; they would temporarily stay actions to arrest, exile, punish, and imprison[944] the bankrupt.

Such a moratorium allowed a debtor to return to town safely and to start a dialogue with creditors, hoping to reach a satisfactory agreement for all the parties involved.[945] It is interesting to mention that Florence, since 1285, justified the concession of this privilege on different grounds, affirming that any debtor had the right to return safely to protect his honor against its creditors notwithstanding any ban.[946]

Creditors did not always, though, look at this tool favorably.

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[942] **Santarelli Umberto**, "*Mercanti e società tra mercanti*", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 101-108.

[943] See **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 276.

[944] In Florence starting in 1285 the law granted bankrupts a right to return to the city-state to defend themselves.

[945] See **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 276.

[946] *Id*. at, 288.

The fear that debtors would make fraudulent use of safe conducts to conceal assets or commit frauds became an unbearable weight on law makers. Hence statutes, such as for example the statute of Bologna of 1509, awarded the power to grant salvacondotti directly to the creditors and to Creditors' committees themselves[947], limiting, in any case, the powers of a debtor to dispose of his assets.[948] Other frameworks imposed duties on the bankrupt who could access this privilege if he had "sincerely and in good faith cooperated with the proceeding by readily handing over all books and records".[949] In Florence, starting in 1582, a distinction applied between honest and dishonest (fraudulent) debtors; the latter would be denied access to safe conducts.

Other statutes posed limits on the duration of safe conducts; in Siena, for example, the decree would be valid for fifteen days only.[950]

2.4.2 Concordato fallimentare

A concordato fallimentare was the product of a mediation between the debtor and his creditors after the opening of a liquidation proceeding. Through this proceeding, creditors would vote on a plan, accepting or rejecting a bankrupt's proposal. Under earlier statutes, those agreements would not be binding upon a dissenting minority; if the debtor was unable to get consent by all creditors, he would be liquidated.

With time, the mediation process grew and became more formal. It started to include relevant elements, such as the:

- capacity to bind minorities[951];
- vote of secured creditors;
- tools to limit frauds and honesty.

Debtors could, in certain circumstances, be "discharged" from paying some debts.

The framework remained, nevertheless, medieval. Although it is true, in fact, that those *concordati* that were approved by a majority of creditors (weighing more those who had the highest-value claims[952]) would become binding also on dissenting minorities, it is also true that the majorities to be reached by statutes posed very high and burdensome standards. In Genoa, for example, bankruptcy laws required the approval of seven out of eight voters.[953]

The voting process was modified over time and acquired several characteristics that made it similar to modern processes. Some statutes differentiated voting powers based on claims and excluded secured creditors under the same rationale which is applied in modern proceedings: creditors who enjoyed great protections could not to decide the destinies of those that had none.[954] Nevertheless, most creditors took part in the process since few, as discussed in the previous paragraphs, enjoyed such a privileged status.[955]

The concept of discharge as we define it in modern times did not apply: debtors were bound to pay their debts. An interesting rule from Florence stated that debtors could attempt to find an agreement with their creditors through a concordato; if they were successful in their mediation, the proceeding would stay further actions, but if the debtor became wealthy again at a later time he would be requested to honor all previous unpaid obligations, including the ones forfeited in the proceeding. If he refused, he would be

[947] The statute of Genoa of 1610 demanded that 7/8ths of the creditors had to agree to grant the safe conduct.
[948] See **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 286.
[949] Laws of Genova, 1632.
[950] See **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 288.
[951] Laws of Bologna, 1509.
[952] Majorities varied depending on statutes, in Genova, for example 7/8 of creditors had to give their approval; in Novara it was 2/3; Siena 1616, 3/4.
[953] See Laws of Genoa, 1589. In this particular case if the debtor managed to reach such high rate of approvals the minority would be bound to the decision. In Siena in 1616 the quorum was of 3/4ths of both heads and value of claims.
[954] See **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 280.
[955] *Id.,* at 302-4.

excluded, together with all his male descendents, from the guilds and commerce within the city and territories of Florence.[956]

In several systems, therefore, debtors tended to remain indebted for life.

The process, though, was perceived as a great opportunity, a gift from society. Frauds and abuses, therefore, were heavily sanctioned. Secret agreements involving the debtor and just a part of the creditors to obtain higher shares in exchange of a positive vote to the plan were null. Guilty creditors would be punished with fines[957] or even made jointly liable with the debtor for the payment of all outstanding debts[958].

2.4.3 Concordato preventivo

A second, more modern form of concordato became more common[959]: the concordato preventivo. The goal of this proceeding was to prevent the opening of a liquidation (and therefore at the least some of its stigmatizing and burdensome effects) and not to merely close one that had already been commenced.

The first organized framework can be found in Lucca in 1556. Debtors would be asked to pay 200 scudi[960] to be allowed to commence a mediation process in front of the competent *Corte dei Mercanti* (Merchant's Court). The debtor had to file all of his books, records, and relevant documents. He would, then, be awarded a safe conduct of a month to close the deal, which required the vote of 3/4 of the creditors.

We will discuss this topic in greater relevance when mentioning the framework developed in Venice which presented major differences in approaches and policies compared to most others in the Italian Peninsula.

2.5 Cross-border insolvency issues in the Middle Ages

In the previous three chapters we discussed the importance of bankruptcy in the international scenario. In Chapter II, we saw the World Bank including specific best practices on this topic in its list[961], and in Chapter III, we mentioned how this field of law is not new, although it gained much attention in recent times due to the growth of the globalized market.

In this section, we will mention some interesting aspects of international bankruptcy dating back to the Middle Ages.

A that time, merchants needed to have solid connections abroad to do business and, upon incurring financial difficulties, they could attempt to use them to find protection under the flag of neighboring states. Communities went to great lengths to prevent losing control over their debtors and knowing that they could be shielded by foreign powers could lead to repercussions.[962] As such, international aspects in bankruptcy cases were common and relevant under an economic, social, and political perspective.

When wealthy debtors fled, city-states had to become involved in the insolvency process, sending ambassadors (at the expense of creditors) to request the extradition of bankrupts or making international accords to regulate diplomatic relations in such instances. Bankruptcy became, therefore, also a matter of international diplomacy and each local government applied its own formula to solve issues that involved foreign citizens and assets.

Initially, governments attempted to expand the application of local rules abroad. While city-states tended not to differentiate the treatment of a foreigner defaulting within their borders, they often attempted to reach out in the case of insolvency of one of their citizens abroad. A statute in Lucca, for example, stated that Lucchese law would apply in all instances in which a Lucchese citizen was declared

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[956] Laws of Florence, 1322.

[957] Laws of Siena, 1616.

[958] Laws of Genova, 1589.

[959] See **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 301.

[960] The currency of the time.

[961] Principle "24" of the World Bank's list of 2001.

[962] **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 305.

bankrupt abroad; Genoa, instead, differentiated among territories, and, in particular, among international markets, stating that Genoese laws would be imposed on those that would go bankrupt at the fairs of Bisanzone and Piacenza (and others organized under the control of Genoa)[963].

To avoid disputes and provide a certain degree of certainty and transparency to the process, statutes became concerned with providing specific frameworks that would regulate the treatment of foreign creditors. With time, they got to enjoy treatment equal to that of local creditors. Judges would decide the lodging of their claims and the administrative difficulties faced in giving notice or sending proceeds were solved by creating deposits in the name of the individual foreign creditors.[964]

2.5.1 An example of conflicting approaches in the medieval international setting: the case of Milan, Venice, and other towns under their control

It often happened in the centuries we are analyzing, though, borders were quite literally crossed. Annexations of land by war or marriage were common. The merger of territories caused different laws and insolvency rules to overlap.

This was not a great issue in the vast majority of cases, since international policies and approaches in the field of insolvency law presented great similarities. As we have observed, most frameworks were heavily stigmatizing and developed following a similar trend, although specific rules did vary. One exception is particularly relevant and worth mentioning though: the laws enacted in the powerful Republic of Venice.

Starting in the thirteenth century, the Republic of Venice enacted frameworks that have much to share with modern approaches. The whole system was known for its relatively milder attitude, enforced by specialized judges[965]. Venice, in fact, deployed a system which supported trust and the voluntary opening of cases.[966]

Reorganizations were incentivized by ample safe conducts[967] (called *fida* in Venetian) which were made amply available to all debtors (the laws did not apply to merchants or traders only, but to any debtor[968]) and made little distinctions (mostly in earlier times[969]) between local and foreign debtors. Frauds were, of course, punished, but honest bankrupts were given an opportunity to find effective solutions to their difficulties.[970]

Moreover most Venetian statutes reduced the impact of stigmatizing factors, especially criminal ones. As it has already been mentioned, in medieval times bankruptcy was not solely a business matter.[971] In Venice, for example, insolvency was not considered a crime per se, nor was fraudulent behavior assumed[972]; bankruptcy crimes were not applied until the end of the 1300s[973] and the impact of criminal courts and statutes in general was much milder compared to other territories in the Italian Peninsula.

More time should be spent discussing the singlular innovations that constituted the Venetian model, but we can allow ourselves only a limited number of pages for this topic. We will, therefore, take for granted the fact that the statutes enacted in these centuries in the Republic of Venice were different and had much in common with the modern Principles and best practices promoted in our times. We will focus, then, on the conflicts that arose in the international scenario when such a “modern”, enlightened model entered into contact with others.

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[963] *Id.,* at 307.
[964] *Id.,* at 310-11.
[965] **Lattes Alessandro**, “*Il fallimento nel diritto comune e nella legislazione bancaria della Repubblica di Venezia*”, Nobu public domain reprints, printed in the US; at 9-10 and 15-16; 20-21.
[966] *Id.,* at 21.
[967] *Id.,* at 20 – safe-conducts helped reducing the number of *fugitivi*.
[968] *Id.,* at 16-17.
[969] *Id.,* at 17.
[970] Venetian Authorities incentivized the good use of the *fida* to promoting agreements between debtors and creditors. **Santarelli Umberto**, “*Mercanti e società tra mercanti*”, Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 105.
[971] **Lattes Alessandro**, *“Il fallimento nel diritto comune e nella legislazione bancaria della Repubblica di Venezia*”, Nobu public domain reprints, printed in the US., at 16.
[972] *Id.,* at 11-10.
[973] *Id.,* at 13.

Milan, as it has been mentioned in the previous pages, applied a very severe interpretation of bankruptcy rules. The powerful town privileged liquidations and stigmatized bankruptcy heavily. Venice and its diametrically opposite approach were less than 300 kilometers away.

These two contrasting approaches were geographically close, and the expansion of borders and the process of transforming city-states into more territorially extended entities led them to collide. In the 1400s, the Republic of Venice commenced expanding inland in the direction of the Dutchy of Milan in the West. The conflict between two great powers of the time led the "*Serenissima*" to annex numerous cities formerly under the control or the influence of Milan, such as Padua, Brescia, Bergamo, Lodi, and Cremona. These towns had to switch rapidly to the Venetian model, but faced great difficulties in the process.[974]

Despite annexation, the statutes applied in each territory remained to a certain extent different. The lack of a uniform framework led to discrepancies and some towns encountered more difficulties than others in adapting to the new model. The debate that involved safe conducts at the time is a good example of the difficulties that were faced.

In Padua, lawmakers struggled to apply the new principles; regulations remained harsh and stigmatizing but ultimately applied a key Venetian principle: no public official could prevent a debtor from obtaining a safe conduct when there was agreement on conceding it among the creditors.[975]

In Brescia, in 1455, merchants complained to the authorities that safe counducts were made available too easily under Venetian domination, damaging the market due to the behavior of those that would take advantage of the rules and to the domino effect caused by proceedings.[976] The debate escalated and the Doge himself was forced to take action, ordering that safe conducts had to be awarded exclusively with the consent of the creditors. At the same time, though, the highest Venetian authority invited local authorities to persuade creditors to make them available.

In Bergamo, a town that proved less prone to modify its Lombard approach, public officials could not award safe conducts without the approval of at the least 3/4 of the creditors.[977]

3. Early Bankruptcy statutes in medieval England

The difficulties and fears faced by the different towns and governments of the Italian Peninsula were, of course, not theirs alone; they were common to all the lands in which business activities took place.[978] Contracting debts, in the end, is a common behavior as old as trading itself. The evolutionary process followed in the two scenarios, though, diverged over the centuries and the answers provided to solve insolvency issues ultimately presented relevant differences.

We discussed in Chapter I how the European Union, and inidivudal European states, have looked with interest at the application of tools such discharge in an attempt to reduce stigma and provide debtors with fresh starts. Discharge rules today are known mostly thanks to their impact in the American insolvency system, but were first enacted in England. We must resist the temptation to flip forward towards the pages that focus on the American Bankruptcy Code, although it is today the main source of inspiration of European insolvency reforms. First, we must understand how they were conceived and they evolved within the English scenario, and then within early Colonial and Federal systems.

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[974] **Santarelli Umberto**, "*Mercanti e società tra mercanti*", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 106.

[975] See **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 298, underlining how the resulting statute still showed the two layers (the Milanese and the venetian one) which could not be harmonized.

[976] **Santarelli Umberto**, "*Mercanti e società tra mercanti*", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 107-8.

[977] **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 298.

[978] See **Campopiano M., Fulton H**.,"*Anglo Italian Cultural Relationss in the Later middle Ages*", York Medieval Press, 9781903153697, (2018); **Miller E., Britnell R. H., Hatcher J.**,"*Progress and problems in Medieval England: essays in honor of Edward Miller*", Cambridge University Press, Cambridge, ISBN 0521522730, (1996).

If we did not do so, in fact, we could miss relevant information. We could be tricked into believing that such tools were developed within the modern American system, which is often considered to be traditionally friendly towards debtors. This would be a mistake.

As we will have a chance to discuss in the next pages, early English insolvency statutes, and consequentially those enacted within the American colonies and by the first federal government of the United States, had much in common with the stigmatizing Italian frameworks of the Middle Ages. They considered bankruptcy to be a crime and punished debtors harshly for their unfortunate condition.

Nevertheless, despite the strength of the stigma, change came with time in common law countries. Our analysis of the evolution of their bankruptcy models will provide us with relevant information on how this change occurred.

We will continue our review with a brief discussion on the salient elements of early English insolvency frameworks up to 1705, the year the first discharge provision was enacted. This part will allow us to spot the differences between the medieval Italian scenario and the English one; it will also operate as an introduction to Chapter V, where we will discuss the evolution of American system.

3.1 A brief overview of early English bankruptcy statutes 1200 - 1700

The history of English bankruptcy laws is rooted in local traditions and tribunals.[979]

Up to the Crusades, trade was not very developed and any bankruptcy issues arising would be addressed based on customary rules that varied on the setting, inland or abroad.[980] Following the Norman conquest, international commerce developed and the application of the *Lex Mercatoria*[981] grew in relevance as a tool to solve international disputes in courts in which common law was not administered.[982] Although hints of the existence of some sort of a regional bankruptcy process can be traced back to the 1200s[983] in some courts, the lack of specific regulations on the matter created several difficulties and much harm to the economy.

The necessity of supporting trade made it so that a special process containing some of the typical features of a bankruptcy regulation was, finally, made available in the main cities.[984] Through it, debts could be acknowledged in front of the Town's mayor, who was the public officer in charge. In case of default, the debtor's assets would be sold and distributed among creditors.

The enacted framework contained numerous stigmatizing elements. Insolvent debtors were imprisoned until full payment.[985] Public registries of indebtedness were available starting in the thirteenth century and became commonly used.

Starting in 1284[986], statutes became more specific and, generally speaking, more afflictive in their application. Bankrupts could be imprisoned the day of the acknowledgment of their debts, regardless of their good faith or of lack of insolvency.[987]

A very relevant access requirement was included in the statute enacted in 1311 (and removed in 1570).[988] The 1311 statute specified that merchants were the only subjects of such oppressive regulations[989], sparing others from punishments. The goal was to limit access to bankruptcy to business debtors so as to promote the interests of England in securing and expanding trade.[990]

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[979] **Levinthal Edward Louis**, "*The Early History of English Bankruptcy*", 67 U. Pa. L. Rev. 1, (1919), at 4.
[980] *Id.*
[981] *Id.,* at 4-5.
[982] *Id.,* at 3-4.
[983] *Id.,* at 6.
[984] *Id.,* at 8.
[985] *Id.,* at 8.
[986] Statute 13 Edward I, St. 3, c.
[987] **Levinthal Edward Louis**, "*The Early History of English Bankruptcy*", 67 U. Pa. L. Rev. 1 (1919), at 8.
[988] **Cohen Jay**, "*The History of Imprisonment for Debt and its Relation to the Development of Discharge in Bankruptcy*", 3 J. Leg. Hist. 153 (1982), at 7: "The 1570 act also changed the definition of who could be declared bankrupt. The statute narrowed the definition of a bankrupt to include only traders and merchants, persons who earned their living by 'buying and selling'. A debtor who fell outside of this definition, a non-trader, could not be declared bankrupt."
[989] Statute of 5 Edward II, c. 33.
[990] **Levinthal Edward Louis**, "*The Early History of English Bankruptcy*", 67 U. Pa. L. Rev. 1 (1919), at 9.

At the time, though, the English legal framework did include protections, which sometimes problematically conflicted with the bankruptcy framework. The most relevant ones were:

- Asylum[991], or the law of sanctuary[992]: in medieval England, obtaining asylum shielded debtors from the reach of their creditors. Public officials who would not respect such immunity would be excommunicated and punished. At the same time debtors, while hiding in plain sight, had a chance to protect property, transferring it to insiders while being unreachable by public authorities and living on rents.[993] [994] Sanctuaries were, of course, not just an English prerogative. An interesting comment on this topic was included in chapter thirty-five of Cesare Beccaria's book "*Dei delitti e delle pene*":

  > "CHAPTER XXXV. OF SANCTUARIES.
  > Are sanctuaries just? Is a convention between nations, mutually to give up their criminals, useful? In the whole extent of a political state, there should be no place independent of the laws. Their power should follow every subject, as the shadow follows the body. Sanctuaries, and impunity, differ only in degree, and as the effect of punishment depends more on their certainty, than their greatness, **men are more strongly invited to crimes by sanctuaries, than they are deterred by punishment**. To increase the number of sanctuaries, is to erect so many little sovereignties; for, when the laws have no power, new bodies will be formed in opposition to the public good, and a spirit established contrary to that of the state. **History informs us, that from the use of sanctuaries have arisen the greatest revolutions in kingdoms and in opinions**. Some have pretended, that in whatever country a crime, that is, an action contrary to the laws of society, be committed, the criminal may be justly punished for it in any other; as if the character of subject were indelible, or synonimous with, or worse than that of slave; as if a man could live in one country, and be subject to the laws of another, or be accountable for his actions to two sovereigns, or two codes of laws, often contradictory. There are also who think, that an act of cruelty committed, for example, at Constantinople may be punished at Paris; for this abstracted reason, that he who offends humanity, should have enemies in all mankind, and be the object of universal execration; as if judges were to be the knights-errant of human nature in general, rather than guardians of particular conventions between men. The place of punishment can certainly be no other, than that where the crime was committed; for the necessity of punishing an individual for the general good subsists there, and there only. A villain, if he has not broke through the conventions of a society of which, by my supposition, he was not a member, may be feared, and by force banished and excluded from that society; but ought not to be formally punished by the laws, which were only intended to maintain the social compact, and not to punish the intrinsic malignity of actions. Whether it be useful that nations should mutually deliver up their criminals? Although the certainty of there being no part of the earth where crimes are not punished, may be a means of preventing them, I shall not pretend to determine this question, until, laws more conformable to the necessities and rights of humanity, and until milder punishments, and the abolition of the arbitrary power of opinion, shall afford security to virtue and innocence when oppressed; and until tyranny shall be confined to the plains of Asia, and Europe acknowledge the universal empire of reason, by which the interests of sovereigns and subjects are best united."[995]

- Royal pardons: the award of royal letters of safe conduct made debtors immune from public reach. Debtors who were cunning, well-connected, and capable enough to secure for

[991] Special protections awarded to political refugees by foreign jurisdictions. See **Garner Brian A.**, "*Black's Law Dictionary"*, ISBN 978-0314151995, (2004), 8th edition.
[992] **Baker Hamilton J.**, "*The English law of sanctuary*", Ecc. L.J. 1990, 2(6), at 8-13.
[993] **Levinthal Edward Louis**, "*The Early History of English Banlruptcy*", 67 U. Pa. L. Rev. 1 (1919), at 10-11.
[994] Some debtors, moreover, that were particularly keen in securing the benevolence of the King could obtain "grace" through a letter of safe conduct which would protect grant them a general protection from creditors. See *id*, at 10.
[995] **Beccaria Cesare**, "*An Essay on Crimes and Punishments*", (1764), English version, Online Library of Liberty, PLL v6.0 (generated September, 2011), at 67. See http://oll.libertyfund.org/title/2193.

themselves this great privilege enjoyed a special status up to the end of the fourteenth century.[996]

- Protections from imprisonment for debts: imprisonment for debts was not allowed in England by early statutes.[997] This factor, together with other traditional limitations weighing on actions by creditors and authorities, may have contributed to the development of a more debtor-friendly approach. Common law, in fact, did not allow the detention of a defendant in a civil suit until 1267 ,and the well known dictum "a man's house is his castle"[998] acted as a protection, preventing seizure of such a relevant and valuable asset.[999]

The difficulties in apprehending debtors and enforcing repayment of unpaid obligations challenged the rights of creditors and created instability. Change occurred under the reign of Richard II in the late 1300s. Protections for debtors, such as asylum, were limited to those impoverished by adversity and not to the ones who were at fault for their default. The privileges connected to asylum were abolished altogether in 1642[1000], while a statute passed under Henry VII in 1487 limited fraudulent or preferential gifts to friends and family for the benefit of the debtor himself.[1001]

Yet much had still to be done to enact a complete and well-structured insolvency framework.

The first full statute on the subject of bankruptcies – which included the principles of compulsory management, administration of the estate;, and distribution of the proceeds among creditors – was the one of 1542.[1002] Before then, in the absence of an injunction to stay individual actions and of a system that carefully and effectively established rankings among claims and fair distribution, each creditor had to race in order to ensure the acquisition of property and the repayment of outstanding obligations.

The framework was drafted to be strongly in favor of creditors; debtors, who were defined as "the offenders"[1003], were heavily stigmatized. The act offered involuntary access to proceedings only. The law trumped the protections awarded in earlier laws, mandating the imprisonment of absconding debtors or of those that hid in their houses, with consequent seizure of all their properties.[1004] Insiders who helped conceal assets would be punished and mandated to pay double their value.[1005] The act also advocated a form of pro-rata distribution of the dividends of the retrieved assets once liquidated.[1006]

The enacted system remained heavily stigmatizing. Debtors were seen as quasi-criminals.[1007] If one escaped, he would be ordered to return; if he failed to surrender within three months of having notice, he

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[996] **Levinthal Edward Louis**, "*The Early History of English Bankruptcy*", 67 U. Pa. L. Rev. 1 (1919), at 10, defining it a "corrupted practice".

[997] *Id*., at 10-11.

[998] We can find this principle in the Bill of Rights and in the Fourth Amendment of the American Constitution: "The right of the People to be secure in their persons, houses, papers and effects, against unreasonable searches and seizures, shall not be violated, and no warrants shall issue, but upon probable cause supported by oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized."

[999] **Cohen Jay**, "*The History of Imprisonment for Debt and its Relation to the Development of Discharge in Bankruptcy*", 3 J. Leg. Hist. 153 (1982), at 6.

[1000] **Levinthal Edward Louis**, "*The Early History of English Bankruptcy*", 67 U. Pa. L. Rev. 1 (1919), at 9-11.

[1001] *Id.,* at 12.

[1002] "An act against such persons as do make bankrupts" 34 & 35 Hen. 8, ch. 4 (1542-43); **Levinthal Edward Louis**, "*The Early History of English Bankruptcy*", 67 U. Pa. L. Rev. 1 (1919), at 14-15.

[1003] **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 169.

[1004] **Mann Bruce H**., "*Bankruptcy in the Age of American Independence*", ISBN 9780674032415, (2002), at 46.

[1005] **Levinthal Edward Louis,** *"The Early History of English Bankruptcy*", 67 U. Pa. L. Rev. 1 (1919), at 16.

[1006] **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 169.

[1007] **Tabb Charles J**., "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 7; **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 169.

would be adjudged out of the King's protection and anyone could help in collecting property and securing him to justice.[1008]

Later statutes in 1571, 1604, and 1623 followed the repressive path of stigmatization[1009], expanding the "acts of bankruptcy" (which, as we will discuss, will play an important role also in early American bankruptcy). The new laws also vested the competent authorities with increasing powers to punish bankrupts and those in connection with them.[1010] Such frameworks (which were in force also in the American colonies) were amended over the course of two centuries, but this did not mitigate their intrinsically afflictive nature; at the time they still did not include any form of discharge.[1011]

4. Important steps in the evolution of bankruptcy systems: honesty and discharge

Most early insolvency frameworks in Italy and England were, therefore, heavily stigmatizing. In order to achieve high levels of effectiveness and efficiency, they focused on imposing several social and criminal burdens on debtors. Liquidations were preferred over reorganizations, since they allowed authorities to have control over the bankrupt and the proceedings.

Not all of the statutes remained bloodthirsty over the centuries, though. With time, policies changed and led to the enactment of milder approaches. Two major factors that had an impact in this process were:

- the debate that advocated a different, and more lenient, treatment for honest bankrupts compared to the one reserved to fraudulent ones;
- the enactment of discharge rules within some early frameworks.

4.1 Differentiating between honest and dishonest bankrupts

We have already met rules giving value to honesty in earlier pages.

In 1473, in Milan under Galeazzo Maria Sforza, bankruptcy statutes started making clearer distinctions between the faults of honest and dishonest debtors. Bankruptcy ceased being a crime per se if it could be proven that objective factors had caused the default, with no guilt on the side of the debtor.[1012] The criminal consequences of the commencement of a case remained, nevertheless, burdensome for centuries.[1013]

In Tuscany, about a century later (April 1582), a statute attempting to isolate and separate the rules of criminal bankruptcy was enacted. The goal was to apply them only to those cases where it could be proven that the debtor intended to defraud creditors.[1014] In Siena, for example, it was left to bankruptcy judges to decide whether insolvency was the product of fraudulent behavior. Such judgment was not to be taken lightly, since the judge could decide "the kind and quantity of the penalty including death."[1015] In Genoa, if it was discovered that a debtor who enjoyed a particularly privileged and benevolent treatment (for example, being freed after coming to an agreement with his creditors) had actually acted to defraud the creditors by hiding assets, all privileges, discharges or stays of actions were revoked.

[1008] **Levinthal Edward Louis,** "*The Early History of English Bankruptcy*", 67 U. Pa. L. Rev. 1 (1919), at 16-17.

[1009] **Rafael Efrat**, "*Personal Bankruptcy in the 21st Century: Emerging Trends and New Challenges. The Evolution Of Bankruptcy Stigma"*, 7 Theoretical Inquiries L, 365, 367-374 (2006), at 373: "The British Bankruptcy Acts of 1604 and 1623 provided that certain bankrupts be pilloried and lose an ear. Further reflective of the punitive nature of bankruptcy in England, the Bankruptcy Act of 1705 offered the death penalty for fraudulent bankrupts, until an 1820 enactment replaced death with imprisonment."

[1010] **Mann Bruce H**., "*Bankruptcy in the Age of American Independence*", ISBN 9780674032415, (2002), at 46.

[1011] **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 169.

[1012] **Santarelli Umberto**, "*Mercanti e società tra mercanti*", Terza edizione, G. Giappichelli Editore, Torino, ISBN 9788834880173, (2012), at 80-1.

[1013] See **Santarelli Umberto**, "*Per la storia del fallimento nelle Legislazioni Italiane dell' Età Intermedia*", CEDAM Casa Editrice dott. Antonio Milani, Padova, (1964), at 148-149.

[1014] *Id.,* 150.

[1015] *Id.,* 152.

The Illuminist Cesare Beccaria wrote the following comment on this point and on bankruptcy in the eighteenth century in general, in 1764[1016]:

> "CHAPTER XXXIV. OF BANKRUPTS.
> The necessity of good faith in contracts and the support of commerce oblige the legislature to secure, for the creditors, the persons of bankrupts. It is, however, necessary to distinguish between the fraudulent and the honest bankrupt. The fraudulent bankrupt should be punished in the same manner with him who adulterates the coin; for to falsify a piece of coin, which is a pledge of the mutual obligation between citizens, is not a greater crime than to violate the obligations themselves. But the bankrupt who, after a strict examination, has proved before proper judges, that either the fraud or losses of others, or misfortunes unavoidable by human prudence, have stript him of his substance; upon what barbarous pretence is he thrown into prison, and deprived of the only remaining good, the melancholy enjoyment of mere liberty? Why is he ranked with criminals, and in despair compelled to repent of his honesty? Conscious of his innocence, he lived easy and happy under the protection of those laws, which it is true, he violated, but not intentionally. Laws, dictated by the avarice of the rich, and accepted by the poor, seduced by that universal flattering hope which makes men believe, that all unlucky accidents are the lot of others, and the most fortunate only their share. Mankind, when influenced by the first impressions, love cruel laws, although being subject to them themselves, it is the interest of every person that they should be as mild as possible; but the fear of being injured is always more prevalent than the intention of injuring others.
> But to return to the honest bankrupt. Let his debt, if you will, not be considered as cancelled till the payment of the whole; let him be refused the liberty of leaving the country without leave of his creditors, or of carrying into another nation that industry which, under a penalty, he should be obliged to employ for their benefit; but what pretences can justify the depriving an innocent, though unfortunate man of his liberty, without the least utility to his creditors?
> But, say they, the hardships of confinement will induce him to discover his fraudulent transactions; an event that can hardly be supposed, after a rigorous examination of his conduct and affairs. But if they are not discovered, he will escape unpunished. It is, I think, a maxim of government, that the importance of the political inconveniences, arising from the impunity of a crime, are directly as the injury to the public, and inversely as the difficulty of proof.
> It will be necessary to distinguish fraud, attended with aggravating circumstances, from simple fraud, and that from perfect innocence. For the first, let there be ordained the same punishment as for forgery; for the second, a less punishment but with the loss of liberty; and if perfectly honest, let the bankrupt himself chuse the method of re-establishing himself, and of satisfying his creditors; or if he should appear not to have been strictly honest, let that be determined by his creditors: but these distinctions should be fixed by the laws, which alone are impartial, and not by the arbitrary and dangerous prudence of judges.
> With what ease might a sagacious legislator prevent the greatest part of fraudulent bankruptcies, and remedy the misfortunes that befal the honest and industrious! A public register of all contracts, with the liberty of consulting it, allowed to every citizen; a public fund formed by a contribution of the opulent merchants for the timely assistance of unfortunate industry, were establishments that could produce no real inconveniences, and many advantages. But unhappily the most simple, the easiest, yet the wisest laws, that wait only for the nod of the legislator, to diffuse through nations wealth, power and felicity; laws which would be regarded by future generations with eternal gratitude, are either unknown or rejected. A restless and trifling spirit, the timid prudence of the present moment, a distrust and aversion to the most useful novelties, possess the minds of those who are empowered to regulate the actions of mankind."[1017]

[1016] His famous manual was concerned with criminal law and at the time Bankruptcy law still was included in this field.
[1017] **Beccaria Cesare**, "*An Essay on Crimes and Punishments*", (1764), English version, Online Library of Liberty, PLL v6.0 (generated September, 2011), at http://oll.libertyfund.org/title/2193

Beccaria's essay shows that society did indeed push for change within bankruptcy systems. Communities were not willing to take lightly the great burdens imposed on all bankrupts. Reforms, though, would take time. As we had a chance to discuss in Chapter I and as we will observe in greater depth in Chapter VI, analyzing more modern Italian frameworks, the stigma continued to remain relevant within the European scenario and to afflict both honest and dishonest debtors up to the new millennium.

4.2 The origins of discharge rules

Discharge is traditionally considered an English innovation in the field of bankruptcy. It was first granted with the statute of Queen Anne in 1705[1018] which gave practical application to the much-debated philosophy of aiding an honest but unfortunate debtor and limiting oppressing sanctions to fraudulent, dishonest ones.[1019] The statute also renounced some of the purely criminal connotations characterizing debtors, protecting those who would surrender to the proceeding and comply with the law (at the least a minimum percentage of debts had to be repaid, though, and creditors still had to consent to the discharge)[1020] [1021].

Attempts to put at least some safeguards to shield honest debtors were meant for the benefit of trade and founded on the principles of humanity and justice.[1022] The act, though, was still heavily permeated by the stigmatizing principles inherited by its predecessors[1023]:

> "Indeed, the fact that only creditors could file a bankruptcy petition negates any serious argument that the 1705 law was intended as a debtor relief measure. Furthermore, non-traders remained ineligible for bankruptcy. Nor was a discharge an automatic entitlement. The commissioners had to certify that the debtor had "conformed" to the requirements of the act, meaning in essence that the debtor cooperated in the bankruptcy proceeding."[1024]

It would take centuries before the slow process of change could produce meaningful effects. This was, nevertheless, a meaningful first step, since it allowed the debate on honesty to reach the coasts of the American continent, where with time it would evolve, leading to radical changes in insolvency models.

In modern times, we often think that the American system took immediate advantage of these seeds of change. As we are about to discuss, though, this was not the case. The rules to support debtors and to award discharges found many barriers in the New World also. Most colonial systems were as stigmatizing as their European counterparts.

Before analyzing the modern U.S. Bankruptcy framework, the model that is inspiring the European Union in such meaningful ways, we will, therefore, continue our historical overview discussing the

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[1018] See **Castagnola Angelo**, "*La Liberazione del Debitore (Discharge) nel Diritto Fallimentare Statunitense*", Casa Editrice Giuffrè Editore, Milan, Italy, (1993).

[1019] **Levinthal Edward Louis**, "*The Early History of English Bankruptcy*", 67 U. Pa. L. Rev. 1 (1919), at 18-20.

[1020] **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 169.

[1021] **Tabb Charles J**., "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 11; **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 168.

[1022] **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 170.

[1023] "in 1698 Massachusetts a hearing could be held at which creditors who suspected the debtor of concealing property could decide to pay to keep him in jail for another three months at the end of which he would be released if no additional property materialized. **Mann Bruce H**., "*Bankruptcy in the Age of American Independence*", ISBN 9780674032415, (2002), at 50.

[1024] **Tabb Charles J.,** "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995).

evolution of early Colonial and Federal models. We will focus on their understanding of bankruptcy and on the difficulties that were faced at the time in structuring early American systems.

5. Analysis of Chapter IV

In this brief chapter, we have discussed several extremely meaningful topics; in particular, we have analyzed:

- **The reasons for the introduction of insolvency systems:** medieval societies needed an organized public proceeding to contain the risks of insolvencies within their frail borders and protect their economies. Public proceedings were important, for they had ample power to ensure that the debtor and his assets would be placed under the authorities' control.
- **The proliferation of different local systems:** within a limited geographic area, countless local frameworks evolved independently. Each showed, though, a common matrix which matches, under several relevant aspects, key aspects of modern ones. Some relevant differences in approaches existed between the majority of towns, which opted for a stigmatizing frameworks based on liquidations, and the Republic of Venice, which supported reorganizations.
- **The evolution of the concept of insolvency:** the original concept of "fleeing" differs greatly from modern definitions of insolvency, which are bound to the scarcity of assets owed by a debtor. Despite different interpretations, insolvency has remained, up to today, a key access criteria and the linchpin of the bankruptcy process. It is just recently that best practices are shifting the focus toward new concepts, such as financial crisis, with the objective of allowing debtors to avail themselves of bankruptcy at an early stage and avoid, if possible, further financial decay. Insolvency remains, in any case, a fundamental factor in bankruptcy. The fact that its definition has changed in such a major way over the centuries should incentivize lawmakers to find an agreement to provide an international definition that could be shared to improve modern cross-border frameworks and support attempts to achieve higher levels of uniformity.
- **Non-business debtors:** although it is understandable that bankruptcy may be seen as a purely business topic, given the vast predominance of business cases, towadays the impact of consumers in the market is great. Bankruptcy must change, acknowledging the need to provide effective safety nets for a greater variety of debtors.
- **The balance between reorganizations and liquidations:** we have observed how liquidations were predominant in the history of bankruptcy frameworks (with the exception of Venice). Modern strategies, though, attempt to empower reorganizations to offer a concrete way out of trouble for honest debtors and an opportunity to get back in the game.

All of them have a relevant impact in our discussion and allow us to gain information on the great barriers surrounding the development of modern European strategies, ones that have caused the impasse in the process of refounding insolvency frameworks.

First of all, by analyzing ancient systems, we have acquired a better understanding of stigma, one of the major barriers negatively affecting the refoundation of insolvency frameworks. The documents we mentioned in Chapter I showed the critical effects of stigmatizing rules on modern economies, their diffusion within European local systems, and the challenges met in changing approaches. Our overview of medieval law shed some light on the origin of this phenomenon, allowing us to observe the true reason that stigma is so difficult to eradicate.

Stigma is nothing but the product of well-structured rules adopted in the past. Although several aspects of them, such as torture, of course do not match our society today, stigmatizing factors operated to ensure high levels of effectiveness and efficiency within proceedings. They reduced the cost and length of bankruptcies. Such rules stuck within the structure of the bankruptcy process of several European countries, because they were seen as necessary and as signs of productivity and proper functioning.

The Union struggles in bringing changes today because it is attempting to eradicate rules which were enacted, and which evolved over time, to protect core principles of its societies and economies over the past seven hundred years.

We have also analyzed relevant elements connected to the other, main, barrier slowing down the process of refoundation: the lack of uniformity among European frameworks. We have observed how

systems, despite relative geographic proximity and a common background, tend to present relevant differences between each other.

It appears that there is a tendency in bankruptcy to structure rules with a strong local identity. This factor would be congruent with our findings in Chapter II and with the principle that an effective and efficient insolvency model must match the society it is enacted within. We will discuss this topic further in the next chapter, when we will learn that the American colonies soon abandoned English law to enact a variety of discordant local statutes, leading to a very uneven scenario. Some states did not even enact a bankruptcy law and most refused to enact discharge rules.

A relevant factor which seems to connect both barriers is time. It took centuries to develop a meaningful distinction within bankruptcy between honest and dishonest failures, just as it took centuries, for example, to:

- develop a definition of insolvency;
- structure different classes of priorities within distribution processes;
- develop reorganization frameworks and apply them as an alternative to liquidations across international models;
- bring the whole field of bankruptcy law out of the realm of criminal regulations.

Societies have taken hundreds of years to refine their structures and tools. In those instances in which different models have merged, modifications never came easily.

We have analyzed, for example, the case of Milan and the cities that were annexed by the Republic of Venice (but we will observe a similar situation – an incapacity of preserving uniformity – also in the beginning of the next chapter, discussing the early history of American systems). Time (and patience) seems to be an absolutely essential element of the evolutionary process of bankruptcy laws. Europe, on the other hand, is trying to achieve its targets and bring major changes in the span of years or a few decades.

This is yet another one of the main aspects causing the impasse in the process of refoundation.

6. Conclusion

In this Chapter, we discussed relevant elements of the process of refounding European insolvency systems, and of the impasse holding back progress, from an historical point of view. We analyzed the medieval roots of our modern frameworks and learned about the origins of the stigma. We also collected more information on the tendency of local statutes to lack uniformity.

In Chapter V, we will see the evolution of these elements within a different context, the American one. The discussion will focus both on historical elements and on an analysis of the modern Bankruptcy Code. Today, in fact, the U.S. framework is being used as model and as source of inspiration by (not to mention being *heavily* transplanted into) several other local models around the world. As discussed in Chapter I, the European Union and Member States have also relied heavily on the American formula to make swift improvements.[1025]

It is still to be seen, though, if the American system can be a good model under modern standards and if it can be effectively be replicated or transplanted into different scenarios and societies in short periods of time.

In the next pages, we will try to collect relevant information on these points.

[1025] **Mc Cormack Gerard, Keay Andrew, Brown Sarah and Dahlgreen Judith**, "*European Commission – Justice and Consumers – Study on a new approach to business failure and insolvency – Comparative and legal analysis of the Member States' relevant provisions and practices*", Tender No. JUST/2014/JCOO/PR/CIVI/0075, (2016).

CHAPTER V.

IMPROVING THE EUROPEAN INSOLVENCY FORMULA THROUGH AMBITIOUS LEGAL TRANSPLANTS: AN OVERVIEW OF THE ORIGINS AND CURRENT STRUCTURE OF THE AMERICAN BANKRUPTCY FRAMEWORK

1. Introduction

In Chapter IV, we started to analyze the relevant insolvency frameworks we have selected. In Chapter V, we will continue on this path, discussing the bankruptcy system of the United States of America from its origins to its modern formula, including references to the ongoing process of reform. These two chapters are connected, since medieval European systems, and in particular English laws, were transplanted into the American Colonies and were in force before the birth of the new nation.

Although they shared a common starting point, the systems followed different evolutionary paths. As discussed in Chapter I, American bankruptcy models developed, with time, several unique features and became a model widely studied by players competing in the globalized market. The European Union, in particular, was greatly inspired by the American framework in designing its strategies.

This chapter could have been divided into two parts, although the final decision was to keep them together to group all U.S.-related topics.

The first part is more historical and is concerned with the evolution of rules and of the whole American bankruptcy scenario. It discusses the early roots of U.S. regulations in the field of bankruptcy laws from the time of the English Colonies until the reforms of 2005, focusing on several relevant aspects, such as:

- bankruptcy within the American Constitution;
- the role of bankruptcy judges;
- the evolution of bankruptcy proceedings;
- the interaction between states and federal statutes;
- potential conflicts between bankruptcy laws and other federal statutes.

The second part is focused on the current version of the Bankruptcy Code and on other bankruptcy-related statutes. Since it would be impossible to discuss the whole Code, choices have been made and topics have been selected to draw a useful picture for drafting our conclusions. This part of the chapter will analyze, among other topics:

- the treatment of business and non-business debtors within the Code;
- the “menu” approach;
- the balance between liquidations and reorganizations;
- tools to incentivize early voluntary access;
- barriers on involuntary proceedings;
- automatic stay;
- creation of the estate and distribution process;
- avoiding powers;
- discharge, exemptions, and fresh starts;
- the costs of bankruptcy;
- bankruptcy crimes;
- tools ensuring protection of discharged debtors from the effects of stigma.

All the above-mentioned topics are greatly relevant within the process of refounding European insolvency systems. Several approaches and rules are being transplanted into European frameworks in order to:

- speed up the process of harmonization of local systems;
- guide Member States in the implementation of models that are deemed fit to succeed in the modern globalized economy and of greater support to the common market.

The end results of such process appear to be uncertain, though.

Although it is a fact that the American economy has been outperforming European ones in the past decades, the Union cannot be blind in its race to catch up. Even if the American bankruptcy framework is deemed to have found a successful balance which supports the development modern economies, Europe may be unable to replicate such positive results by merely transplanting it (or parts of it) into its local frameworks.

2. The evolution of American bankruptcy statutes[1026]

2.1 Insolvency Statutes in the American colonies

The roots of American insolvency frameworks are found in the English statutes which we briefly discussed in Chapter IV. Their enactment in the “new” continent allowed the creation of a uniform scenario far away from the motherland. With the disaggregation of the Crown’s influence, though, the different local courts opted for modifications, reinterpreting rules, policies, and approaches and creating a heterogeneous, dissonant, colony-by-colony system.[1027]

Although, just like its predecessors, the British Act of 1705 (which included the embryo of discharge rules) was enforced also in the American colonies, only a few territories enacted full insolvency regulations including discharge provisions; some did not make available any specific statute at all.

Most local legislative bodies limited bankruptcy to traders and merchants (following in the path of the inherited European models); others, such as Rhode Island, contained no restrictions.[1028] It can be affirmed that the uniform progress achieved through hundreds of years of evolution of English laws were soon forgotten or, in any case, mitigated by the difficult conditions met in a “new world” which was struggling to find an effective balance through continuous wars and economic crises.[1029]

The elements that served as a link between the different colonial models, as it commonly happens in the field of bankruptcy, were often stigmatizing ones. At the time, in fact, a generalized conservative approach spread in the American territories formerly under British control. The enactment of forms of discharge and debt relief was greatly opposed due to the fear that leaving any freedom to bankrupts would make people financially reckless and irresponsible, damaging the texture of society itself.[1030]

Overall, debtors in the New World, just like their continental peers, did not have an easy life and were often imprisoned due to their condition.[1031]

Local authorities were swift in incarcerating all those subjects who did not find a bondsman to stand bail, knowing that, in most circumstances, debtors would go through great effort to avoid the

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[1026] For an overview of this topic see: **Warren Charles**, "*Bankruptcy in United States History*" Published by William S. Hein & Co. INC., Buffalo, New York State, in 1994; **Coleman Peter J**., "*Debts and Creditors in America. Insolvency, Imprisonment for Debts and Bankruptcy, 1607-1900*", published by Beard Books, Washington D.C., in 1999; **Skeel David A**., "*Debt's Dominion. A History of Bankruptcy Law in America*", Published by Princeton University Press, in 2004; **Mann Bruce H.**, “*Bankruptcy in the Age of American Independence*”, ISBN 9780674032415, (2002); **Tabb Charles J.** , "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5, (1995).

[1027] **Coleman Peter J.**, "*Debts and Creditors in America. Insolvency, Imprisonment for Debts and Bankruptcy, 1607-1900*", published by Beard Books, Washington D.C., in 1999, at 9.

[1028] *Id.,* at 11.

[1029] **Mann Bruce H**., “*Bankruptcy in the Age of American Independence*”, ISBN 9780674032415, (2002), at 51.

[1030] **Coleman Peter J.**, "*Debts and Creditors in America. Insolvency, Imprisonment for Debts and Bankruptcy, 1607-1900*", published by Beard Books, Washington D.C., in 1999, at 13.

[1031] Arrest due to insolvency was a “pillar” of bankruptcy frameworks and was not questioned until the 1750s. See **Mann Bruce H.**, “*Bankruptcy in the Age of American Independence*”, ISBN 9780674032415, (2002), at 81.

punishment.[1032] Jails were overcrowded[1033], insalubrious places, where disease spread among inmates.[1034] Bankrupts were often mixed with other criminals awaiting sentencing or execution.[1035] They were left starving[1036], often just dying of fatigue[1037], wishing for mercy and charity.[1038]

There was little room for hope, though. Models were not built to provide ways out. Debtors could be spared the consequences of their default only if they could pay their debts, a result that would be difficult to achieve while imprisoned.

Moreover, delays in proceedings were common[1039] due to the court systems of some states. Going through the allowed trials (often under the model of county courts for the first hearing and appeal, and a last appeal in front of the competent Supreme Court) burdened the poorer debtors who had to pay the costs of proceedings if they lost and suffered an increase in their debts due to interest rates. They lacked any true hope of capitalize on such a delay by, for example, forcing creditors to an agreement, or convincing lenders to halt a proceeding by offering adequate security.[1040]

The fear of the consequences of bankruptcy was a key factor adopted to prevent cases, just like in medieval European systems. Yet, it also discouraged debtors and limited cooperation. Given such harsh conditions, bankrupts often felt they were left with no real other alternative than to escape to another colony or far-away territory; a place where the consequences of their insolvency would find as many geographical obstacles as possible in reaching them and where they could be possibly saved from their creditors.

Authorities at the time found great difficulties in coordinating efforts and in structuring effective and efficient local models to regulate the field.

The ample recourse to tools of criminal law such as imprisonment did not cure insolvency and caused further difficulties in colonial societies. By being in close contact with "true" criminals in such gloomy and helpless environments, in fact, bankrupts often became criminals themselves, leaving little room for redemption.[1041].Even if no actual "contamination" was derived from such condition, the imprisonment of debtors had an impact on society: bankrupts were automatically seen as villains and stigmatized.

Moreover, the fragile economies of the new colonies were deprived of valuable and productive human capital. Communities had to pay the bill since they could not take advantage of the work and capacities of honest bankrupts and they had to account for their families and the people depending on them who were left in poverty.[1042]

Therefore, with time, attempts were made to improve frameworks.

The distinction between honest and dishonest bankrupts, which could grant a reduction in the number of inmates, was mentioned in a few regulations, but it did not have any real value but for spiritual purposes.[1043] It was only in the second half of the eighteenth century that things started to change. States started experimenting with formulas that would limit the social costs of generalized imprisonment, in an attempt to compensate for the impoverishment that followed the Seven Years' War.[1044] At that time, in fact:

[1032] *Id.*, at 21.
[1033] *Id.,* at 94.
[1034] *Id.,* at 99.
[1035] *Id.,* at 85.
[1036] *Id.,* at 96. Their condition was worse than the one of common criminals whom were allowed the necessary supplies to maintain life, while debtors were often left to starve.
[1037] *Id.,* at 29.
[1038] *Id.*, at 88.
[1039] *Id.,* at 22.
[1040] *Id.,* 21-22.
[1041] *Id.,* 88-89.
[1042] **Coleman Peter J.,** "*Debts and Creditors in America. Insolvency, Imprisonment for Debts and Bankruptcy, 1607-1900*", published by Beard Books, Washington D.C., in 1999, at 9.
[1043] **Mann Bruce H.**, "*Bankruptcy in the Age of American Independence*", ISBN 9780674032415, (2002), at 37.
[1044] *Id.*, at 55.

> "War had made everyone familiar with risk, economic risk included…and it became harder to stigmatize insolvency as moral failure."[1045]

Insolvency regulations that allowed discharges at the end of bankruptcy proceedings were finding more public support, but the path towards the modern, debtor-friendly American statutes we know today was, as we are about to discuss, still long and winding.

2.2 Bankruptcy in the U.S. Constitution

At the time of the American revolution, before bankruptcy became a federal matter, only three colonies had enacted insolvency laws which included discharge provisions. Of the remaining ones, four did not provide an insolvency statute at all.[1046] Colonies gave rise to high levels of instability and uncertainty in trade by:

- giving dissonant answers to the conflicts between debtors and creditors;
- administering different forms of punishment and relief;
- providing different rules on the enforcement of contracts[1047].

Just as it happened in the Italian city states and in England, protecting trade and curing the effects of continuous economic crises gave great impulse to the debate in the field of bankruptcy and pressured the Constitutional Convention to improve the available system. The Framers took action[1048], and a "Bankruptcy Clause" was included in Article I, Section 8, Clause 4.

> Section 8 of Article 1 reads as follows:
> "The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States;
> To borrow money on the credit of the United States;
> To regulate commerce with foreign nations, and among the several states, and with the Indian tribes;
> **To establish** a uniform rule of naturalization, and **uniform laws on the subject of bankruptcies throughout the United States**;
> To coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures;
> To provide for the punishment of counterfeiting the securities and current coin of the United States;
> To establish post offices and post roads;
> To promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries;
> To constitute tribunals inferior to the Supreme Court;

[1045] In commerce, however, credit became recognized as a necessary evil and once it is used, things can go wrong. *Id.*, at 55-56.

[1046] **Coleman Peter J**., "*Debts and Creditors in America. Insolvency, Imprisonment for Debts and Bankruptcy, 1607-1900*", published by Beard Books, Washington D.C., in 1999, at 14.

[1047] *Id.*, at 16.

[1048] As observed by James Madison in the *The Federalist*, "The Powers Conferred by the Constitution Further Considered From the New York Packet", n. 42, Tuesday, January 22, 1788: "The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question. The power of prescribing by general laws, the manner in which the public acts, records and judicial proceedings of each State shall be proved, and the effect they shall have in other States, is an evident and valuable improvement on the clause relating to this subject in the Articles of Confederation. The meaning of the latter is extremely indeterminate, and can be of little importance under any interpretation which it will bear. The power here established may be rendered a very convenient instrument of justice, and be particularly beneficial on the borders of contiguous States, where the effects liable to justice may be suddenly and secretly translated, in any stage of the process, within a foreign jurisdiction." At http://www.let.rug.nl/usa/documents/1786-1800/the-federalist-papers/

To define and punish piracies and felonies committed on the high seas, and offenses against the law of nations;
To declare war, grant letters of marque and reprisal, and make rules concerning captures on land and water;
To raise and support armies, but no appropriation of money to that use shall be for a longer term than two years;
To provide and maintain a navy;
To make rules for the government and regulation of the land and naval forces;
To provide for calling forth the militia to execute the laws of the union, suppress insurrections and repel invasions;
To provide for organizing, arming, and disciplining, the militia, and for governing such part of them as may be employed in the service of the United States, reserving to the states respectively, the appointment of the officers, and the authority of training the militia according to the discipline prescribed by Congress;
To exercise exclusive legislation in all cases whatsoever, over such District (not exceeding ten miles square) as may, by cession of particular states, and the acceptance of Congress, become the seat of the government of the United States, and to exercise like authority over all places purchased by the consent of the legislature of the state in which the same shall be, for the erection of forts, magazines, arsenals, dockyards, and other needful buildings;--And
To make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the government of the United States, or in any department or officer thereof."

The lengthy list of heterogeneous powers that were included in Article I attempted to cover the all the fields which would be relevant to a country in its formation process. Section 8 was concerned with a wide variety of topics that range from organizing commerce and imposing taxation, to regulating armies and naval forces, to building roads and administering post offices. Bankruptcy was placed among them with little debate. Only Connecticut objected, observing that bankruptcies were punished by death under some international statutes (such as some of the English ones), which was in contrast with the ideals embodied in the new Constitution. Such objection, though, was ultimately overcome and Congress acquired the power to regulate the field, imposing a uniform regulation upon all the states.

A decade had to pass, though, before a first federal statute occupying this field of law could be enacted. When it finally happened, it was mainly to meet the periodic crises of the growing unified economy. Despite the absence of discharge provisions, state insolvency statutes were still perceived as sufficient tools to regulate insolvency in ordinary times, while federal laws were viewed as temporary or emergency remedies.[1049] This status quo lasted up until the end of nineteenth century.

The federal statutes enacted before then had a very limited impact, often lasting just a few years before being repealed, with powers to regulate the subject reversing to the states. The path followed in their evolution is, in any case, worthy of discussion and of interest to our study.

2.3 The first federal bankruptcy statutes: 1800-1874[1050]

The Framers included bankruptcy among the enumerated powers in an attempt to achieve higher levels of uniformity and prevent the divergent and discriminatory treatment of debtors among states. The system was also intended to grant discharges which could be valid through the nation and to protect and support trade.

Yet, such power was not taken full advantage of, and did not have the desired impact, until late in the nineteenth century.[1051]

[1049] **Skeel David A.**, "*Debt's Dominion. A History of Bankruptcy Law in America*", Published by Princeton University Press, (2004).

[1050] The evolution of bankruptcy Courts in the US will be discussed in greater depth in the next pages.

[1051] **Tabb Charles J.**, "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5, (1995), at 14.

Although federal statutes were enacted and in effect in the years 1800-1803, 1841-1843, and 1867-1878, no results truly followed the various attempts made by Congress to regulate the field permanently. Mostly due to budgetary reasons, each act had a very short life and the duty to manage insolvency was mostly left to the states.[1052] Moreover, Federal frameworks were viewed as emergency solutions to the numerous crises afflicting the expanding economy of the New World and, as such, they were not built to last; they were not given the necessary structure to permanently support economic growth nor to ensure stability in the market.[1053]

The steps taken in improving federal formulas with the enactment of a new model were, though, meaningful and constituted the platform that allowed federal laws to monopolize the field of bankruptcy laws effectively and to create a system that is considered a model in the modern international scenario.

The first federal bankruptcy statute was enacted in 1800 under President John Adams, thirteen years after the Constitution empowered Congress to regulate the field of bankruptcy.[1054] The model was based on the English system and restricted proceedings to merchants.[1055] A case could be commenced involuntarily only, and bankruptcy was treated as a criminal offense not punishable by death[1056]; a primitive form of relief was present in the form of discharge and made available to cooperative[1057] bankrupts.[1058]

The statute had an expected duration of five years, but was repealed after just three.[1059] It served as a temporary measure (no more than 500 cases were filed[1060]) to address the financial consequences of the various crises of the last decade of the eighteenth century that led to the imprisonment of thousands of debtors.[1061] With the abolishment of imprisonment for debts in 1839, attempts were made to improve the condition of debtors and the consequent effects on society; the overall economic situation worsened nevertheless andsStates struggled in turning local solutions into useful remedies.[1062]

Thirty eight years had to pass before a revised federal statute could be enacted. Despite its extremely short life, the act of 1841 (repealed in 1843)[1063] presented several very relevant modifications compared to its predecessor. Bankruptcy became available voluntarily to "debtors", a category that was no longer limited to traders or merchants, although corporations were still excluded.[1064] The act also contained rules to prevent the fraudulent or preferential conveyance of assets of the estate made in an attempt to trick the proceeding, and empowered Courts to appoint the trustee.[1065] Discharge would remain available to cooperative debtors surrendering their assets.

[1052] Statutes enacted by the single states were often used in early times as a models for federal codification. *Id.,* at 17.

[1053] **Mann Bruce H**., "*Bankruptcy in the Age of American Independence*", ISBN 9780674032415, (2002), at 202.

[1054] 2 STAT. 19

[1055] **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 170; **Mann Bruce H.**, "*Bankruptcy in the Age of American Independence*", ISBN 9780674032415, (2002), at 207-208: Statues applied to commercial debtors for only they could not avoid risks.

[1056] **Tabb Charles J.**, "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5, (1995), at 14.

[1057] Two thirds of the creditors (counting "heads" and cumulative value of claims) had to give their consent.

[1058] **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 171.

[1059] Historians attribute the dissatisfaction with the act also with the abuses committed by debtors. *Id.*

[1060] *Id*., at 170.

[1061] **Tabb Charles J**., "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 14.

[1062] **Coleman Peter J.**, "*Debts and Creditors in America. Insolvency, Imprisonment for Debts and Bankruptcy, 1607-1900*", published by Beard Books, Washington D.C., in 1999, at 21.

[1063] 6 STAT. 440.

[1064] **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 171.

[1065] *Id.,* at 172.

Although short-lived, the 1841 Act was significant in its attempts to de-stigmatize bankruptcy by allowing multitude of debtors to file voluntarily in an attempt to obtain a discharge. For the first time, honest debtors could avoid being considered "criminals" and imprisoned solely due to their financial default.[1066]

A third act in 1867[1067] enjoyed a longer life and lasted until 1878. It allowed corporations to file, and so could any person subject to the threat of involuntary bankruptcy (voluntary petitions were limited to debtors owing at least $300).[1068] The law limited access to discharge by establishing prerequisites: debtors had to ensure the repayment of shares of their debts in order to obtain relief; when less than 50% of the outstanding claims could be reimbursed, in fact, the consent of creditors was needed.[1069] Moreover, discharge was available just once unless creditors consented further. Despite posing some limitations, the statute allowed a form of rehabilitation of debtors and gave life, therefore, to an interesting scenario.[1070]

The amendments to the Act of 1874 contained the first form of reorganization (a composition agreement) through which a debtor could remain in possession and repay a part of his debts on a schedule while being discharged for the remainder. It also introduced the "best interest of creditors" test, which would require creditors to receive, in a composition, at least as much as they would be paid in a liquidation; hence justifying the proceeding.[1071]

Despite the innovations that were included in the model enacted in 1874, the entire act was ultimately repealed and considered to have done more harm than good. Its biggest weakness were the excessive costs (fees; administrative expenses) that would often leave too little, if anything, left to be distributed amongst the creditors.[1072]

2.4 The Bankruptcy Act of 1898 and the Chandler Act of 1938

The Bankruptcy Act of 1898[1073] was the first permanent bankruptcy law of the United States of America. Different factors are considered to have triggered its enactment; the great crisis originated after the depression of the year 1893, as all the crises of the precedent decades, called for federal intervention in the field of bankruptcy, and so did the growth of the unified American economy with the beginning of large-scale industrialization that followed the ongoing expansion towards the West.[1074] The statute remained effective for more than 80 years, despite numerous amendments.[1075]

The Act tried to be a better meeting point between the needs of both creditors and debtors[1076] at a time in which the rapidly growing economy was still suffering the traditional ups and downs that doomed its

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[1066] *Id.*

[1067] 14 STAT. 617. The 1867 Act was a response to the Civil War which had crippled the American economy. *Id.*

[1068] **Tabb Charles J.**, "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 19; **Kennedy David S., Clift Spencer R. III**, "*An Historical Analisys of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 172

[1069] "An amendment passed in 1974 reduced the percentage to 30 and changed the consent provision to one- fourth", *Id.* See also **Tabb Charles J**., "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 19; **Coleman Peter J.**, "*Debts and Creditors in America. Insolvency, Imprisonment for Debts and Bankruptcy, 1607-1900*", published by Beard Books, Washington D.C., in 1999, at 25.

[1070] **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 173.

[1071] *Id.*

[1072] *Id.,* at 174. Quoting **In re Oakland Lumber Co**., 174 F 634 (C.C.A. 2d Cir. 1909).

[1073] 30 STAT. 544.

[1074] *Id.*, at 175.

[1075] **Tabb Charles J.**, "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 23. See also **Kimlinger Katie T., Wassweiler William P**., "*The good faith fable of 11 U.S.C. § 707 (a): how bankruptcy courts have invented a good faith filing requirement for Chapter 7 debtors*", 13 Bankr. Dev. J. 61, (1996), at 63.

[1076] "Ironically, in half a century the debate had come full circle; bankruptcy was now being urged only as a relief measure for debtors.", see **Tabb Charles J.**, "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 23.

predecessors.[1077] Creditors needed a tool to put pressure on debtors that were reluctant to repay their debts while debtors, especially farmers, needed a way out of the harshness of their difficult economic situation. The resulting law was an uneasy, much-debated compromise.

Debtors (individuals and most partnerships and businesses[1078]) had the right to file for bankruptcy (exclusively liquidations[1079]) voluntarily, seeking what today is referred to as "bankruptcy protection" (from the individual actions of their numerous creditors). Discharge was made available with fewer restraints than in the previous statutes, although over time limitations were enacted to respond to concerns that the law went too far in favoring debtors.[1080] Good faith was irrelevant upon filing for voluntary liquidation, but it became a relevant parameter to prevent abuses within the system in the case of a composition.[1081]

The commencement of involuntary proceedings was limited. It was no longer sufficient for creditors to prove that the debtor was in difficult financial conditions; they also had to prove that the debtor was engaged in some sort of risky or wrongful conduct, called an "act of bankruptcy", such as a preferential transfer or fraudulent payment, just as in the Act of 1867. However, the list of acts was shortened in this reformed version.[1082]

The Act also empowered courts to:

- enjoin collection proceedings;
- avoid preferential or fraudulent conveyances;
- trump unperfected security interests.

It also established a system of priorities and created rules for the distribution of a debtor's remaining assets. Whether the proceeding was voluntary or involuntary, discharge was made available at the end of both liquidations and compositions and debtors were legally empowered to start over.

The Act of 1898 survived many attempts to repeal it during the 80 years of its existence, but the process of modification leading to improvements was continuous[1083] up to the Great Depression, which pushed Congress toward structuring a more debtor-oriented framework. At such a time of great economic difficulty, American society was willing to allow bankrupts greater relief and an opportunity to continue, hopefully, to be a productive part of the market.

The most comprehensive review happened through the Chandler Act of 1938.[1084] [1085] The model was shaped in response to the desperate economic situation that the nation was facing in those troubled years.[1086] Congress focused on reorganizing the reorganization chapters[1087], limiting the role of liquidation proceedings and protecting businesses as a going concern.

Individuals benefitted from the reforms themselves, since they were for the first time given a chance to manage their state of insolvency. While before their choices were limited to liquidations or staying out of

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[1077] See **In re Gibraltor Amusements**, 291 F2d 22, 28 (ed Cir) (Friendly, J. dissenting).

[1078] **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 175.

[1079] *Id.*

[1080] **Tabb Charles J**., "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 25.

[1081] **Kimlinger Katie T., Wassweiler William P**., "*The good faith fable of 11 U.S.C. § 707 (a): how bankruptcy courts have invented a good faith filing requirement for Chapter 7 debto*rs", 13 Bankr. Dev. J. 61, (1996), at 63-4.

[1082] **Tabb Charles J.**, "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 25.

[1083] *Id.,* at 27.

[1084] 62 STAT. 840, 841.

[1085] In the following forty years the Act was modified in numerous other occasions; yet such amendments are not of great relevance. See **Tabb Charles J**., "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 32.

[1086] **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 176.

[1087] The first seven Chapters dealt with liquidations on the basic schemes of the previous Act; while Chapters eight to fifteen regulated the rehabilitation of debtors. *Id.*, at 177.

bankruptcy altogether, the Chandler Act empowered them to manage their financial problems under the protections offered by bankruptcy law.[1088]

2.5 The Bankruptcy Reform Act of 1978 and its modifications until 2005

The process to reform the Bankruptcy Act started in 1970, when Congress established the "Commission on Bankruptcy Laws of the United States[1089]" to study, analyze, evaluate, and recommend changes to the amended 1898 Act.[1090] The revision process lasted nearly a decade before President Jimmy Carter finally signed an amended bankruptcy law in 1978.[1091]

The updated law, the Bankruptcy Code of 1978, led to numerous changes and created the backbone of the modern structure. Because the Commission did not find that too many cases were being filed under the previous law or that there was a need to restrict access to bankruptcy, the Code remained available to a wide variety of debtors. The term "bankrupt" was avoided, hence reducing stigma.[1092]

The framework implemented a system to reduce the leverage of "ill-founded" involuntary petitions.[1093] Following the Commission's recommendations, the Code included four ways to commence a case: voluntary individual cases (§ 301); voluntary joint cases (§ 302); involuntary cases (§ 303); and cases ancillary to foreign proceedings (§ 304).[1094]

Voluntary petitions could be filed under Chapter 7 (liquidation) or Chapters 9, 11 and 13 (the ancestors of the modern reorganization chapters; Chapter 12 would be enacted only later in 1986 and served, initially, as a temporary measure) by "persons"[1095] residing in the US. The new rules mandated for an involuntary case to be filed by three[1096] creditors holding $5.000 or more in unsecured, non-contingent claims.[1097] Through such access requirements, the Code aimed to prevent the use of bankruptcy law as a mere collection tool.[1098]

Filing fees would be substantially increased compared to the previous law.[1099]

The Code modified the concept of "estate"; upon commencement of a case[1100] all of the debtor's property had to be handed over a trustee to the administrator of a case. A new "automatic stay", a self-

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[1088] As long as the petition was filed in good faith. **Kimlinger Katie T, Wassweiler William P.**, "*The good faith fable of 11 U.S.C. § 707 (a): how bankruptcy courts have invented a good faith filing requirement for Chapter 7 debtors*", 13 Bankr. Dev. J. 61, (1996), at 64.

[1089] See **Kennedy, Frank R.**, "*The Report of the Bankruptcy Commission: The First Five Chapters of the Proposed New Bankruptcy Act*," Indiana Law Journal Vol. 49 Iss. 3, Article 3, (1974).

[1090] **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 177.

[1091] 92 STAT. 2657. **Tabb Charles J**., "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 33.

[1092] **Kennedy Frank R.**, "*The Commencement of a Case Under The New Bankruptcy Code*", 36 Wash. & Lee L. Rev. 977 (1979), at 978.

[1093] *Id.,* at 979.

[1094] *Id.*

[1095] Individuals, partnerships or corporations. Chapter 9 would be made available to municipalities. Banks and insurance companies would be excluded. Railroads would be allowed to liquidate or reorganize through Chapter 11.

[1096] Exceptions will be discussed in the next sections.

[1097] **Kennedy Frank R.**, "*The Commencement of a Case Under The New Bankruptcy Code*", 36 Wash. & Lee L. Rev. 977 (1979), at 1004.

[1098] **Godshall Brad E., Giluhy Peter M**., "*The Involuntary Bankruptcy Petition: the World's Worst Debt Collection Device?*", 53 Bus. Law. 1315, (1998).

[1099] **Kennedy Frank R**., "*The Commencement of a Case Under The New Bankruptcy Code*", 36 Wash. & Lee L. Rev. 977 (1979), at 994.

[1100] The expansion of the meaning of property of the estate was so strong that in the Manville (**In re Johns -Manville corp**, 36 B.R. 743 Bankr S.d.n.y. 1984) it was established that even those who had not yet contracted asbestos poisoning nonetheless had claims that were cognizable by bankruptcy. In the Piper Aircraft Corporation case (**Epstein v. Official committee of unsecured creditors ODF the estate of piper aircraft corporation**, 58 F. 3rd 1573 (11th circuit 1995) the concept was expanded even further to include future persons (born and unborn) who would suffer personal

executing injunction, would arise at the moment of filing, preventing any action that could deplete the estate. Exemptions were made available to aid individuals as a concrete support in reaching a meaningful fresh start.

Chapter 11 became the most relevant reorganization chapter. By leaving the debtor "in possession", it saved expenses, limited the circumstances in which a trustee would be appointed to administer the case, and encouraged a more effective and efficient solution to the debtor's economic difficulties before insolvency, and eventually liquidation, became inevitable. The DIP[1101], in fact:

- enjoyed a 120 days "exclusivity period" to propose a plan;
- was awarded the powers of a trustee;
- remained in charge of the operations in an attempt to reach the best interest of the creditors.

One of the most interesting and debated aspects of the reform, though, was the expansion of powers granted to bankruptcy judges (called "referees" up to 1970). The Code gave them the power to hear all matters in and related to a bankruptcy case.[1102] Such innovation gave rise to the need for further revisions of the Code due to constitutional conflicts which will be discussed in depth in the next pages. A more in-depth discussion of this topic is included in another section in which we will analyze the most relevant steps of the evolution of U.S. Bankruptcy Courts.

For now, we will limit ourselves to listing the different steps of the evolution of insolvency statutes. On the 29th of June, 1984, Congress enacted the BAFJA[1103] (Bankruptcy Amendments and Federal Judgeship Act), which cured the constitutionality issues that arose with the enactment of the Code and modified the sections addressing jurisdiction, venue ,and appeals, creating a system in which Bankruptcy Courts would be maintained as units of the District Courts. Such units would be empowered to hear cases only by referal of the District Courts.

In 1986, Congress enacted the "Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act"[1104], which added a new reorganization Chapter, Chapter 12, specifically designed to assist family farmers. Although Chapter 12 was designed to be temporary, it was never repealed, and it became a permanent part of the Bankruptcy Code in 2005 when it was also expanded to include "family fishermen".[1105] The 1986 revisions also established the United States Trustee System (in all states except North Carolina and Alabama, where bankruptcy administrator programs are established)[1106] so that the executive branch would join the judiciary in overseeing cases.

After less than twenty years, a second commission was appointed to study the opportunity of further modifications to bankruptcy laws.

2.6 The Bankruptcy Abuse Prevention and Consumers Protection Act (BACPA)

The Bankruptcy Abuse and Consumer Protection Act[1107] enacted on April 20, 2005 is the most extensive review of the Code up to today. It constituted a direct answer to a widespread concern about abuses in bankruptcy at large, and in consumer bankruptcies in particular.[1108] Following ancient arguments, the feeling was that the protective role of bankruptcy had to be reserved to debtors in real need.

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injury due to crashes that had not occurred yet of the company's pre-bankruptcy airplanes, some of which decades old.

[1101] Debtor in Possession.

[1102] **Tabb Charles J**., "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 35.

[1103] 98 STAT 333.

[1104] 100 STAT. 3088.

[1105] **Tabb Charles J.**, "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 40.

[1106] **Kennedy David S., Clift Spencer R. III**, "*An Historical Analysis of Insolvency Laws and their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and its Judicial Officers*", 9 J. Bankr. L. & Prac. 165 (2000), at 181.

[1107] Public Law 109-8.

[1108] **Sousa Michael D.**, "*Just punch my bankruptcy ticket: a qualitative study of mandatory debtor financial education*", Marquette Law Review, Vol 97, p. 391, (2013), at 402-3.

Moreover, the framework aimed to limit liquidations to cases of great difficulties only. Less critical situations should have been redirected to and solved under reorganizations, in the case of consumer debtors through the use of Chapter 13, hence making debtors more responsible.[1109] Such an approach was supported by fear of the consequences of a persisting raise in the number of bankruptcies, of natural persons in particular, and the consequent escalation in the rate of discharges, many of which were awarded in Chapter 7 cases to debtors with regular income whomcould have paid some part of their debt over time through a repayment plan.

The Act of 2005 limited the access to Chapter 7, under a "presumption of abuse" arising in cases in which a consumer debtor could afford a Chapter 13 reorganization. The evaluation of the capacities of a debtor to undergo a Chapter 13 reorganization were based on a specific test.

Further modifications were made to prevent abuses. The new system attempted to prevent repetitive filings and forum shopping (reducing the availability of exemptions to debtors who would change their domicile to obtain higher benefits). The amendments also made specific counseling aimed to teach, support, and help debtors available and mandatory, in order to reduce the chances that the critical financial conditions like the ones that led to filing would not be experienced again.

3. Bankruptcy law in the U.S. Constitution

3.1 The relevance of the Bankruptcy Clause

A constitution shapes the vital values of a society.[1110]

Including a clause on the issue of insolvencies is a meaningful sign of the importance and impact of this phenomenon-within the community. To what extent the Framers were actually concerned with bankruptcies at the time is a matter of discussion. It is undeniable, though, that the presence of ample discrepancies among the different local statutes was a concern that held consequences similar to the ones experienced in the Italian city-states.[1111] The territorial expansion of the country made it easy for dishonest debtors to escape while the difficulties in recognizing local discharges among states prevented honest ones from obtaining a meaningful fresh start:

> "The great question remained whether action in one state could protect the debtor if he ventured in another state. The Connecticut records for the period show debtors from other states petition for protection from imprisonment while coming to Connecticut, and we have the evidence of the early conflicts cases in the Pennsylvania courts reported in the first volume of Dallas.
> James v. Allen – 1 Dall. 188 (C.P. Phila. County, 1786) – the First case was decided by the Common Pleas Court of Philadelphia County during the September term 1786, only held a year before the opening of the Constitutional Convention in Philadelphia. In issue was the effect in Pennsylvania of an order for release from imprisonment by a New Jersey Court. The Common Pleas Court rules that the order had no effect outside of New Jersey. Millar v. Hall (1 Dall. 229 (Sup. Ct. Pa. 1788)), the other case, was pending in the Supreme Court of Pennsylvania at the time of the Constitutional Convention and was decided during the January term 1788. Here a discharge from debt granted in Maryland was involved. It can be assumed that law members of the Convention – and the Convention had many – were familiar with these problems."[1112]

[1109] *Id.*

[1110] Supremacy Clause of the Constitution, Article IV, Clause 2: "This Constitution, and the laws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any State to the contrary notwithstanding."

[1111] See **Kurt H. Nadelmann,** "*On the Origin of the Bankruptcy Clause - The American Journal of Legal History",* Vol. 1, No. 3 (Jul., 1957), at 215-228.

[1112] *Id.*, 224-5.

Creating uniform laws on this topic would help, therefore, in supporting and fostering trade, easing the burdens on interstate commerce.[1113] The task of designing a whole new system which could be efficient, effective, and uniformly adopted, though, was a great challenge. A uniform (federal) regulation had to pursue its goals while balancing several, often irreconcilable, policies; ultimately, every single step made on the way towards the modern Code has been derived from mediation; when one interest would win, others would inevitably lose. This was true both at state and federal level.

No corner of our society seems immune from the ubiquitous reach of bankruptcy[1114] and all must be accounted for in structuring a new model. The new regulations had to be aware and effectively balance the interests of debtors and creditors; of farmers and industries; of companies and natural persons; of businessmen and employees; of states and of the national government; of local, national, and international regulations, just to mention a few. In this chapter we analyze several such conflicts and the solutions that have been adopted in the US. Some, as we have already discussed, are unique and have become a model to follow at the international level.

In this section we will briefly focus on some of the difficulties met in making bankruptcy regulations fit within the whole framework. Bankruptcy had to find its place, coordinating itself within the federal system and with states' statutes. Determining how broadthe power granted by the Constitution was to operate and write the new law became itself the subject of infinite debates.[1115]

The process took time and caused, as we will see in the next sections, some relevant conflicts.

3.2 The necessary balance between state and federal regulations in bankruptcy

It is first of all worth mentioning that the states never ceased to be a relevant part of the bankruptcy picture. The core of insolvency regulations, and their ample reach, leads them inevitably to interact with a great number of other laws and also with local rules. Although federal frameworks were successfully imposed, full uniformity could not be achieved.

Even today, as we will discuss in the next pages, relevant aspects of the Bankruptcy Code are indissolubly bound to state statutes. Although the differences among local solutions cause consequences such as forum shopping, this process is inevitable. Even today, full uniformity cannot be achieved and cooperation at the local and federal level is absolutely necessary.

This point is particularly relevant to the process of refounding European insolvency regulations. It proves that enacting a “superior” regulation binding on local entities does not ensure that full uniformity can be achieved at a local level. This is true even in a setting such as the early American one, where society was a clean slate that would be easier to shape than the complex European one.[1116]

3.3 Constitutional conflicts

Conflicts, of course, arise naturally among different components of the federal system as well.

In the United States, debates focused on conflicts between the Bankruptcy Code and:

- the Fifth Amendment[1117];
- the Sixth Amendment;
- the Seventh Amendment;
- Article III of the Constitution.

The last case is of particular relevance to our study and will be discussed in greater depth in the next section; we will now briefly mention some of the core aspects of the first three cases.

[1113] **Mann Bruce H.**, “*Bankruptcy in the Age of American Independence*”, Harvard University Press, London, ISBN 9780674032415, (2002).

[1114] **Tabb Charles J**., "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 5.

[1115] **Kurt H. Nadelmann,** “*On the Origin of the Bankruptcy Clause - The American Journal of Legal History”,* Vol. 1, No. 3 (Jul., 1957), at 227-8.

[1116] **Martin Nathalie**, “*The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: the Perils of Legal Transplantation*”, 28 B.C. Int’l & Comp. L. Rev. 1, (2005).

[1117] See **Peyton Gaumer Craig, Nail Charles L. Jr.**, "*Truth or Consequences: the Dilemma od Asserting the Fifth Amendment Privilege Against Self-Incrimination in Bankruptcy Proceedings*", 76 Neb. L. Rev. 497, (1997).

Three main aspects of the Fifth Amendment have been at the root of much debate in bankruptcy: "eminent domain" with regard to the seizure of property and just compensation; "double jeopardy" ("*ne bis in idem*"); and the prohibition against self incrimination.

Bankruptcy is "all about the property". It is not difficult to imagine how constitutional provisions to protect individuals from the seizure of property may conflict with organized procedures that are rooted in the collection of property necessary to repay debts. Creditors too, at the same time, find themselves often dispossessed of specific items or rights to pursue the goal of an organized distribution, which may reward some and damage others.[1118] This issue arose in relevance in the early stages of evolution of bankruptcy statutes through the various attempts to discipline the field and balance the impact of individual rules when proposed or enacted statutes and amendments would not ensure enough protections.[1119] In modern times, most debate concerns bankruptcy crimes.[1120]

Conflicts with regard to the Fifth Amendment may arise also in connection with double jeopardy. Although we have analyzed how US statutes have evolved into a less stigmatizing and oppressing framework, bankruptcy can still be harsh at times. The interests at stake demand high care in the administration of cases, which remain at continuous risk of frauds. Defendants in criminal cases have argued that civil punishments awarded within the bankruptcy system, such as conversion of reorganization cases to a Chapter 7 liquidation or deprivation of discharge, would shield them from further criminal sanctions.[1121]

The Sixth Amendment concerns attorney-client privileges, i.e. the protection of confidential information. The modern bankruptcy framework relies heavily on attorneys to assist their clients effectively but also to supervise them in the interest of the system. BAPCPA amendments have imposed heavier burdens on attorneys to ensure the veracity and reliability of documents filed with court during different phases, such as the filing of schedules and the valuation of assets. Hence, conflicts may arise with clients.

The Seventh Amendment concerns the right to jury trials in civil cases. In the U.S., such a right is considered a protection. Over time, positions on the topic have shifted; the main issue to address was if bankruptcy court would be considered purely a court of equity in which jury trials cannot be allowed.[1122] Nowadays, the debate has been solved in favor of the admissibility of such trials, at the least in some aspects of the proceeding, although they remain extremely rare: Section 157 (e) of Title 28 of the U.S. Code states that:

> "If the right to a jury trial applies in a proceeding that may be heard under this section by a bankruptcy judge, the bankruptcy judge may conduct the jury trial if specially designated to exercise such jurisdiction by the district court and with the express consent of all the parties."

We will discuss conflicts between Article I and III of the US Constitution in the next section, which will include a general overview on the evolution of the American Bankruptcy Court system. The topic is addressed by the World Bank's Principles in Part D. We will, though, analyze it first so that it can be tied to our historical overview and to what we have just mentioned on conflicts within the US system in general.

[1118] In Chapter 11, for example, a debtor in possession has a right to continue using property that is necessary for the accomplishment of the plan.

[1119] **Tabb Charles J.**, "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 49-50.

[1120] See on the topic: **Gewerts Nevin M**., "*Act or Asset? Multiplicitous Indictments Under the Bankruptcy Fraud Statute"*, 18 USC § 152", 76 U. Chi. L. Rev. 909, (2009)

[1121] **Peyton Gaumer Craig**, "*Bankruptcy Remedies and Double Jeopardy*", 17 Am. Bankr. Inst. J. 10, (1998).

[1122] **Katchen v. Landy**, 382 U.S. (1966); Stern v. Marshall, 131 S. Ct. 2594 (2011), see also on this topic **Granfianciera, S.A. v. Nordberg**, 492 U.S. (1989); Langenkamp v. Culp, 428 U.S. 42 (1990).

4. The evolution of bankruptcy courts in the United States

Bankruptcy judges, through their experience on the field and reliability, guarantee impartial supervision and contribute to the functioning and trustworthiness of an incredibly complex "machine".[1123] As Professor Charles Tabb stated:

> "No corner of our society seems immune from the ubiquitous reach of bankruptcy."[1124]

Contracts, successions, crimes, etc., can all have relevant effects in proceedings. Bankruptcy courts are, then, called to decide a vast variety of matters and to ensure that cases can move forward in a swift, fair, and organized manner. The obstacles that are caught in the cogs of this complex system can cause delays and consequences.

The existence and effective and efficient functioning of bankruptcy courts is of critical importance to a framework that is worth billions in assets in with massive, high-stakes litigations. It is important to mention, in fact, that in the United States, out of a total of about 2,4 million cases filed yearly in federal courts, about eighty percent are connected to bankruptcies.[1125] This is therefore the most onerous field of law at the federal level.

The evolution of bankruptcy courts in the US, though, has followed somehow surprising steps.

The American bankruptcy system, as we will discuss in the next pages, ran for over a century (up until the seventies) in the absence of judges directly supervising cases. Moreover, the powers of American bankruptcy courts were limited and derivative of federal district courts. This structure was considered imperfect, but reforming it has proven difficult and has caused conflicts that have risked paralyzing the entire system.

4.1 The evolution of the American bankruptcy court system until the enactment of the Code of 1978

The American bankruptcy court system has been running for almost two centuries in the absence of specialized bankruptcy judges. Their functions were, in fact, reserved to "adjuncts" and "units" of federal district courts, who enjoyed limited authority. With the passing of time their relevance grew, although issues and conflicts on the powers of bankruptcy judges, as we will discuss, still remain today.

Ever since the enactment of the first federal bankruptcy act in 1800, all relevant bankruptcy powers remained embodied in federal district court judges who were authorized to appoint adjuncts, at the time called bankruptcy commissioners, to assist with mostly administrative functions. Commissioners were good and substantial individuals, although in practice they did not need to be judges per se, or even to be trained in law for that matter. They mostly were politically-connected lawyers or merchants[1126] appointed to work on a particular case. They did not enjoy a permanent status, although the aid of commissions was of common use (maybe a sign here of the early reluctance of district courts to get involved in bankruptcy matters).

District judges retained the power to award discharges and would become part of the proceeding in numerous occasions. Commissioners were authorized to perform administrative functions such as:

- exercising the power to have the bankrupt arrested;
- taking possession and appraising a bankrupt's property;
- notifying the public of the bankruptcy;
- scheduling a meeting of creditors;

[1123] **Samahon Tuan**, "*Are Bankruptcy Judges Unconstitutional? An Appointments Clause Challenge*", 60 Hastings L.J. 233 (2008), at 234.

[1124] **Tabb Charles J**., "*The History of the Bankruptcy Laws in the United States*", 3 Am. Bankr. Inst. L. Rev. 5 (1995), at 50.

[1125] www.uscourts.gov/cgibin/cms2005.pl

[1126] **Samahon Tuan**, "*Are Bankruptcy Judges Unconstitutional? An Appointments Clause Challenge*", 60 Hastings L.J. 233 (2008), at 237; **Mann Bruce H**., "*Bankruptcy in the Age of American Independence*", ISBN 9780674032415, (2002), at 225.

- taking evidence of the validity of debts;
- summoning and examining witnesses under oath.[1127]

However, they had limited adjudicative functions, which they could exercise exclusively with substantial judicial oversight. Commissioners "made all important initial determinations of whether the debtor was actually "bankrupt""[1128]; but the debtor could demand a jury trial before a district judge on the issue, just like creditors could demand judicial oversight on a commissioner's decision valuating their claims.

In 1841, Congress passed a new bankruptcy act (a short-lived one, as we have already mentioned, which was repealed already in 1843), delegating to district courts original jurisdiction on all bankruptcy proceedings together with the power to appoint bankruptcy "Commissioners and Assignees".

Not much changed till the Act of 1867, which referred, for the first time, to district courts as "constituted courts of bankruptcy", granting original jurisdiction on all bankruptcy matters and authorizing for the appointment of "Registers in Bankruptcy"[1129]. Although they enjoyed no safeguards against removal, registers were appointed on standing.[1130] They:

- received the bankrupt's property;
- administered oaths;
- presented at meetings with creditors;
- received the proofs of claim;
- generally handled uncontested matters and the administrative business of bankruptcy.

Registers in Bankruptcy could not decide, though, any legally or factually disputed issue.

In 1898, it was the time for the appointment of "referees" who enjoyed lengthier terms than their predecessors and wider powers; they were the first group of bankruptcy adjuncts to be required to have legal training.[1131] They were vested with "summary jurisdiction" (jurisdiction over controversies involving property in the actual or constructive possession of the Court) and with consent also on some plenary matters such as disputes involving property in possession of a third person.

The process of reform that started in 1973 culminated with the Bankruptcy Reform Act of 1978, which finally renamed the "referees" to "judges" (Bankruptcy Rule 901 (7)).[1132] The act established, under the reformed 28 U.S.C. § 151:

> "(a) There shall be in each judicial district, as an adjunct to the district court for such district, a bankruptcy court which shall be a court of record known as the United States Bankruptcy Court for the district.
> (b) Each bankruptcy court shall consist of the bankruptcy judge or judges for the district in regular active service. Justices or Judges designated and assigned shall be competent to sit as judges of the bankruptcy court.
> (c) Except as otherwise provided by law, or rule or order of court, the judicial power of a bankruptcy court with respect to any action suit or proceeding may be exercised by a single bankruptcy judge, who may preside alone and hold a regular or special session of court at the same time other sessions are held by other bankruptcy Judges."

With this major reform, judges in bankruptcy courts were appointed to office by the President and confirmed by the U.S. Senate for fourteen-year terms[1133], subject to removal by the judicial council of the

[1127] **Samahon Tuan**, "*Are Bankruptcy Judges Unconstitutional? An Appointments Clause Challenge*", 60 Hastings L.J. 233 (2008), at 238.
[1128] **Mann Bruce H.**, "*Bankruptcy in the Age of American Independence*", ISBN 9780674032415, (2002), at 225.
[1129] **Hermes Grant**, "*A uniform Federal Judiciary enables Bankruptcy Courts to bring relief to debtors and creditors*", 34 Whittier L. Rev. 261, at 267.
[1130] **Samahon Tuan**, "*Are Bankruptcy Judges Unconstitutional? An Appointments Clause Challenge*", 60 Hastings L.J. 233 (2008), at 239.
[1131] Id., at 240.
[1132] **Northern Pipeline Construction Company v. Marathon Pipe Line Company**, 458 U.S. 50 (1982).
[1133] **Wilson Steven H.**, "*The U.S. Justice system: law and Constitution in early America*", Volume 1, ISBN 1598843044, 9781598843040, ABC-CLIO publisher, (2012), at 1075.

circuit on account of "incompetency, misconduct, neglect of duty or physical or mental disability".[1134] In addition, the salaries of bankruptcy judges were set by statute and subjected to adjustment under the Federal Salary Act.[1135]

The powers granted to bankruptcy judges were, therefore, much broader than those exercised in the former referee system, eliminating the distinction between "summary" and "plenary" jurisdiction. The Code, at the time, granted courts jurisdiction:

- over all "civil proceedings arising under Title 11 or arising in or related to cases under Title 11"[1136];
- to hear claims based on state law as well those based on federal law;
- the powers of a court of equity, law, and admiralty, with an exception: "they could not enjoin another court or punish a criminal contempt not committed in the presence of the judge of the court or warranting a punishment of imprisonment"[1137];
- the power to hold jury trials[1138];
- to issue declaratory judgments[1139];
- to issue, under certain circumstances, writs of habeas corpus[1140];
- to issue all writs necessary in aid of the bankruptcy court's expanded jurisdiction[1141];
- to issue any order or judgment necessary or appropriate to carry out the provisions of Title 11.[1142]

The new status quo, though, raised several concerns and caused constitutional conflicts.

4.2 Constitutional issues in the reform of 1978

The structure of bankruptcy courts as conceived and enacted in the seventies was consistent with the goals of efficiency and effectiveness of the new system and constituted a meaningful answer to the necessity of having a competent, specialized judiciary who could face the depth, variety, and complexity of bankruptcy issues. The reformed framework was also practical, given the number of cases that were filed.

Conflicts, though, arose at the constitutional level. The U.S. Congress is empowered to create certain specialized courts or agencies and such authority derives directly from its enumerated powers combined with the "necessary and proper" clause.[1143] The capacity to create and organize a system of bankruptcy courts could be considered analogous to the one of creating military or tax courts (stemming respectively from the enumerated powers to set up an army and a navy[1144] or to collect and impose taxes), and a necessary part of the power granted in the Bankruptcy Clause. In the end, without bankruptcy courts the whole bankruptcy system would be impossible to operate and the power to establish rules in this field of law would not have any effect.

At the same time, though, Section I of Article III of the Constitution clearly states that:

> "The judicial power of the United States, shall be vested in one Supreme Court, and in such inferior courts as the Congress may from time to time ordain and establish. The judges, both of the supreme and inferior courts, shall hold their offices during good behavior, and shall, at stated times, receive for their services, a compensation, which shall not be diminished during their continuance in office."

[1134] § 153 (b) (1976 ed.).
[1135] 2 u.s.c. §§ 351-361 (1976 ed.); 28 USC § 154 (1976 ed.). The term of 14 years, the causes for removal, and the salary system remain largely unaltered today.
[1136] 28 usc § 1471 b (1976 ed. , Supp. IV).
[1137] 28 usc § 1481 (1976 ed. , Supp. IV).
[1138] 28 U.S.C. § 1489.
[1139] 28 U.S.C. § 2201.
[1140] 28 U.S.C. § 2256.
[1141] 28 U.S.C. § 451.
[1142] 11 u.s.c. § 105(a) (1976 ed. , Supp. IV).
[1143] **American Insurance Co. V Canter**, 26 U.S. (1 Pet.) 511 (1828).
[1144] U.S. Const art. I § 8 cl. 14.

Congress could not, therefore, create a separate court system vested with the same status and privileges granted by Article III. The powers of bankruptcy judges had to remain limited and derivative of the ones of the district court of which they had been units[1145] for over 150 years.

With the enactment of the Bankruptcy Code in 1978, the process of reform went too far in granting ample decisional powers to bankruptcy courts and was, therefore, challenged.[1146] In the landmark case *Northern Pipeline Construction Co. v. Marathon Pipe Line Co*[1147], the Supreme Court held that the grant of such broad powers unconstitutional. The ruling weakened the 1978 Act's efforts to reform the bankruptcy process. In order to prevent an unprecedented crisis of the system, and to give Congress time to make the necessary modifications in the bankruptcy law, the Supreme Court stayed the effects of its decision until October 4, 1982.

When Congress failed to meet the deadline, the Supreme Court extended it further, showing the critical importance of the matter and its potentially devastating effects on the economy. During the interim period, to prevent the whole system from collapsing, the Judicial Conference of the United States enacted an emergency rule reinstating the previous bifurcated framework, dividing jurisdiction between district courts and bankruptcy courts. A final answer came only in 1984, with the enactment of the necessary amendments (Bankruptcy Amendments and Federal Judgeship Act, 98 STAT. 333) dealing with jurisdiction and venue; confirming the role of bankruptcy judges as units and introducing a distinction between "core" and "noncore" matters, granting the capacity of entering final decisions on the former.

The "superpowers" included in the 1978 Act, in any case, lasted only a few years and could not be confirmed.

4.3 Bankruptcy Courts today

Section 28 U.S.C. § 157, today, reads as follows:

> "**(a)** Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.
> **(b) (1)** Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title.
> **(2)** Core proceedings include, but are not limited to **(A)** matters concerning the administration of the estate; **(B)** allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under Chapter 11, 12, or 13 of title 11but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11; **(C)** counterclaims by the estate against persons filing claims against the estate; **(D)** orders in respect to obtaining credit; **(E)** orders to turn over property of the estate; **(F)** proceedings to determine, avoid, or recover preferences; **(G)** motions to terminate, annul, or modify the automatic stay; **(H)** proceedings to determine, avoid, or recover fraudulent conveyances; **(I)** determinations as to the dischargeability of particular debts; **(J)** objections to discharges; **(K)** determinations of the validity, extent, or priority of liens; **(L)** confirmations of plans; **(M)** orders approving the use or lease of property, including the use of cash collateral; **(N)** orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate; **(O)** other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and **(P)** recognition of foreign proceedings and other matters under Chapter 15 of title 11.

[1145] 28 U.S.C. § 1334.
[1146] 28 U.S.C. § 152 (2000).
[1147] **Northern Pipeline Construction Company v. Marathon Pipe Line Company**, 458 U.S. 50 (1982).

> **(3)** The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11. A determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.
> **(4)** Non-core proceedings under section 157(b)(2)(B) of title 28, United States Code, shall not be subject to the mandatory abstention provisions of section 1334(c)(2).
> **(5)** The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending.
> **(c) (1)** A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected. **(2)** Notwithstanding the provisions of paragraph (1) of this subsection, the district court, with the consent of all the parties to the proceeding, may refer a proceeding related to a case under title 11 to a bankruptcy judge to hear and determine and to enter appropriate orders and judgments, subject to review under section 158 of this title.
> **(d)** The district court may withdraw, in whole or in part, any case or proceeding referred under this section, on its own motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce.
> **(e)** If the right to a jury trial applies in a proceeding that may be heard under this section by a bankruptcy judge, the bankruptcy judge may conduct the jury trial if specially designated to exercise such jurisdiction by the district court and with the express consent of all the parties."

Bankruptcy judges are, therefore, appointed by the Court of Appeals of the United States for the circuit in which such a court is located and not by the President. They continue serving for terms of fourteen years rather than having life tenure. Most notably, they may be removed for motives that are not exclusively bound to the process of impeachment[1148]:

> "A bankruptcy judge may be removed during the term for which such bankruptcy judge is appointed, only for incompetence, misconduct, neglect of duty, or physical or mental disability and only by the judicial council of the circuit in which the judge's official duty station is located. Removal may not occur unless a majority of all of the judges of such council concur in the order of removal. Before any order of removal may be entered, a full specification of charges shall be furnished to such bankruptcy judge who shall be accorded an opportunity to be heard on such charges"

The discussion on the limits of powers granted to bankruptcy judges is ongoing and some relevant chapters are being written even today. In 2011, for example, in the case *Stern v. Marshall*[1149], the Supreme Court ruled that it was unconstitutional for Congress to award bankruptcy courts the power to rule on some state law counterclaims by including them among the core issues.

As discussed in the introduction to this section, despite the compromises that have been necessary in the process of their formation, bankruptcy courts today supervise a higher number of cases than any other

[1148] 28 U.S.C. 151 (e).
[1149] ***Stern v. Marshall***, 564 U.S. 462 (2011).

field of federal law.[1150] Bankruptcy judges are not mere judicial pawns, but the knights of the judicial hierarchy; their role is key in the effective functioning of the whole system. The World Bank's Principles are correct in awarding great relevance to this area, structuring measures to ensure that courts can operate successfully, that they can inspire trust in all interested parties and society, and contribute to solving complex matters that hold great relevance for an economy.

5 The U.S. Bankruptcy Code today[1151]

5.1 Introduction

Through our brief historical overview of the evolution of US bankruptcy statutes, we have had a chance to observe how, in the beginning, the approaches adopted by American models did not differ greatly from European ones. Stigma was heavily present also in the "new" continent. Early American statutes originally did not even include the possibility for a case to be commenced voluntarily[1152], and criminal punishments were harsh.

As laws and society evolved, though, things changed radically.

In the next pages, we will discuss several topics of great relevance for the modern European scenario. The structure of the American Bankruptcy Code is complex and the tools contained therein are deeply interconnected. The Union has attempted to replicate the good results obtained in the US by cherry-picking rules and approaches which were then applied (or transplanted at a local level) through the refoundation of its systems.

We will continue our analysis in this chapter, examining the structure of the Code and some of its most relevant aspects, such as:

- granting ample access to great numbers of debtors (business and non-business ones);
- protecting society from abuses;
- making reorganizations the preferred proceeding to solve insolvency-related issues;
- supporting fresh starters and granting discharges.

We will try to gain a better understanding of how this inspiring model works, of some of its weaknesses, and of what may go wrong in transplanting it (if that is even possible) into different scenarios and societies.

5.2 The commencement of cases

5.2.1 Voluntary filings

In the United States, nowadays, bankruptcy is made available voluntarily, even jointly[1153], to a great number of debtors facing a variety of degrees of financial difficulties. Being a modern debtor under the Code, in fact, does not require being insolvent[1154]:

[1150] **Hermes Grant**, "*A uniform Federal Judiciary enables Bankruptcy Courts to bring relief to debtors and creditors*", 34 Whittier L. Rev. 261, at 272. Total filings have declining for years but, recently, they seem to be growing again.

[1151] For an overview on this topic see: **Warren Elizabeth**, "*Bankruptcy and Article 9 – Statutory Supplement*", Wolters Kluwer, New York, ISBN, 978145894599, (2018); **Blum Brian A.**, "*Bankruptcy and Debtor/Creditor*", Sixth Edition, Wolters Kluwer Law & Business, New York, ISBN 9781454833918, (2014); **Warren Elizabeth**, **Westbrook Jay M.**, **Porter Katherine**, **Pottow John**, "*The law of debtors and creditors – text, cases and problems*", Seventh Edition, Wolters Kluwer Law & Business, New York, ISBN 9781454822387, (2014); **Eisenberg Theodore**, "*Bankruptcy and Debtor-Creditor Law – cases and materials*", fourth edition, Foundation Press, New York, ISBN 9781599414362, (2011). For the relevant topics connected to the topic of secured transactions see: **LoPucky Lynn M.**, **Warren Elizabeth**, **Lawless Robert M.**, "*Secured Credit a systems approach*", Eight Edition, Aspen Publishers, New York, ISBN 978-1454857938, (2015).

[1152] Although such obstacle could be circumvented if necessary. When it was deemed convenient or necessary to do so, cunning debtors would avail themselves of the aid of a "friendly" creditor (holding a pre-existing claim or creating, first, a debt exclusively for such purpose) to file and commence the case in lieu of them. **Mann Bruce H.**, "*Bankruptcy in the Age of American Independence*", Harvard University Press, London, ISBN 9780674032415, (2002).

[1153] Natural persons are allowed to file jointly at will under Section 302 as long as they are married and they are both eligible under the Chapter of election (joint filing is not allowed in involuntary cases where each case has to be filed separately). Exceptions apply, in fact, in case filing occurs under Chapter 12, in which case each spouse must meet the requirements to be eligible under the Chapter. The same is true also for Chapter 13 with a further restriction: in order

> "One of the most notable features of United States bankruptcy law is the relative ease with which a debtor can invoke the protection of the bankruptcy court. Typically, the debtor need do no more than pay the appropriate filing fee and sign the petition. The debtor need not be insolvent, and in fact, there has been substantial doubt on this issue in some of our best-known bankruptcies." [1155]

Agreements among parties to renounce one's right to file for bankruptcy not permitted.[1156]

Centuries of stigmatization and of identification of "acts of bankruptcy" have become to a certain degree irrelevant.[1157] Nowadays a debtor is not bound to have reached such a level of financial distress as to be in irreparable danger in order to access the remedies offered in the Code. Bankruptcy has become available to any eligible petitioner that may deem it useful or beneficial to him and to its creditors.

Insolvency in the Code continues to be present and has not been completely deleted, but it preserves a mostly residual relevance.[1158] Its limited function remain mainly detectable in involuntary cases, which will be discussed more in depth in the following pages.

Different eligibility requirements apply. Some are general for all petitioners, others are specific, depending on the Chapter a debtor wishes (or is statutorily required) to file under. If, in fact, bankruptcy is made amply available, all debtors do not necessarily follow the same path towards a much-desired fresh start.

To access bankruptcy relief the Code requires a debtor to be, first of all, a "person"[1159] (an individual, a partnership, or a corporation) as defined in section 109 (a). Not all debtors can, therefore, apply for the commencement of a proceeding under Title 11. The securities industry, for example, finds specific regulations in the Securities Investors Protection Acts. Estates[1160] and non-business trusts[1161] also cannot be

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to file, neither the husband nor the wife may be a stock or commodity broker. Joint filing in general allows the couple to save half the filing expenses. Such a choice may be beneficial also upon electing exemptions. Limitations apply and only a legally married couple can file jointly. In case the couple lives together in a state that does not give legal value to common law marriages, for example, it will be necessary to file two separate petitions and successively ask for them to be joined. See **In re Lucero** (BC CD CA 2009) 408 BR 348, 350.

[1154] § 109, for example, does not include insolvency as a requirement. See also **In re Marshall** (CD CA 2009) 403 BR 668, 684-685. Although filing when not in debt may be seen as an abuse of the system and result in dismissal of the case.

[1155] See **Picker Ronald C**., "*Voluntary Petitions and the Creditor's Bargain*", 61 University of Cincinnati Law Review 519, (1992), at 519.

[1156] **In re Adana Mtg. Bankers, Inc.**, 12 B.R. 989 (Bankr. N.D. Ga. 1981).

[1157] The insolvency requirement is mentioned in § 109 (c) for municipalities but not for "persons" in § 109 (a).

[1158] The term "insolvent" is defined by the code in § 101 (32). Section 109 entitled "Who may be a debtor" mentions insolvency in point (c) (3) in connection with Chapter 9 limiting it to Municipalities. Chapter 9 is very specific in its focus and is not of main interest to our discussion, hence we will assume in general in the rest of our discussion that being insolvent has lost, within the American system, the unique features that make it still relevant in the European context.

[1159] The term "person" is defined in § 101 (41): "the term "person" includes individual, partnership, and corporation, but does not include governmental unit, except that a governmental unit that (A) acquires an asset from a person (i) as a result of the operation of a loan guarantee agreement; or (ii) as receiver or liquidating agent of a person; (B) is a guarantor of a pension benefit payable by or on behalf of the debtor or an affiliate of the debtor; or (C) is the legal or beneficial owner of an asset of (i) an employee pension benefit plan that is a governmental plan, as defined in section 414(d) of the Internal Revenue Code of 1986; or (ii) an eligible deferred compensation plan, as defined in section 457(b) of the Internal Revenue Code of 1986 shall be considered, for purposes of section 1102 of this title, to be a person with respect to such asset or such benefit." As such a person is included in the term "entity" defined in § 101 (15) as: "The term 'entity' includes person, estate, trust, governmental unit and United States trustee".

[1160] See **In re Estate of Witheside** 64 B.R. 99 (Bankr. E.D. Cal. 1986).

[1161] See **Hunt v TRC Properties, Inc (In re Hunt),** 160 B.R. 131 (B.A.P. 9th Cir 1993); **In re Mortgage Banking Trust**, 2008 Bankr. LEXIS 2238 (Bankr. D Md. July 23, 2008). Trusts aimed to solely maintain the "trust res" in favor of beneficiaries will not be considered in most cases business trusts, **In re Treasure Island Land Trust** (BC MD FL 1980) 2 BR 332, 334, and testamentary trusts are not eligible for bankruptcy either, **Matter of Walker** (BC MD FL 1987) 79 BR 59, 62.

debtors under the Code[1162] (while trusts created for profit and pursuing business activities are business trusts under § 101 and therefore eligible for bankruptcy relief[1163]).

In order to be eligible, petitioners must have contacts or a "nexus" to the United States. A debtor does not have to be a citizen; the only requirement is to have a domicile, a place of business, or hold property in the US.[1164]

Interestingly enough, "having a domicile, a residence, a place of business or property located in the US" makes filing possible for a variety of debtors such as aliens and undocumented immigrants in financial distress, who are traditionally barred from seeking most forms of assistance available to citizens.[1165] Moreover, the Code does not set a "minimum value" requirement regarding the property that may be possessed within the US[1166]. This, combined with the debtor-friendly nature of American bankruptcy, law may be a temptation for foreigners who, by meeting the relatively loose "domicile" requirements, may manage to take advantage of a more benevolent bankruptcy structure than the one available under other jurisdictions.[1167] [1168]

Upon filing under any of the available Chapters, a petitioner must also comply with some formalities, such as paying the requested fees[1169] (the costs of bankruptcy, as we will see in the next pages, vary depending on the Chapter of election[1170]), a much-debated topic that impacts both voluntary and involuntary bankruptcy deeply; and completing the necessary forms in good faith.[1171] Such forms, which include details on available assets and debts, are very important; partial or erroneous completion may cause the dismissal of the case.

Completing the voluntary procedure with the clerk of the bankruptcy court constitutes an "order for relief" under the Chapter for which the petition was filed. As we will discuss in the next sections, this creates a "debtor's estate" that absorbs all of debtor's assets and will be protected by an automatic stay preventing individual actions.

Creditors still have standing to petition the case to be dismissed or converted to a different Chapter; the burden will be on the debtor to prove that such a petition should not be granted.[1172] If a debtor makes a mistake in filing, the Court retains jurisdiction and may either dismiss the case or convert it under the appropriate Chapter.[1173] Difficulties may arise in those cases in which the mistake is made by a couple filing jointly under Chapter 12 or 13 without meeting the necessary statutory requirements, for the petition shall be dismissed and will have to be eventually re-filed individually by the one allowed to under the Code.

[A] Preventing abuses in the system

[1] Duties imposed on filing debtors

[1162] Municipalities defined under § 101 (40) can file under Chapter 9 only upon being insolvent. See § 109 (c).

[1163] See **Brady-Morris v. Schilling (In re Kenneth Allen Knight Trust)**, 303 F.3d 672, 676 (6th Cir 2002).

[1164] Bankruptcy Code 109 (a) "Notwithstanding any other provision in this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title".

[1165] See on this topic **Ondersma Chrystin**, "*Undocumented Debtors*", 45 U. Mich. J.L. Reform 517 (2012) at 517-561.

[1166] "There is no statutory requirement as to the property's minimum value". See **In re Paper I Partners**, L.P. 283 B.R. 674; fraudulent or dishonest attempts to place property in the US to take advantage of US bankruptcy laws have not been allowed; though **In re Yukos Oil Co.** (BC SD TX 2005) 321 BR 396, 406-407, 411-412, and courts may decide to abstain or dismiss the case upon finding an abuse is being committed.

[1167] See **In re Global Ocean Carriers Ltd**. (BC D DE 2000) 251 BR 31, 39 as an example of a foreign corporation allowed to file under the Code, and, **In re Yukos Oil Co.** (BC SD TX 2005) 321 BR 396, 406-407, 411-412 for a case in which such a possibility was denied due to the fact that the nexus with the United States had been created exclusively to "create" jurisdiction.

[1168] The Code does not include age requirementsm hence implying that even a minor may be a petitioner. See on the topic: **Warren Elizabeth**, "*Bankrupt Children*", 86 Minn. L. Rev. 1003, (2002).

[1169] Changes have been made in 2005 and courts are now allowed to support indigent individuals, waiving the fees.

[1170] Bankruptcy Code § 301; see Fed. R. bankr. P. 1002 (a) In the appropriate Federal Court (district of domicile, residence, principal place of business or place where assets are situated) 28 USC § 1408(1).

[1171] The forms are mandatory (and numerous). Since they are a relevant part of the petition, it is of absolute importance for a petitioner to make sure that all forms are updated and filed correctly. See FRBP 9009.

[1172] **Matter of Morgan Strawberry Farm** (BC MD FL 1989) 98 BR 584, 585.

[1173] **In re Wenberg** (9th Cir. 1990) 902 F2d 768.

The Code is strict in imposing requirements on debtors upon filing. Non-compliance can be reason for dismissal of the case.[1174]

§707 (a) includes three main enumerated grounds for dismissal "for cause":

> **"(a)** the court may dismiss a case under this Chapter only after notice and a hearing and only for cause, including:
> **(1)** Unreasonable delay by the debtor that is prejudicial to creditors;
> **(2)** Nonpayment of any fees or charges required under Chapter 123 of title 28; and
> **(3)**failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521(a), but only on a motion by the United States Trustee."

Moreover, § 521 (i) adds that:

> "(i)(1)Subject to paragraphs (2) and (4) and notwithstanding section 707(a), if an individual debtor in a voluntary case under Chapter 7 or 13 fails to file all of the information required under subsection (a)(1) within 45 days after the date of the filing of the petition, the case shall be automatically dismissed effective on the 46th day after the date of the filing of the petition.
> (2)Subject to paragraph (4) and with respect to a case described in paragraph (1), any party in interest may request the court to enter an order dismissing the case. If requested, the court shall enter an order of dismissal not later than 7 days after such request.
> (3)Subject to paragraph (4) and upon request of the debtor made within 45 days after the date of the filing of the petition described in paragraph (1), the court may allow the debtor an additional period of not to exceed 45 days to file the information required under subsection (a)(1) if the court finds justification for extending the period for the filing.
> (4)Notwithstanding any other provision of this subsection, on the motion of the trustee filed before the expiration of the applicable period of time specified in paragraph (1), (2), or (3), and after notice and a hearing, the court may decline to dismiss the case if the court finds that the debtor attempted in good faith to file all the information required by subsection (a)(1)(B)(iv) and that the best interests of creditors would be served by administration of the case."

[2] The "good faith" in filing requirement

To be eligible to file voluntarily, the Code requires petitions to be filed in "good faith".[1175]

The application of the "good faith requirement" has been, over time, the object of much litigation and modifications of the law contained in the different drafts of the bankruptcy acts.[1176] As we have been discussing in previous sections, honesty in the past was not an issue, for debtors were assumed to be dishonest criminals and they were even prevented from filing for bankruptcy voluntarily; nowadays it has become a topic of great relevance in the process, aimed to find a more effective balance among the interests of debtors and creditors.[1177] This requirement is explicitly set forth by Congress[1178] in Chapters 7[1179], 11[1180], 12[1181], and 13.[1182]

[1174] The official forms required for filing can be found online and they are often revised, so it is necessary to pay great care to avoid the dismissal of the case due to silly mistakes:
http://www.uscourts.gov/forms/bankruptcy-forms

[1175] § 1112 (b).

[1176] See **Kimlinger Katie T**; **Wassweiler William P**., "*The good faith fable of 11 U.S.C. § 707 (a): how bankruptcy courts have invented a good faith filing requirement for Chapter 7 debtors*", 13 Bankr. Dev. J. 61, (1996).

[1177] *Id*., at 62.

[1178] *Id.,* at 63.

[1179] § 707 (b). See **In re Kelly**, 841 F.2d 908 (9th Cir. 1988).

[1180] §1129 (a) (3).

[1181] §1225 (a) (3).

[1182] §1325 (a) (3).

The great relevance given to this matter in the reorganization Chapters will be discussed in the pages that analyze the different reorganization and rehabilitation options available within the Code. It can be briefly mentioned, though, that each Chapter provides debtors with great benefits as long as they cooperate honestly. Plans are to be filed in good faith, subject to harsh consequences in case of violations. All such rules attempt to prevent abuses and to ensure that the system can be trusted.

On the topic of liquidations: §707, which lists causes of dismissal (or conversion) of a case, was amended in 1984 to include § 707 (b), which applies primarily to consumer debtor cases and will be therefore discussed in greater detail in a later part. We can briefly anticipate here that the new section aims to prevent "abuses"[1183] perpetrated by all those creditors that would seek a quick, "easy" discharge under Chapter 7 liquidation when their assets and income would allow a higher quota payment to their debtors through Chapter 11 or Chapter 13 plans.[1184] If the Court makes such a finding, then the petition for a Chapter 7 can be denied or converted under the appropriate reorganization Chapter of the Code.

A generalized approach to dismissal on the ground of dishonesty allows courts to make a 360 degree evaluation of a petition and to prevent access to discharge in all those cases in which they perceive a debtor attempts to take advantage of the system[1185] to "have a head start instead of a fresh start".[1186] The fact, though, that Courts may have a subjective, heterogeneous[1187], case-by-case approach to §707 may lead to "honest but unfortunate debtors" being deprived of bankruptcy relief[1188], which seems in contrast with the goal of Chapter 7 to grant open access to the bankruptcy process.[1189]

[3] Dismissal of a voluntary petition due to abusive and repetitive filings

The inappropriate use of bankruptcy is sanctioned.

Recourse to the Bankruptcy Code, in fact, may be a strategy to prevent and delay creditors' individual actions at a state level (in particular, attempts of foreclosure).

Upon filing, the debtor and his properties are protected by an automatic injunction.[1190] The law provides such a powerful shield for the benefit of all parties involved in the process. The debtor has an evident interest in preventing the dissipation of the remaining assets; creditors also benefit from it, for the stay allows for an organized distribution of the available property, preventing races.

A debtor may have an interest in attempting to broaden the time of the stay for as long as possible by filing multiple cases under different Chapters, re-filing repeatedly under the same Chapter, or by subdividing assets among different entities to file additional independent cases. In all such ways, a debtor acting in bad faith may be able to take advantage of the automatic stay and of other lapses in the system by making collection efforts much more energy consuming and altogether problematic, thus pushing at least some of the creditors to find an agreement to his advantage.

[1183] It used to read "substantial abuses", showing that the reform lessened its pro-debtor approach.

[1184] **Tsang Pamela C**., "*The Case Against 'Bad Faith' Dismissals of Bankruptcy Petitions Under 11 U.S.C. § 707 (a)*", 59 Am. U. L. Rev. (2010), at 695.

[1185] "Bad faith" behavior includes: a) living in a lavish life style and deplating one's fortune that would have been sufficient to repay debtors; a violation of § 727; c) petition filed for "improper motives" under Chapter 7; an attempt to escape the jurisdiction of a particular Court or general fraudulent behavior. **Kimlinger Katie T., Wassweiler William P.**, "*The good faith fable of 11 U.S.C. § 707 (a): how bankruptcy courts have invented a good faith filing requirement for Chapter 7 debtors*", 13 Bankr. Dev. J. 61, (1996), at 72-73.

[1186] **Tsang Pamela C.**, "*The Case Against 'Bad Faith' Dismissals of Bankruptcy Petitions Under 11 U.S.C. § 707 (a)",* 59 Am. U. L. Rev. (2010), at 691.

[1187] Applications of standards has not been equal through the Court system: " While the United States Court of Appeals for the Ninth Circuit generally has not required the debtor to file for bankruptcy in good faith, the United States Courts of Appeals for the Third and Sixth and Eight Circuits have imposed this good faith filing requirement […] The Third and Sixth Circuits have applied the broadest interpretation of § 707 (a) and held that a debtor's lack of good faith alone is a sufficient justification to dismiss –egregious cases- under Chapter 7 – such as concealment or misrepresentation of assets and income, lavish lifestyle, or an attempt to avoid considerable debt through fraud, misconduct or gross negligence". See *Id*., 696-7.

[1188] For a case against dismissal under § 707 see *Id.*

[1189] Report of the commission of the bankruptcy laws of the United States, h.r. doc. No. 93-137, pt I, at 75-79 (1973).

[1190] See the discussion on Principle "C. 5" and the "Automatic Stay".

Although the Code does not, per se, put a bar on multiple filings[1191], it does act to prevent abuses by, first of all, limiting access to bankruptcy to certain re-filers, and by limiting the protections offered by the automatic stay. Under § 109 (g) (1) and (2), a debtor who is an individual or a family farmer/fisherman is denied relief if she has been a debtor in a bankruptcy case during the 180 days before her petition was filed and her previous petition was dismissed, either due to debtor's willful failure to abide by the bankruptcy court's orders to appear before the court in proper prosecution of the case[1192] or in response to the debtor's request for dismissal following a creditor's request for relief from the automatic stay.[1193]

Under sections 362 (c) (3) and (4), abusive use of multiple filings is further frustrated though limits to the automatic stay. If two petitions are filed within one year, the stay will last only 30 days from the date of filing of the second petition[1194], while the automatic stay will not protect the debtor at all in case a petition is filed three times within a year.[1195]

5.2.2 Involuntary Filings

The evolution of the involuntary filing process in modern American bankruptcy law is of great interest, for it moves radically away from traditional models in which bankruptcy is mainly, if not purely, an involuntary tool.

In about two centuries, the American insolvency framework has managed a complete 180 turn: moving from the purely involuntary system limited to "merchants" which was inherited from English statutes and applied as of the early 1800s, to the modern array of safeguards that protect an ample variety of debtors under the Bankruptcy Code.

Statistically, involuntary petitions in today's American bankruptcy can be considered rare, almost numerically irrelevant compared to other local frameworks. As we will discuss in Chapter VI, the situation in modern Italy, for example has traditionally been almost the opposite (we have already discussed in Chapter IV the harshness of medieval Italian laws). The structure of the Code makes such an option, to a certain extent, difficult to pursue, risky, and overall unattractive for creditors.[1196]

Moreover, an involuntary case can be commenced[1197] exclusively under Chapters 7 and 11, and exclusively against a "person" or a "commercial corporation"[1198] that qualifies as a debtor under the Chapter under which the case is filed[1199], by a minimum of three qualified creditors (in the majority of cases and unless exceptions apply[1200]), holding undisputed, non-contingent claims[1201], for a total value of at the

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[1191] See FRBP 1015 (a) on consolidation of multiple proceedings.

[1192] § 109 (g) (1).

[1193] § 109 (g) (2). For an analysis of the interpretations and applications of §109 see **Waxman Ned W**., "*Judicial Follies: Ignoring the Plain Meaning of Bankruptcy Code § 109 (g) (2)*", 48 Ariz. L. Rev. 149 (2006).

[1194] An exception applies in case the debtor proves the case is filed in "good faith" § 362 (c) (3).

[1195] See though §§ 362 (c) (3) (B) – (4) (B) by which the court may extend the stay if the case is filed in "good faith"

[1196] As we will discuss in Chapter VI, this is a common action taken by creditors in a stigmatizing environment such as the Italian one. See Kilborn J., Walters A., "Involuntary bankruptcy as debt collection: multi-jurisdictional lessons in choosing the right tool for the job": "Experience in England and Wales suggests that involuntary insolvency proceedings can be used successfully both as a collection device and a tool of policy" promises and perils of involuntary bankruptcy proceedings", at 46,
https://www.iiiglobal.org/sites/default/files/19036439v1%20-%20Involuntary%20Bankruptcy%20As%20Debt%20Collection%20(Jason%20Kilborn).PDF

[1197] See the requirements of §§ 303 (b) (1)-2; 303 (h) (1).

[1198] An involuntary case cannot, therefore, be commenced against a farmers or fishermen or charitable corporations. Moreover § 109 (A) includes joint stock companies, unincorporated companies, and business trusts. See **In re Hunt** (9th Cir. BAP 1993) 160 BR 131, 134-136: non-business trusts are excluded; a petition can be filed also against a corporation dissolved under state law as long as it still exists under state laws, for example it is in its winding up phase. See **In re Blackoaks, Inc.** (BC ND OH 1990) 116 BR 550, 551.

[1199] § 303 (a).

[1200] An involuntary case can be commenced also: a) in case the debtor owes to less than twelve creditors with noncontingent, undisputed claims, a single creditor may file autonomously. Such a creditor will still need to reach a total of §15.325 in value of his own undisputed noncontingent claims (or he may be joined by other creditors); b) in the case of a partnership by fewer than all the general partners, or, in case an order for relief has been entered against every single general partner, i) by one of the general partners; ii) by the trustee in the case of one of the

least $15.325. Upon filing the petition with the clerk of the bankruptcy court, more creditors must, therefore, join their efforts against a specific debtor who can be the subject of an involuntary action while suffering more costs and risks in paying the necessary fees.[1202]

Even if all the above-mentioned requirements were to be successfully met, an order for relief would be entered only in absence of a timely answer filed by the debtor.[1203] In case the debtor contests the petition, the claimants would have to prove either that:

- A) the debtor is generally not paying its undisputed debts as they become due[1204] (to the day of the petition[1205]) under a "totality of the circumstances" test[1206]; or
- B) a custodian has been appointed under state law to take control of substantially all of the debtor's assets within 120 days of filing.[1207]

The requirements to be met are, therefore, many.

Moreover, there is much room for interpretation. Is a single major debt enough to prove the debtor is not "current"? What about 100 small debts amounting to a small percentage of the cumulative value of the business operations of the debtor? The general rule is that a single major debt is not sufficient to access modern involuntary bankruptcy unless exceptions apply. This is to keep the insolvency process from becoming the surrogate of a two-party dispute, which is more appropriate among enforcement systems.[1208] Bankruptcy frameworks remain a tool for the organized definition of multiple claims while other, less complex and expensive tools can be of better use in a one-to-one situation.[1209]

The second prong applies to the removal of the state proceeding from a state court to federal court, which is consistent with the Bankruptcy Clause of the Constitution.[1210] It usually applies when the debtor has made an assignment for the benefit of creditors or state court has appointed a receiver and "substantially all the property" is taken. Situations in which only part of the available property is taken for the benefit of creditors are not included.

It is important, though, for a petitioner to have no doubts and to file in good faith, complying with the requirements set forth in the Code. Heavy sanctions await those that would attempt to use bankruptcy as a mere collection tool.

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general partners; iii) by a creditor holding a claim against the partnership see § 303 (b) (3); c) by the foreign administrator of a case concerning the debtor which has been commenced abroad. See § 304.

[1201] See the definition of "claim" given by the Code in section 101 (5).

[1202] An order for relief is a final order determining the status of a debtor as a bankrupt; **In re McGinnis** (8th Cir. 2002) 296 F3d 730, 731. Involuntary petitions differ from voluntary petitions in which the order for relief is granted immediately; in an involuntary proceeding there may be space for the debtor to object and the court must verify that all the required statutory elements have been matched. Despite such a gap between filing and the order, the automatic stay is triggered to protect debtor's property and the interests of the creditors.

[1203] A debtor will have 20 days after the involuntary petition is served to file an answer; such term may be extended by court's order if service has to happen out of the State § 303 (h); Bankruptcy Rules 1011 (b); 1013 (b).

[1204] § 303 (h) (1) – language unclear due to lack of definition of "insolvency".

[1205] Hence payments made following notification of a pending petition cannot prove a debtor is "current". **Matter of Bishop, Baldwin, Rewald, Dillingham & Wong, Inc**. (9th Cir. 1985) 779 F2d 471, 475; In re All Media Properties, Inc. (BC SD TX 1980) 5 BR 126, 144.

[1206] **In re Vortex Fishing Systems, Inc.** (9th Cir. 2002) 277 F3d 1057, 1072.

[1207] § 303 (h) (2); 101 (11).

[1208] Exceptions apply in cases in which debtor acts fraudulently or dishonestly. **In re Concrete Pumping Service, Inc.** (6th Cir. 1991) 943 F2d 627, 629-630; **In re Fischer**, 202 BR 341 (EDNY 1996), at 346-347.

[1209] See **Baker, C. J.**, "*The one, two, threes of involuntary bankruptcy: creditor numerosity in the Fifth Circuit*", 48 Texas Tech Law Rev 387, at 393-394: "One argument against the expansive use of involuntary petitions, particularly when prosecuted by a single petitioning creditor, is that the extreme nature of the remedy and significant consequences on the debtor's creditworthiness make involuntary petitions inappropriate for most two-party disputes", quoting **In re McMeekin**, 18 B.R. 177, 177 (Bankr. D. Mass. 1982). See also **In re Feinberg**, 238 B.R. 781 (B.A.P. 8th Cir. 1999); **In re Nordbrock**, supra, 772 F2d at 400; **Paroline v. Doling** (BC SD OH 1990) 116 BR 583, 587; contra creditor has been allowed to file involuntarily to collect a single credit when all other remedies under state and federal Laws were precluded (extremely rare) **In re Fischer**, 202 BR 341 (EDNY 1996), at 346-347.

[1210] U.S. Const. Art. I § 8, cl, 4.

In a surprising contrast with the origins of bankruptcy statutes, involuntary filings nowadays can therefore be considered tricky. The whole process with its numerous limitations and requirements has become burdensome for creditors.[1211] Pulling the trigger today may cause costs and sanctions.

The times in which creditors could have the debtor arrested under a mere presumption of insolvency without risking much seem far gone.

[A] Commencing an involuntary proceeding

Involuntary cases are not allowed under Chapters:

- 9, against the United States, a state[1212], a territory or a municipality (unless a state allows it, waiving such a right);
- 12, against a family farmer or family fisherman (a heritage of the long tradition of preventing involuntary petitions against farmers and fishermen)[1213] and charitable organizations;
- 13[1214], against a consumer who meets the Chapter's eligibility requirements (in this particular reorganization Chapter ,the plan would be impractical to follow without the cooperation of the debtor).

Moreover, a debtor must be eligible to file voluntarily under the chosen Chapter for an involuntary case to be eventually commenced.

Since railroads, for example, cannot file voluntarily under Chapter 7, they cannot be forced into it involuntarily.[1215] Yet, they may be the subjects of involuntary filings under Chapter 11 as the possibility of their reorganization is expressly included in the Code[1216]. Under the same logic, other kinds of entities which are excluded from bankruptcy *tout court* cannot be the object of involuntary filings.[1217] Among them: financial institutions, with the exception of stockbrokers or commodity brokers[1218], foreign and national banks, and insurance companies (excluded because their insolvency is governed by other federal laws[1219]).

About the exclusions of farmers[1220] and charitable corporations[1221], such categories of debtors enjoy higher protections against the threat of involuntary filings[1222] due to public policy reasons[1223], although they may indeed choose to avail themselves of bankruptcy relief voluntarily under Chapters 7, 11, and 12.

This said, it may not be easy at times to discern between a debtor against whom it may be possible to commence an involuntary case and a "protected" one. This is often the case, for example, of farmers and charitable corporations. Individuals that are not anymore farmers because they ceased business activity the year before, for example, are excluded and do not enjoy any protections.[1224] More borderline cases that easily come to mind are the ones of mega-corporations operating in the farm business, or of schools and hospitals charging very high fees for their services.

[1211] See on the topic in general **Block-Lieb Susan**, "*Why Creditors File so Few Involuntary Petitions and Why the Number is not Too Small*", 57 Brook. L. Rev. 803 (1991).

[1212] See on the topic **Feibelman Adam**, "*Involuntary Bankruptcy for American States*", 7 Duke J. Const. L. & Pub. Pol'y 81, (2012), arguing on the possibility of creating an involuntary bankruptcy regime for states and government debtors.

[1213] § 303 (a). See **Weintraub Benjamin and Resnick Alan N**., "*Involuntary Petitions Under the New Bankruptcy Code*", 97 Banking L.J. 292 (1980), at 297-298.

[1214] **In re Weinstein** (9th Cir. BAP 1998) 227 BR 284, 291, fn. 5.

[1215] §109 (b) (1); § 303 (a).

[1216] §§ 1164, 1174.

[1217] See insurance companies; banks; financial institutions govern by other statutes of federal law.

[1218] § 109 (d); 303 (a).

[1219] § 109 (b), (d); 303 (a).

[1220] See definitions under §§ 101 (18) (A); 101 (20).

[1221] "A corporation that is not a moneyed, business, or commercial corporation" § 303 (a). On the topic see **Weisbord Reid K.**, "*Charitable insolvency and corporate governance in bankruptcy reorganization*", 10 Berkeley Bus. L.J. 305 (2013), at 305-362.

[1222] §303 (a).

[1223] It includes churches as eleemosynary institutions. See **Stone Mayo Andrew**, "*For God and Money: the Place of the Megachurch Within the Bankruptcy Code*", 27 Emory Bankr. Dev. J. 609 (2011) analyzing the differences between the liturgy and spiritual aspects of religions compared to others exercised in corporate fashion.

[1224] **Potmesil v. Alexandria Production Credit Ass'n** (WD LA 1984) 42 BR 731, 732-733.

Careful legal reasoning upon filing is important to avoid being sanctioned. The outcome of an eligibility challenge, though, may vary upon a number of factors and the result is not automatic. A debtor[1225] that wants to raise such a defense must do so in timely manner and expressly answer the involuntary petition, or else he may suffer the consequences, for once relief is entered, it becomes impossible to claim such defense even if it is valid.[1226]

"Joint involuntary" cases are not allowed.[1227] Each petition must be filed individually, even in the case of a married couple. The petitioners must file separately against each debtor and each petition must comply with all the requirements of the Code to be valid.[1228] In case a joint involuntary petition is filed, the court may dismiss it *tout court* for lack of subject matter jurisdiction.[1229] It may be in the interest of the debtors, though, and it is permissible for them to eventually ask for the cases to be consolidated.[1230]

Several strict requirements are imposed by the Code upon filing in an attempt to challenge creditors' capacity to commence futile or oppressive involuntary actions.

Such requirements concern:

a) "numerosity" - the minimum number of creditors needed in order to commence the action;

b) the "quality" and "quantity" of the claims that such creditors hold[1231];

c) crucial administrative formalities including the payment of mandatory filing fees.

Moreover, the entire procedure is subjected to Court's finding that the debtor is generally not paying his debts as they come due or that a custodian was appointed within 120 days before the petition was filed. Despite meeting all requirements, the case may still be dismissed at any time upon violation of the statutory requirements, or upon finding that proceeding is being commenced in bad faith.

Unless exceptions apply, in order for an involuntary case to be filed, a minimum number of three petitioners[1232] must join and coordinate their efforts[1233]; each of them[1234] must hold at the least one claim[1235] that is both noncontingent[1236] or the subject of a "bona fide dispute".[1237] The cumulative value of such claims must add up to a total of at least $15.775[1238] in unsecured credits[1239].

An involuntary case can be filed by fewer than three creditors (even by a single creditor alone) if the debtor has fewer than twelve qualified creditors (unsecured, holding a claim that is noncontingent or the

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[1225] In the case of a partnership, the answer can be filed by the debtor, a general partner that did not file the involuntary petition see § 303 (d) and F. Rules of Bankruptcy P. 1011 (a).

[1226] **In re McCloy** (5th Cir. 2002) 296 F3d 370, 375.

[1227] Joint petitions are allowed exclusively as voluntary filings § 302.

[1228] **In re Benny** (9th Cir. 1988) 842 F2d 1147, 1148-1149; **King v. Fidelity Nat'l Bank of Baton Rouge** (5th Cir. 1983) 712 F2d 188, 190.

[1229] **In re Jones** (BC ED VA 1990) 112 BR 770, 772-773; Courts may allow to fix such by correcting the petition cancelling the name of one of the spouses and continuing the action summoning just one party as long as there is no prejudice for the defendants. **In re Gale** (BC ED MI 1995) 177 BR 531, 535-537.

[1230] In community property states, the protections applying to the case of one spouse will extend also to all items of joint property. See § 541(a)(2).

[1231] Creditors are claim holders, see In re Smith, 243 B.R. 169, 179 (Bankr. N.D. Ga. 1999) ("any person or entity that has a 'right to payment' satisfies the first requirement of § 303(b)(1) ...").

[1232] "An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under Chapter 7 or 11 of this title (1) by three or more entities…" § 303 (b) (1).

[1233] § 303 (b) (1).

[1234] It is still disputed if the two parameters (number of creditors and dollar amount) can be taken into consideration separately, hence having a fully secured debtor "counting" as a petitioning creditor while two unsecured creditors (or partially secured creditors) hold credits for more than $ 15.775; see **In re Apache Trading Group, Inc**. (BC SD FL 1997) 210 BR 869, 875.

[1235] § 101 (5).

[1236] See **In re All Media Prop., Inc**., 5 B.R. 126, 128 (Bankr. S.D. Tex. 1980).

[1237] See In re Lough, 57 B.R. 993, 997 (Bankr. E.D. Mich. 1986).

[1238] The dollar amount may vary and is adjourned based on cost of living parameters every three years § 104(a); the last change occurred April, 1st 2016.

[1239] "… if such noncontingent, undisputed claims aggregate at least $ 15,775 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims" § 303 (b) (1).

subject of a bona fide dispute excluding any employee[1240] or any transferee if such transfer is voidable under other sections of the Code[1241]) as long as the monetary threshold is met, meaning the undisputed, noncontingent, unsecured credit must be of higher value than $15.775[1242].

In most cases, therefore, a single creditor does not have the power to threaten a debtor with bankruptcy.[1243]

An involuntary case can also be commenced by the foreign representative of a bankruptcy case involving the debtor in an attempt to secure control over the assets located in the US, while a special rule applies to partnerships. If the debtor is a partnership, an involuntary petition can be filed by one or three creditors of the partnership (while creditors of an individual partner may not file against the whole entity) or by fewer than all of the general partners[1244] (if the petition is filed by all of the general partners, then it would be regarded as voluntary[1245]). In a limited partnership, limited partners are not granted an individual right to file unless they hold independent claims that pass the test of § 303 (b) (1) and (2)[1246]. General partners do, and should, file in all those cases in which they fear that their patrimony is being dissipated or fraudulently handled. By triggering bankruptcy, it is possible to revoke undue transactions and to reorganize the entity under the court's supervision. In case of conflict, the debtor or a general partner that did not join the petition may file an answer.[1247] If all of the general partners are debtors in their own personal (voluntary) bankruptcy cases, an involuntary petition against the partnership itself may be effectively filed either by a single general partner, by her trustee, or by any creditor of the partnership.[1248]

[B] § 303 (b) a formidable protection made available to debtors

[1] The "numerosity" requirement

At times it may be difficult to establish *ex ante* the number of creditors needed to file effectively (or the total number of claim holders at the time the petition is filed[1249]). It may happen that a debtor is, in good faith, deemed to owe to less than twelve creditors and that a case may be, therefore, filed by a single creditor, only to find subsequently such information is wrong. In this case courts, upon verifying that the mistake occurred in good faith, may grant sufficient time for the creditors to coordinate and correct the petition by joining more qualified petitioners.[1250]

In case a petition is filed by an incorrect number of creditors (or incorrectly in general), the debtor must object in a timely manner and raise a defense, giving proof of the noncompliance with statutory requirements[1251], or else relief may be granted by the court and the decision may not subsequently voided.[1252] Given such strict requirements, in order to avoid the risks of a petition being dismissed and the

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[1240] Former employees are not excluded see for example In re Demirco Group (North America), L.L.C., 343 B.R. 898 (Bankr. C.D. Ill. 2006).

[1241] §§ 544, 545, 547, 458, 549, 724 (a). Although "employees", "insiders" or "voidable transfers transferees", may all be regular potential creditors, their claims are not "valid" in reaching the "twelve creditor"; see **In re J.J.S. Co.** (7th Cir. 1971) 445 F2d 138, 139; **In re Little Bldgs., Inc.** (BC ND OH 1985) 49 BR 889, 890-891.

[1242] § 303 (b) (2); but see **In re Nordbrock** (8th Cir. 1985) 772 F2d 397, 399-400; where a petition was dismissed when a single creditor attempted to collect a single disputed credit.

[1243] Other exceptions listed in § 303 have already been mentioned.

[1244] § 303 (b) (3) (A); see **Blaney Karen**, "*What do you mean may partnership has been petitioned into bankruptcy?*", 19 Fordham Urb. L.J. 833, (1992).

[1245] A voluntary petition must be filed with the consent of all general partners; if there is dissent partners can object to the decision of filing for bankruptcy and the petition itself would be considered involuntary.

[1246] **In re Royal Gate Assocs., Ltd**. (BC MD GA 1988) 81 BR 165, 166-167.

[1247] § 303 (d).

[1248] § 303 (b) (3) (B).

[1249] The threshold must be met at the time of filing, subsequently paying off creditors does not have an impact **In re Corvalho Industries, Inc.**, 68 B.R. 254 (Bankr. D. Ore. 1986); **In re Claxton,** 21 B.R. 905 (Bankr. E.D. Va. 1982).

[1250] § 303 (c); FRBP 1003(b); see **In re Vortex Fishing Systems, Inc.**, supra, 277 F3d at 1071; In re Alta Title Co., 55 B.R. 133 (Bankr. D. Utah 1985).

[1251] **Atlas Machine & Iron Works, Inc. v. Bethlehem Steel Corp.** (4th Cir. 1993) 986 F2d 709, 715-716; **In re Knoth** (BC D SC 1994) 168 BR 311, 312.

[1252] **In re Mason** (9th Cir. 1983) 709 F2d 1313, 1318-1319; **In re Trusted Net Media Holdings, LLC** (11th Cir. 2008) 550 F3d 1035, 1040-1046; see also **In re Barth** (BC D CT 1990) 109 BR 570, 574; no creditor adverting the involuntary

loss of time and money that would derive from it, more unsecured creditors may join the original petitioners so that if one or more of them is found noncompliant, other joining creditors can guarantee that all statutory requirements are effectively met.[1253] Post-petition creditors can also join and count (if qualified) at any time before the case is dismissed.[1254] If the petition is assessed to have been filed in bad faith, though, it will be dismissed and the Court will not allow more creditors to join.[1255]

The way the Code is built highlights the value of qualified claims compared to their plain number. Under the statute a single creditor may hold more valid claims but he will always count as a single petitioner[1256]; while three creditors will be sufficient even if two have a single valid independent unsecured credit of minimal value (one dollar, for example) and the third covers the remaining quota necessary to meet the statutory "quantum"[1257] and, eventually, exceed it by far (two million dollars, for example).

This rule led to debate on its practical application. We can see how a bank holding over a million in credits may be stopped from filing involuntary bankruptcy against a debtor that manages to file a list of more than twelve creditors, counting relatively irrelevant sums such as five dollars owed to a pharmacy and ten dollars owed to a doctor (medical bills account for a vast majority of individual debtor's debts).

The debate evolved into two different approaches[1258]:

a) a "strict approach" under which courts interpret and apply the rule literally (hence granting any creditor, no matter how small the claim, a right to file validly);

b) a "judicial qualification approach" under which, in similar circumstances, courts find that it would make little sense to protect the debtor with a number of small claims to block relief for a major creditor.[1259]

With regard to circumventing such issues, a common tactic deployed by creditors has been based on sharing a single claim among more closely related creditors so that the numerosity requirement could be met in full. Such practice has been considered unacceptable and in violation of the policies supported by the Code. Closely connected creditors may count individually and reach the statutory requirements as long as:

- they are not mere alter egos[1260];
- that each of them holds a valid independent claim, meaning that they did not split among themselves a single credit just for the purpose of getting the debtor through bankruptcy. Dishonest behaviors are heavily sanctioned.[1261]

At the same time a debtor may be tempted to create minor debts in order to burden the creditors. This behavior is also not allowed.

Secured claims do not count. The reasoning is that such credits are sufficiently protected. Exceptions apply. It is possible to allow secured creditors to join for the unsecured portions of their credits.[1262] They may also count towards meeting the numerosity requirement if they renounce their privileged status (even for a portion of their cumulative credits), hence becoming unsecured creditors. In this case, though, they would suffer all the consequences of such a choice. This option comes at a high price, since the

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petition has standing to object **In re Earl's Tire Service, Inc**. (D DE 1980) 6 BR 1019, 1021-1022; **In re Ludlum Enterprises, Inc.** (5th Cir. 1975) 510 F2d 996, 1002.

[1253]§ 303 (c); see **In re Vortex Fishing Systems, Inc.** (9th Cir. 2002) 277 F3d 1057, 1071.

[1254] **In re Federated Group, Inc.** (9th Cir. 1997) 107 F3d 730, 732-733; **In re Nazarian** (BC D MD 1980) 5 BR 279, 281.

[1255] **Atlas Machine & Iron Works, Inc. v. Bethlehem Steel Corp.** (4th Cir. 1993) 986 F2d 709, 716; **In re LaRoche** (D RI 1991) 131 BR 253, 256.

[1256] **In re Gilbert** (BC SD NY 1990) 115 BR 458, 461-462.

[1257] **In re Okamoto** (9th Cir. 1974) 491 F2d 496, 497-498.

[1258] See on the topic the discussion in **Baker, C. J**., "*The one, two, threes of involuntary bankruptcy: creditor numerosity in the Fifth Circuit*", 48 Texas Tech Law Rev 387, at 393-394.

[1259] **In re Denham**, 444 F.2d at 1379.

[1260]See **Subway Equip. Leasing Corp. v. Sims (In re Sims)**, 994 F.2d 210, 220 (5th Cir. 1993) for a case in which the court refused to consider a number of petitioners as "one" as alter egos of each other; **In re Reid** (7th Cir. 1985) 773 F2d 945, 947.

[1261] Fed Rules of Bankruptcy P. 1003 (a); **In re Focus Media, Inc.** (9th Cir. 2004) 378 F3d 916, 927-928.

[1262] **Matter of East-West Associates** (SD NY 1989) 106 BR 767-777.

modification could not be modified again to return to a higher status of protection. The credit would remain unsecured, and its chances of being recovered would strongly decrease.[1263]

[2] The "claims"

Claims must be:

a) "noncontingent[1264] as to liability"[1265], meaning that the right to payment must not be based on the occurrence of a future fact contemplated by parties at the time of contract's executions[1266]; nor

b) "the subject of a bona fide dispute as to liability or amount".[1267]

Such requirements have been modified heavily in recent years. In 1978[1268] the claim just had to be noncontingent and court had to enter an order of relief if the debtor was generally not current on his payments as they became due.[1269] The "bona fide dispute" requirement of § 303 (b) was added in 1984 in an attempt to limit a split in interpretation by which many courts would allow recourse to involuntary bankruptcy against a debtor that was refusing to pay certain debts as they came due without first judging if

[1263] **In re American Gypsum Co.** (BC D NM 1983) 31 BR 187, 188.

[1264] There has been much debate on the definition of "contingent". For an interpretation see **Semel v. Dill (In re Dill)**, 731 F.2d 629 (9th Cir. 1984), stating that a contingent claim has not yet accrued and it is dependent on a future event that may never happen. Under such definition, it is evident why the legislature would be concerned with such perspective claims counting under § 303; see also **In re Smith**, 123 B.R. at 179: a claim is noncontingent if the debtor's legal duty to pay does not come into existence until triggered by the occurrence of a future event and such future occurrence was within the actual or presumed contemplation of the parties at the time the original relationship of the parties was created. See also **In re All Media Prop., Inc.**, 5 B.R. 126, 128 (Bankr. S.D. Tex. 1980): "[1] in the case of the classic contingent liability of a guarantor of a promissory note executed by a third party, both the creditor and guarantor knew there would be liability only if the principal maker defaulted. No obligation arises until such default. [2] In the case of a tort claim for negligence, the parties at the time of the alleged negligent act would be presumed to have contemplated that the alleged tort feasor would be liable only if it were so established by a competent tribunal. Such a tort claim is contingent as to liability until a final judgment is entered fixing the rights of the parties. [3] On the other hand, in the ordinary debt arising from, for example, a sale of merchandise, the parties to the transaction would not at that time view the obligation as contingent. Subsequent events might lead to a dispute as to liability because of, for example, defective merchandise, but that would merely serve to render the debt a disputed one but would not make it a contingent one. A legal obligation arose at the time of the sale, although the obligation can possibly be avoided. Such a claim is disputed, but it is not contingent", at 133.

[1265] § 303 b (1).

[1266] Trouble in interpretation on the contingency issue may arise when a suit is pending and, therefore, the parties are awaiting a decision on the existence and value of a claim. For example: in the case of an unadjudicated tort claims, the credit is "unliquidated", meaning that the facts have already happened at the time of the petition; the only missing piece of information is the "quantum" which is subject to a bona fide dispute. Hence the creditor will not be disqualified from counting, although the liquidated amount of claims will have to exceed the requested amount. See **In re Longhorn 1979-II Drilling Program** (BC WD OK 1983) 32 BR 923, 927; 11 USC 303(b)(1).

[1267] § 303 (b) (1) and (2). See **In re Lough**, 57 B.R. 993, 997 (Bankr. E.D. Mich. 1986): T"there is either a genuine issue of material fact that bears upon the debtor's liability, or a meritorious contention as to the application of law to undisputed facts." See also **In re Everett** (BC ND OH 1994) 178 BR 132, 143 and **In re Busick**; 831 F.2d 745, 750 (7th Cir. 1987; see on the topic also **Baker, C. J.,** "*The one, two, threes of involuntary bankruptcy: creditor numerosity in the Fifth Circuit*", 48 Texas Tech Law Rev 387, at 393-394.

[1268] Before 1978: under the 1898 Act, reformed in 1938, for involuntary petition (seeking the liquidation of the debtor's estate; involuntary reorganization proceedings could occur only under former Chapter X) to be filed against an eligible debtor, three creditors holding unsecured claims for a value of more than $500 had to join their efforts. The debtor could contest the claims in which case the creditors would have to prove the debtor had committed an "act of bankruptcy" within four months prior to the filing of the petition. See **Block-Lieb Susan**, "*Why Creditors File so Few Involuntary Petitions and Why the Number is not Too Small*", 57 Brook. L. Rev. 803 (1991), at 807-9.

[1269] See **Kennedy Frank R.**, "*The Commencement of a Case Under The New Bankruptcy Code*", 36 Wash. & Lee L. Rev. 977 (1979), 977-1025; **Weintraub Benjamin and Resnick Alan N**., "*Involuntary Petitions Under the New Bankruptcy Code*", 97 Banking L.J. 292 (1980); **Winkelman Steven J.**, "*A Dispute over Bona Fide Disputes in Involuntary Bankruptcy Proceedings*", 81 U. Chi. L. Rev. 1341 (2014), at 1345.

the reasons for failing to do so were legitimate[1270]; an approach that was contributing to the old (stigmatizing) approach to involuntary bankruptcy.[1271] Despite its laudable intent, though, Congress failed at that time to give a definition that would help courts in giving a uniform interpretation of the new requirement.[1272]

In 2005, a further addition was made in sections 303 (b) and (h) "as to liability or amount" led to questions on how to compute the total amount of undisputed claims in order to the much needed total of $15.775, with some cases barring the entire quota of credits of a single petitioner when even only a portion was disputed, and another line of cases allowing the portion of undisputed claims to count.[1273]

Moreover, under section 303 (e), after notice and a hearing the court may require, for cause, petitioners to file a bond to indemnify the debtor for such amounts (costs, reasonable attorney's fees, and eventually damages) as the court may later allow (upon dismissal of the case under section 303 (i), which includes the possibility of punitive damages) to sanction the filing creditors[1274].

Such additions result in renewed protection for the debtors.[1275]

The fact that the debtor may assess a counterclaim does not, per se, prevent the court from entering relief[1276], although a counter credit arising from the very same transaction may prevent the creditors from reaching the necessary monetary threshold.[1277] Objecting that the statute of limitation has elapsed and bars recovery under a certain claim may be a more successful obstruction.[1278] In general, the burden of proof is on the petitioning creditors, who have to provide all the necessary supporting evidence to assess compliance with the parameters set forth in the Code for each claim; sanctions may be awarded in case of dishonest filing or behavior.[1279]

It is evident how reaching the needed number of petitioners, "quantum", and quality of valid claims can act as a barrier to involuntary petitions, impacting economic relations heavily. § 303 (b) therefore represents much more of a formidable protection for debtors than it may seem from simply reading the Article on its face.

[C] Entry of order for relief in an involuntary case

An order for relief will not be entered automatically by Court under the Chapter of election of the creditors unless a timely (within 21 days from service of the involuntary petition[1280]) answer is filed by the debtor.

If an answer is filed in a timely manner, the Court must order relief only in two circumstances:

- if the debtor is generally not paying his debts as they become due[1281]; or

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[1270] A definition "bona fide" is not mentioned in the Code. Courts have manifested different interpretations, See **Block-Lieb Susan**, "*Why Creditors File so Few Involuntary Petitions and Why the Number is not Too Small*", 57 Brook. L. Rev. 803 (1991), at 824-6; **Winkelman Steven J**., "*A Dispute over Bona Fide Disputes in Involuntary Bankruptcy Proceedings*", 81 U. Chi. L. Rev. 1341 (2014), at 1347.

[1271] See **Winkelman Steven J**., "*A Dispute over Bona Fide Disputes in Involuntary Bankruptcy Proceedings*", 81 U. Chi. L. Rev. 1341 (2014), at 1346.

[1272] *Id*., at 1347 – 1352.

[1273] See on different approaches and interpretations **Dean David G**., "*Courts Reverse Trend on Interpretation of § 303 (b) (1)*", 33 Am. Bankr. Inst. J. 44, (2014).

[1274] **See Block-Lieb Susan**, "*Why Creditors File so Few Involuntary Petitions and Why the Number is not Too Small*", 57 Brook. L. Rev. 803 (1991), at 828-834.

[1275] See **Block-Lieb Susan**, "*Why Creditors File so Few Involuntary Petitions and Why the Number is not Too Small*", 57 Brook. L. Rev. 803 (1991), at 828-34; **Winkelman Steven J**., "*A Dispute over Bona Fide Disputes in Involuntary Bankruptcy Proceedings*", 81 U. Chi. L. Rev. 1341 (2014), at 1353.

[1276] **In re Dill** (9th Cir. 1984) 731 F2d 629, 631.

[1277] **In re Seko Investment, Inc**., supra, 156 F3d at 1009.

[1278] **In re Vortex Fishing Systems, Inc.** (9th Cir. 2002) 277 F3d 1057, 1069.

[1279] See Id. at 1064; **In re Byrd**, supra, 357 F3d at 437.

[1280] See FRBP 1011(b).

[1281] Nonpayment of a single debt is usually not enough, see on the topic **In re Smith**, 123 B.R. 423, 425-26 (Bankr. M.D. Fla. 1990).

- a custodian has been appointed to take charge of substantially all of the debtor's property within 120 days before the date of filing of the petition.[1282]

The petitioning creditors bear the burden of proof.

The first prong may be difficult to prove. Creditors may lack information on the debtor's general accounting. The very same standard presents difficulties; an insolvent debtor is not current by definition, but what about all other stages of a dangerous crisis and the risks a creditor would face in a good faith attempt to prevent a major default?

Single major unpaid debts are not enough to grant the entry of an order for relief.[1283] Different approaches have been followed by Courts. In general a "totality of the circumstances test" is used to discern between temporary financial difficulties while balancing the interests at stake.[1284]

The second prong may be easier to prove. § 101 (11) defines a "Custodian" as the:

> "(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;
> (B) assignee under a general assignment for the benefit of the debtor's creditors; or
> (C) trustee, receiver or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors." Verifying the appointment of such third party in the brief period of 120 days pre-petition does not constitute, usually, much of a challenge."

Situations may vary, though. A custodian is not just a third party to which the debtor bequests all of his assets in an attempt to defraud the creditors. The appointed liquidator of a partnership, for example, may also constitute a custodian to the extent of this section, while auctioneers[1285] or repossessing creditors[1286] have been found not to meet the definition.

Issues arise most often when a receiver or a trustee takes control of a part of the debtor's assets. In general, such instances do not constitute ground for the entry of an order for relief when the purpose is to enforce a lien.[1287]

Regardless of the ending result, such process will require time.[1288] As long as the case is pending and it is not dismissed or converted to another Chapter or an interim trustee is not appointed under § 303 (g)[1289], the debtor remains in possession[1290] and may continue to operate its property and business (including cash

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[1282] See **Block-Lieb Susan**, "*Why Creditors File so Few Involuntary Petitions and Why the Number is not Too Small*", 57 Brook. L. Rev. 803 (1991) at 839-844.

[1283] **In re Smith**, 123 B.R. 423, 425-26 (Bankr. M.D. Fla. 1990).

[1284] **Bartmann v. Maverick Tube Corp.**, 853 F.2d 1540, 1546 (10th Cir. 1988); **In re Harmsen**, 320 B.R. 188, 198 (10th Cir. BAP 2005); **In re Knoth**, 168 B.R. 311, 317 (Bankr. D.S.C. 1994); All Media, 5 B.R. at 143.

[1285] **In re North County Chrysler Plymouth, Inc**., 13 B.R. 393, 400 (Bankr. W.D. Mo. 1981).

[1286] **In re Lewis**, 12 B.R. 106 (Bankr. M.D. Ga. 1981).

[1287] **Bayonyi,** 211 B.R. at 943-45.

[1288] The so called "Gap period".

[1289] Court can have an "interim trustee" appointed, if necessary by the US Trustee in Chapter 7 cases only. 11 U.S.C. 303 (g). The appointment of an "interim trustee" is a tool meant to prevent "irreparable harm" (see **In re Reed,** 11 B.R. 755 (Bankr. W.D. Va. 1981)) and dissipation of the estate during the months while a contested involuntary bankruptcy case is adjudicated. Once the trustee is appointed, she cannot be removed by, for example, conversion of the case to a voluntary reorganization Chapter – this point is debated by Courts but underlines the relevance of a trustee's role, see for example **In re Seychelles** (BC ND TX 1983) 30 BR 75, 76, fn. 1. A trustee may be removed by court's order if it is proved that her supervision is not anymore necessary. Due to the impact the appointment may have on a debtor (whom may eventually succeed in fighting the petition), the moving party must provide evidence of the necessity of taking such a step. See **In re Landmark Distributors, Inc**., 189 B.R. 290 (Bankr. D.N.J. 1995).

[1290] § 303 (f); the fact that the debtor may continue to operate the business in the gapperiod does not vest him of the powers of a trustee. A debtor in possession pending an involuntary filing cannot, for example, agree on relief from automatic stay **In re E.D. Wilkins Grain Co.** (BC ED CA 1999) 235 BR 647, 650.

collateral). This means the debtor can continue to "impact"[1291] his assets in numerous neutral, positive, or negative ways – the latter are, of course, the ones of higher relevance. In the general, ordinary course of business, transactions and transfers happening in the gap period between the filing and the order of relief will be enforced[1292]; the same cannot be said for fraudulent conveyances, which will be avoidable.

In case of perceived misbehavior, the creditors can ask the court to act to prevent a debtor from dissipating assets while the case is pending (even if contested), imposing specific limitations on the operations a debtor may accomplish.[1293] Therefore, upon filing of a proper objection by the debtor, courts must determine the issue at the earliest practical time, entering an order for relief dismiss the petition or any other appropriate order.[1294]

[D] Other impediments or possible causes of a creditor's failure to commence a case

A number of other factors contribute to discouraging the improper use of the involuntary bankruptcy process.

Courts have the capacity to abstain from hearing a case at any time, even if the petitioners meet all the requirements of § 303, under section 305, "abstention", when the interests of the creditors and the debtor would be better served by dismissal.[1295] Such power is broad and not subject to the review of a superior court[1296], hence it was intended by Congress to be a sort of exceptional remedy.[1297]

They may also dismiss an involuntary petition *sua sponte* when filed with fraudulent or collusive intent.[1298] Dismissal requires notice to all creditors and an opportunity for hearing[1299]; notice allows other creditors that may want the petition to continue to join or otherwise intervene.[1300] The petition can also be dismissed without a determination of its merits on the motion of any petitioning creditor, with the consent of all of the petitioners and the debtor, or for lack of prosecution by the petitioning creditors.[1301]

[1] Dismissal due to bad faith

Over time a number of stratagems have been enacted in an attempt to circumvent the protections placed by the Congress to limit the abuse of involuntary filings.

If the court dismisses the involuntary petition on the merits it can award costs and attorney's fees to discourage filings by holders of doubtful claims[1302]. If the court determines that filing by any petitioner was in bad faith the case can be dismissed, even if all the parameters of § 303 have been met[1303] and it can award damages.[1304] "Bad faith" may cover a variety of behaviors. Federal Rule of Bankruptcy Procedure §

[1291] The gap period can last for years. See for example **Wynn v. Eriksson, (In the Matter of R.C. Wynn)**, 889 F.2d 644 (5th Cir. 1989).

[1292] § 549 (b).

[1293] Filing an appropriate petition to request restrictions on the capacity of the debtor to operate, § 303 (g).

[1294] FRBP 1013(a).

[1295] **In re Paper I Partners, L.P.**, 283 B.R. 661 (Bankr. S.D.N.Y. 2002); to be used in extraordinary circumstances.

[1296] § 305 (c).

[1297] For a test adopted by courts in determining whether to abstain. See **In re Paper I Partners, L.P**., 283 B.R. 661 (Bankr. S.D.N.Y. 2002).

[1298] See **In re Forever Green Athletic Fields Inc. v. Dawson** 514 B.R. 768 (E.D. Pa. 2014). See also In re WLB-RSK Venture, 296 B.R. 509 (Bankr. C.D. Cal. 2003).

[1299] § 303 (j) (2). See **In re Taub**, 150 B.R. 96 (Bankr. D. Conn. 1993): notice to be given to all creditor, not just the ones with disputed claims.

[1300] **In re Mi La Sul** (BC CD CA 2007) 380 BR 546, 554-555.

[1301] § 303 (j) (1).

[1302] § 303 (i) (1); bad faith is not per se relevant in awarding compensation for costs of proceeding and legal fees, which can be awarded regardless of the dishonest intent of the petitioners. See **Block-Lieb Susan**, "*Why Creditors File so Few Involuntary Petitions and Why the Number is not Too Small*", 57 Brook. L. Rev. 803 (1991), at 828-34.

[1303] See for example **In re WLB-RSK Venture**, 296 B.R. 509 (Bankr. C.D. Cal. 2003).

[1304] 303 (i) (2); the debtor exclusively has standing to recover damages in this case, see **In re Mike Hammer Productions, Inc.** (9th Cir. BAP 2003) 294 BR 752, 754-755. The court may not award punitive damages against governmental institutions §§ 106(a)(3), 303(i)(2).

9011[1305] gives information on what may constitute a dishonest behavior. In particular, it mentions actions that "harass"; that cause "needless delay" and "needless increase costs of litigation"[1306]; filing a document based on "frivolous" arguments[1307]; or, in general, the fact that the allegations lack the necessary evidentiary support or the opportunity for further investigations to gain evidentiary support.

[1305] Federal Rule of Bankruptcy Procedure 9011: "Signing of Papers; Representations to the Court; Sanctions; Verification and Copies of Papers.

(a) Signature. Every petition, pleading, written motion, and other paper, except a list, schedule, or statement, or amendments thereto, shall be signed by at least one attorney of record in the attorney's individual name. A party who is not represented by an attorney shall sign all papers. Each paper shall state the signer's address and telephone number, if any. An unsigned paper shall be stricken unless omission of the signature is corrected promptly after being called to the attention of the attorney or party.

(b) Representations to the Court. By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances, (1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation; (2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law; (3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

(c) Sanctions. If, after notice and a reasonable opportunity to respond, the court determines that subdivision (b) has been violated, the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation. (1) *How Initiated.* (A) *By Motion*. A motion for sanctions under this rule shall be made separately from other motions or requests and shall describe the specific conduct alleged to violate subdivision (b). It shall be served as provided in Rule 7004. The motion for sanctions may not be filed with or presented to the court unless, within 21 days after service of the motion (or such other period as the court may prescribe), the challenged paper, claim, defense, contention, allegation, or denial is not withdrawn or appropriately corrected, except that this limitation shall not apply if the conduct alleged is the filing of a petition in violation of subdivision (b). If warranted, the court may award to the party prevailing on the motion the reasonable expenses and attorney's fees incurred in presenting or opposing the motion. Absent exceptional circumstances, a law firm shall be held jointly responsible for violations committed by its partners, associates, and employees. (B) *On Court's Initiative*. On its own initiative, the court may enter an order describing the specific conduct that appears to violate subdivision (b) and directing an attorney, law firm, or party to show cause why it has not violated subdivision (b) with respect thereto. (2) *Nature of Sanction; Limitations*. A sanction imposed for violation of this rule shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated. Subject to the limitations in subparagraphs (A) and (B), the sanction may consist of, or include, directives of a nonmonetary nature, an order to pay a penalty into court, or, if imposed on motion and warranted for effective deterrence, an order directing payment to the movant of some or all of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation. (A) Monetary sanctions may not be awarded against a represented party for a violation of subdivision (b)(2). (B) Monetary sanctions may not be awarded on the court's initiative unless the court issues its order to show cause before a voluntary dismissal or settlement of the claims made by or against the party which is, or whose attorneys are, to be sanctioned. (3) *Order*. When imposing sanctions, the court shall describe the conduct determined to constitute a violation of this rule and explain the basis for the sanction imposed (d) Inapplicability To Discovery. Subdivisions (a) through (c) of this rule do not apply to disclosures and discovery requests, responses, objections, and motions that are subject to the provisions of Rules 7026 through 7037.

(e) Verification. Except as otherwise specifically provided by these rules, papers filed in a case under the Code need not be verified. Whenever verification is required by these rules, an unsworn declaration as provided in 28 U.S.C. §1746 satisfies the requirement of verification.

(f) Copies of Signed or Verified Papers. When these rules require copies of a signed or verified paper, it shall suffice if the original is signed or verified and the copies are conformed to the original."

[1306] FRBP § 9011 (b) (1).

[1307] FRBP § 9011 (b) (2).

Hence, bad faith may be found[1308] if creditors, before filing, do not take the necessary steps to ascertain that filing is proper and that the petitioners have meet the necessary requirements[1309]; as it could be inferred by a variety of subjective and objective circumstances that a court deems relevant and worthy of sanctions[1310]; or by proof that the petition included materially false supporting facts[1311] to support, for example, the argument that a claim was not the subject of a bona fide dispute.[1312]

Attorney's fees; costs of proceeding; actual and punitive damages; and, eventually, other bankruptcy statutory sanctions[1313] and recovery under other common law principles or statutes[1314] may be awarded cumulatively and may not be discharged in case they are significant enough to cause the bankruptcy of a former creditor[1315], becoming a relevant burden on petitioners.[1316] Expenses can be awarded also in the case of dismissal of the case due to abstention of the court, which deems such an action in the best interest of the parties.[1317] Responsibility is joint and several; hence, a debtor can recover against any of the petitioners[1318] and the court may ask the petitioners to deposit a bond for cause during the proceeding, to ensure that the debtor will be able to recover any amount ruled in his favor under section 303 (i).[1319] [1320]

It is also worth mentioning that such behaviors may be sanctioned also under the specific criminal sections of Title 18 of the United States Code.[1321]

[2] Other causes of dismissal of the case

The debtor and the petitioners may file jointly to have the case dismissed; it usually happens when a satisfactory monetary agreement is found.[1322] [1323] The court may decide to dismiss a case upon petition if doing so would better serve the interest of the debtor and of all creditors.[1324] In such a case, notice must be given in advance to all creditors so that the case may continue with any qualified party willing to join[1325],

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[1308] Parameters differ and some Courts have found a presumption of good faith operating in favor of the petitioner with duty on the quasi-bankrupt to rebut. **In re Bayshore Wire Products Corp.** (2nd Cir. 2000) 209 F3d 100, 105.

[1309] See **In re Kearney** (BC MD FL 1990) 121 BR 642, 646-647.

[1310] **In re Macke Int'l Trade, Inc.** (9th Cir. BAP 2007) 370 BR 236, 256; **Atlas Machine & Iron Works, Inc. v. Bethlehem Steel Corp.** (4th Cir. 1993) 986 F2d 709, 716; for example, it may be bad faith if a creditor who knows that debtor has more than twelve qualified creditors files autonomously, **In re Kearney** (BC MD FL 1990) 121 BR 642, at 645-646.

[1311] **In re Kidwell** (BC ED CA 1993) 158 BR 203, 217.

[1312] **In re John Richards Home Building Co., L.L.C.** (6th Cir. 2006) 439 F3d 248, 257-261.

[1313] See for example FRBP 9011.

[1314] See for example the torts of interference with business relationships; intentional infliction of emotional distress or, in general, sanctions for abuse of process.

[1315] **In re Antonini,** Adv. Pro. No. 10-03792-AJC.

[1316] **In re Ramsden** (BC ND GA 1981) 17 BR 59, 61; set-off with petitioners' credits is not allowed because it would reduce the impact of § 3030 (i) and incentivize an incorrect use of involuntary bankruptcy to the disadvantage of debtors. **In re Macke Int'l Trade, Inc.** (9th Cir. BAP 2007) 370 BR 236, 254-256.

[1317] *Id.*, 248-253.

[1318] **In re Maple-Whitworth, Inc.** (9th Cir. BAP 2007) 375 BR 558, 568-570.

[1319] § 303 (e).

[1320] The bond protects the debtor against a number of negative effects that derive from filing the petition, including depreciation of the assets that, by becoming property of the estate, may not be sold to avoid loss in value. **Matter of Dill** (BC D NV 1981) 13 BR 9, 11.

[1321] See, for example, 18 U.S. Code § 157 - Bankruptcy fraud: "A person who, having devised or intending to devise a scheme or artifice to defraud and for the purpose of executing or concealing such a scheme or artifice or attempting to do so (1)files a petition under title 11, including a fraudulent involuntary petition under section 303 of such title; (2)files a document in a proceeding under title 11; or (3)makes a false or fraudulent representation, claim, or promise concerning or in relation to a proceeding under title 11, at any time before or after the filing of the petition, or in relation to a proceeding falsely asserted to be pending under such title, shall be fined under this title, imprisoned not more than 5 years, or both."

[1322] § 303 (j); the debtor and the petitioners are the only ones having standing to request the dismissal of the case **In re Taylor & Assocs., LP** (BC ED TN 1996) 191 BR 374, 381.

[1323] Other grounds for dismissal apply, less relevant to the topics we are discussing, such as lack of jurisdiction. See for example FRCP § 12.

[1324] **In re Fales** (BC SD OH 1987) 73 BR 44, 46; **In re Oak Winds** (BC MD FL 1980) 4 BR 528, 531.

[1325] FRBP §§ 1017(a); 2002(a), (k).

while any creditor, even the ones that may have their claim contested, have standing to object to the dismissal of the case.[1326]

There may be cases in which the debtor, pending an involuntary petition, instead of objecting may file a concurrent voluntary petition, or convert the involuntary petition into a voluntary one. In such cases the court would construe it as an admission of incapacity to repay debts, would grant relief under the appropriate Chapter of the Code, and the debtor would take over the case[1327].

A case shall not be dismissed upon debtor's petition for failure to obtain the necessary pre-filing counseling of § 109 (h); such a requisite, in fact, is applicable and necessary to voluntary petition only.[1328]

6. The automatic stay

Principle C5 of the World Bank's List of 2015 addresses the important topic of protecting the assets of bankruptcy proceedings through moratoriums and injunctions. As we have had a chance to discuss in Chapter II, Principle C5 is divided into three subsections describing the effects of a stay on a creditor's or third party's actions in the following circumstances:

- when a decision on an application is pending and an order of relief has not yet been entered (during the so-called "gap period" of involuntary proceedings, for example);
- through the whole duration of the proceeding;
- in reorganizations to ensure that assets are maintained by the debtor so that she may be as successful as possible in her attempt.

We will discuss all the above-mentioned factors in the US insolvency scenario through a brief analysis of Section 362 of the Bankruptcy Code. We will also briefly mention the stay within Section 524 which protects discharged debtors.[1329]

The automatic stay is a powerful tool and a fundamental safeguard provided by bankruptcy statutes.[1330] It consists of an automatic[1331] injunction trigged by the act of filing a bankruptcy petition[1332] that protects the debtor and the property of the estate.[1333] [1334] It operates by stopping an individual creditor's collection activities.[1335] The deployment of the stay allows vital "breathing room"[1336] under the authority and control of a court's jurisdiction to organize and take all the necessary steps for the proceeding to be successful until its termination and the eventual grant of discharge. It provides time to

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[1326] **In re Broshear**, supra, 122 BR at 707.

[1327] **In re Premier Gen. Holdings, Ltd.** (BC WD TX 2010) 427 BR 592, 599.

[1328] **In re Allen** (BC ND TX 2007) 378 BR 151, 153.

[1329] For cross-border aspects see **Klidonas George**, "*Automatic Stay in Chapter 15: Global Stay Applicable only in Chapter 11 Cases*", 29 Am. Bankr. Inst. J. 38 (2010); **Stromes P. David**, "*The Extraterritorial Reach of the Bankruptcy Code's Automatic Stay: Theory vs. Practice*", 33 Brook. J. Int'l L. 277 (2007); **Bassin William**, "*Why Courts Should Refulse to Enforce Pre-Petition Agreements that Waive Bankruptcy's Automatic Stay Provision*", 28 Ind. L. Rev. 1 (1994).

[1330] **Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection**, 474 U.S. 494, 503, 106 S. Ct. 755, 88 L. Ed. 2d 859, 13 Bankr. Ct. Dec. (CRR) 1262, 13 Bankr. Ct. Dec. (CRR) 1269, 13 Collier Bankr. Cas. 2d (MB) 1355, 23 Env't. Rep. Cas. (BNA) 1913, Bankr. L. Rep. (CCH) P 70923, 16 Envtl. L. Rep. 20278 (1986).

[1331] A court order is not required See **In re Mellor** (9th Cir. 1984) 734 F2d at 1396-1398.

[1332] The automatic stay is triggered by filing a petition voluntarily, jointly or involuntary. It is not related to the entering of an order for relief which is automatic upon filing voluntarily or involuntarily while happens in a second time in an involuntary case due to the necessity to assess if the necessary requirements for the case to proceed have been met.

[1333] See the discussion on property that is "arguably" part of the estate, **Manz S.**, "*To infinity and beyond: exploring the reach of the automatic stay*", 30 A.B.I. J. 34, (2011), at 34.

[1334] § 362 (a) even if the claim arose pre or post petition see §§ 362 (a) (4), (5).

[1335] The stay impacts the position of secured creditors differently. Secured creditors, in fact, are entitled to "adequate protection".

[1336] For an interesting discussion of different relevant policies at conflict. See **Back Adam A.**, "*Crossroads: the Collision of Bankruptcy's Automatic Stay and Environmental Laws's Injunctive Relief*", 20 J. Nat. Resources & Envtl. L. 103 (2005-2006) discussing the impact of the stay as a tool to "freeze the status quo" which is absolutely necessary to grant debtors and creditors a chance to address their issues in an orderly fashion and the interests protected by another very relevant policy such as the protection of the environment which often requires swift action.

organize numerous necessary activities, such as putting administrators in charge (for example the trustee of a Chapter 7 bankruptcy liquidation); organizing and recovering all available assets; liquidating the estate; and ranking a variety of different claims for distribution purposes.[1337]

As such the protection offered by the automatic stay serves two of the most important interests in bankruptcy. It protects the debtor from a variety of collection activities, which include not only the formal steps of legal actions – such as commencing or continuing a law suit, levy, or foreclosure – but also the generalized, incessant, almost threatening barrage of phone calls and letters that some creditors push, or dangerous attempts to repossess items of property or collect sums of money. At the same time, though, it also serves the equally relevant, contrasting interest of the creditors to avoid races through an organized administrative proceeding, collecting and distributing property among them; hence preventing disorganized, inequitable, and expensive rushes towards dismembering the debtor, which may prove detrimental to many claim holders.[1338]

Although the stay remains a meaningful and powerful tool, over time a number of limitations have been enacted. They cover a wide range of heterogeneous policies that may be unduly harmed by the preservation of the status quo. Such policies range, for example, from the reasonable need to ensure that support obligations are paid despite a bankruptcy case being filed, to more surprising ones, such as the protections awarded to certain lessors or vendors of aircrafts or vessels in Chapter 11. Unless an exception justifies lifting the stay, the injunction remains in force until the law may demand its termination upon a number of factors.

The stay protects the debtor and the property of the estate. Items of property differ greatly in nature and may have different destinies within the proceeding. Some may be of value and the administrator of the case may sell them quickly; others may have no actual economic importance and may have to be abandoned in the interest of the creditors to avoid suffering the costs of storing or maintaining them, which often prove to be more onerous than the perspective returns. Some specific items may remain the property of the debtor even after the case is successfully closed, in which case they would continue to enjoy a special degree of protection.

Triggering the stay does not per se ensure that violations will not occur during its duration, though. It is rather common for a creditor to violate the stay knowingly or unknowingly. At times, in fact, a creditor may not be aware that a bankruptcy case has been filed and that limits apply to the use of the property.[1339] Unless exceptions apply, all such voluntary[1340] or involuntary acts that violate the stay are void. Willful,

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[1337] **In re Computer Communications, Inc.** (9th Cir. 1987) 824 F2d 725, 731. See **Howe Eric**, "*Benefitting the bankruptcy system through deterrence: allowing a Chapter 7 Trustee to recover punitive damages for a violation of the automatic stay under 362 (h)*", 90 Iowa L.Rev. 1939 (2004-5).

[1338] See **Matter of Rimsat**, Ltd., 98 F.3d 956, rehearing denied (7th Cir. 1996); **Efrat Rafael**, "*The Case for Limited Enforceability of a Pre-Petition Waiver of the Automatic Stay*", 32 San Diego L. Rev. 1133, (1995), at 1138.

[1339] No notice to creditors is necessary for the stay to be effective (see **In re Eisenberg** (BC ED NY 1980) 7 BR 683, 686), although to avoid trouble notice is given of the commencement of the case and it is in the best interest of the debtor to let, for example, a creditor about to sell foreclosed property that such an act would be in violation of the Code. See also **Manz S**., "*To infinity and beyond: exploring the reach of the automatic stay*" 30 A.B.I. J. 34, (2011), at 65: "In situations where a creditor has already technically violated the automatic stay by taking action without knowledge of a bankruptcy filing, they may be required to restore the status quo and avoid willful violation of the automatic stay by, for example, returning repossessed collateral or seeking to vacate a state court contempt order. One case recently held that creditors also have affirmative duties to correct the actions of third parties, even when the creditor informs the third party of the filing prior to it taking actions in violation of the automatic stay."

[1340] § 362 (h) applying to individuals (not corporations):

(1) In a case in which the debtor is an individual, the stay provided by subsection (a) is terminated with respect to personal property of the estate or of the debtor securing in whole or in part a claim, or subject to an unexpired lease, and such personal property shall no longer be property of the estate if the debtor fails within the applicable time set by section 521(a)(2)(A) to file timely any statement of intention required under section 521(a)(2) with respect to such personal property or to indicate in such statement that the debtor will either surrender such personal property or retain it and, if retaining such personal property, either redeem such personal property pursuant to section 722, enter into an agreement of the kind specified in section 524(c) applicable to the debt secured by such personal property, or assume such unexpired lease pursuant to section 365(p) if the trustee does not do so, as applicable; and (B) to take

malicious, or dishonest noncompliance with the rules may cause the imposition of actual and even punitive damages on the offending creditor.[1341]

Pre-petition waivers of automatic stay have been deemed unenforceable, possibly as an extension of the principle that forbids agreements to not file for bankruptcy, which would be in violation of policy.[1342] As such, the stay is an inevitable protection in bankruptcy and a relevant strategic factor in incentivizing debtors in filing for bankruptcy relief.

The heavy sanctions for violating the stay, combined with the fact that such powerful protection may last for long periods due to the length of some proceedings, raises a negative perception in the creditors about this tool and insolvency frameworks as a whole. The stay remains, though, a procedural necessity without which the bankruptcy process could not take place.

Section 362 of the Code is organized into 8 subsections. It defines the scope of the stay by listing both the actions that are expressly stayed by filing for bankruptcy and the ones that serve as exceptions; it determines the duration of the injunction; it determines the grounds by which a creditor may seek relief from it including emergency rules to avoid "irreparable harm". Moreover, it includes parameters to punish violations.

6.1 Scope of the automatic stay § 362 (a)

Section 362 (a) lists a number of specific judicial and administrative activities that are barred under the Code. Whenever they are continued without being expressly authorized by Courts they constitute a violation and may be punished.

The automatic stay specifically halts the following individual actions:

§ 362 (a) (1) stays	"The commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title."[1343]

The stay differentiates between claims arising pre- and post petition. The injunction bars the commencement or continuation of all actions to recover pre-petition credits; it is not relevant if the creditor acquires knowledge of the cause of action after filing has occurred, as long as all of the elements that constitute the claim derive from pre-petition claims.[1344]

The automatic stay does not bar actions arising post-petition, including all the causes of action that may arise within the proceeding itself, such as frauds committed through alienating or concealing property of the estate to damage the estate and the creditors.

§ 362 (a) (2)	"The enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title."

In order to allow the fair and correct development of the proceeding, the enforcement of pre-petition judgments is stayed; this rule is consistent with the goal of providing organized proceedings for the

timely the action specified in such statement, as it may be amended before expiration of the period for taking action, unless such statement specifies the debtor's intention to reaffirm such debt on the original contract terms and the creditor refuses to agree to the reaffirmation on such terms.

[1341] § 362 (k). See **Easterbrook John W**., "*A real estate loan trap: how a junior leanholder can create mischief*", 125 Banking L.J.842 (2008), at 848-9.

[1342] **In re DB Capital Holdings LLC**, 454 B.R. 804 (Bankr. D. Colo. 2011); for contrasting decisions on the topic see **Alexander SRP**, 2012 WL 1910088; **In re Bryan Road LLC**, 382 B.R. at 849, listing factors that by which a court may determine such a waiver to be enforceable.

[1343] **Ellis v. Consolidated Diesel Electric Corp**. 894 F.2d 371 (10th Cir. 1990).

[1344] **In re Johns-Manville Corp. of America**, 58 B.R. 101.

distribution of property to creditors based on the rank of their claims, and preventing a race to be the first (and maybe the only) one to be paid.[1345]

§ 362 (a) (3)	"Any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate."
§ 362 (a) (6)	"Any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title."

§ 362 (a) (3) prohibits any action to obtain possession of property of the estate. It applies also to self-help repossessions even if permitted under state law or the UCC[1346] [1347], and even if executed without a "breach of the peace".[1348] The interests protected by this rule are analogous to the ones protected under the previous section: ensuring the organized distribution of the property of the estate though the system adopted within the enacted bankruptcy framework.

Moreover, through § 362 (a) (6) the stay prohibits any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case, even if such acts are not per se unlawful, or are allowed under other statutes such as the UCC.[1349] "Acts to collect" include a variety of actions and circumstances, such as sending letters or making phone calls[1350], that may threaten or harass the debtor.[1351] Colleges that refuse to provide students with a transcript until they pay their discharged debt have been found to violate automatic stay[1352]; and, as we just mentioned, all sorts of self repossessions or the use of repossession agencies (even in the cases in which breaches of the peace do not occur) are forbidden.[1353]

On the other hand, it is not forbidden to provide the debtor with useful information about his debts, such as statements regarding an adjustment in interest rates, without any attempt to collect.

§ 362 (a) (4)	"Any act to create, perfect, or enforce any lien against property of the estate."
§ 362 (a) (5)	"Any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title."

362 (a) (4) and (5) restrain any action a creditor might take to create, perfect, or enforce a lien against estate property. Perfection of a right gives a privileged position to a creditor in distribution and allows for special protections and a higher chance of repayment. Whenever, though, all the necessary steps towards acquisition of such status have not been completed before enactment of the stay, the creditor will not enjoy such privilege.[1354]

[1345] **Zuckemberg Mark S.**, "*The heart of bankruptcy: the automatic stay*", 54 Res Gestae 24, (2010), at 24.

[1346] The "UCC" is the Uniform Commercial Code which has been adopted in the US to bring uniformity in commercial laws.

[1347] **In re Holman**, 92, B.R. 764 (bankr. S.D. Ohio 1988).

[1348] See **Garner Brian A**., "*Black's Law Dictionary*", ISBN 978-0314151995, (2004), 8th edition, defining "breach of the peace" as: "The criminal offense of creating a public disturbance or engaging in disorderly conduct particularly by making an unnecessary or distracting noise" and mentioning the following interesting quote: "The beginning of our criminal justice… was concerned very largely with the problem of keeping the peace. Because of this fact all early indictments included some such phrase as "against the peace of the King"; and until recently statutory provisions for simplification, indictments in this country were thought to be incomplete without some such conclusion as "against the peace and dignity of the state". As a result of this history all indictable offenses are sometimes regarded as deeds which violate the public peace, and hence in a loose sense the term "breach of the peace" is regarded as a synonym for crime." **Rollin M. Perkins and Ronald N. Boyce**, Criminal Law 477 (3d ed. 1982). In this case the element of the stay protects the order and organization imposed by the bankruptcy system.

[1349] UCC 9-317 (e); see the discussion in **Zuckemberg Mark S**., "*The heart of bankruptcy: the automatic stay*", 54 Res Gestae 24, (2011), at 25.

[1350] **In re Withrow** (BC WD NC 1988) 93 BR 436, 438.

[1351] **In re Zotow** (9th Cir. BAP 2010) 432 BR 252, 258.

[1352] **In re Kuehn** 563 F3d 289.

[1353] **In re Rodriguez** (BC D PR 1988) 97 BR 136, 138.

[1354] Specific exceptions apply such as § 546 (b).

§ 362 (a) (7)	"The setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor."

§ 362 (a) (7) forbids post-petition offsets of pre-petition debts unless the court lifts the stay. Exceptions apply. They mainly protect brokers and financial institutions as a stay of operations on the market may have great effects that go far beyond the single insolvency that has been triggered.[1355]

§ 362 (a) (8)	"The commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title."

§ 362 (a) (8) restricts the commencement or continuation of a proceeding before the US Tax Court as such power vests in the Bankruptcy Court.

6.2 Exceptions to the automatic stay: § 362 (b)

Congress has enacted, over time, several exceptions to the stay. Almost thirty are included in § 362 (b). Some are very specific and of limited applicability; others serve to protect fundamental interests that would suffer great harm and prejudice by the enforcement of the stay. The following sections are of particular relevance and present useful examples of the interests that found specific protection over time.

Under section 362 (b): "The filing of a petition under sections 301, 303, 303 of this title, or of an application under section 5 (a) (3) of the Securities Investor Act of 1970 does not operate as a stay":

- **to the commencement or continuation of criminal actions or proceedings**: § 362 (b) (1) makes it so that the filing of a petition does not work as a safe haven for criminals by preventing state or federal criminal proceedings from being affected by bankruptcy filing.[1356]
- **to the commencement or continuation of some civil actions or proceedings**: § 362 (b) (2) includes the commencement or continuation of civil proceedings:
  - (A) (i) for the establishment of paternity; (ii) for the establishment or modification of an order of domestic support[1357]; (iii) concerning child custody; (iv) for the dissolution of a marriage, except to the extent that such proceeding seeks to determine the division of property that is property of the estate; (v) regarding domestic violence;
  - (B) the collection of a domestic support obligation from property that is not property of the estate;
  - (C) with respect to the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial administrative order or statute.[1358] Moreover, § 362 does not operate to prevent a proceeding to halt domestic violence.[1359]

Giving priority to family obligations and family-related actions and debts seems consistent with the general scheme of the Code, which makes them non-dischargeable and even authorizes dismissal of Chapter 11[1360], 12[1361], and 13[1362] petitions if they are not regularly paid.

[1355] See § 363 (b) (6) and **In re Weisberg** (9th Cir. 1998) 136 F3d 655, 659.
[1356] See on the topic **Peyton Gaumer Craig**, "*Curbing an Expropriation of Power: the Argument Against Allowing Bankruptcy Courts to Enjoin State Criminal Proceedings*", 16 Am. Bankr. Inst. J. 12, 16-MAR Am. Bankr. Inst. J. 12 (1997).
[1357] § 101 (14A).
[1358] § 362 (a) (2) (C) is a BACPA expansion of the paragraph; see **Zuckemberg Mark S.**, "*The heart of bankruptcy: the automatic stay*", 54 Res Gestae 24, (2010), at 27-28.
[1359] § 362 (b) (2) (A).
[1360] §1112 (b) (4) (P).
[1361] § 1208 (c) (10).
[1362] § 1307 (c) (11).

- **To halt some governmental actions**: per § 362 (b) (4), the stay is inapplicable to prevent the commencement or continuation of a proceeding by a governmental unit or any organization exercising authority under the Convention on the prohibition of the development, production, stockpiling, and use of chemical weapons and on their destruction to enforce such unit's police and regulatory power**.** §362 (b) (9) permits acts to collect taxes or to create or collect tax liens. An exception to the exception applies: governmental units are stayed from enforcing money judgments since such actions are not derived from their police and regulatory power but tend to protect a mere monetary interest.[1363]
- **To halt actions to retake possession of premises in commercial leases**: §362 (b) (10) permits lessors of commercials real estate to retake possession of the premises when the lease expired either before the case was filed or while the case is pending.
- **To halt actions in connection with unpaid negotiable instruments**: § 362 (b) (11) limited action in connection with unpaid negotiable instruments expressly allowed under Article 3 of the UCC. The Code does not allow the creditor to receive payment, but he may get notice of and protest the use of such an instrument.[1364]

6.3 Duration and termination of the stay in absence of abuses

The stay remains in effect during the whole time in which the case is pending until its closure or dismissal, unless the competent bankruptcy judge modifies it and protects both the debtor and property of the estate.[1365] Such a shield ceases to have effect upon the occurrence of specific facts, such as the time at which items of property that constitute the estate may be sold or abandoned.[1366]

Some property, in fact, may stop being part of the estate before the proceeding is closed. The reasons vary. Items may, for example, have been sold in order to constitute the liquidity necessary to pay creditors. Just as commonly, property may have been abandoned by the trustee because they were damaged or, in general, of no value (meaning also that there may be no equity left in the property for distribution, hence making that particular item of no interest for the procedure[1367]).

Sometimes the management, storage, and preservation of particular types of assets may cost more than what they are worth. A clear example is old office technology such as computers (or, in my personal experience, I can mention old and incredibly heavy printers)[1368]. They may be completely illiquid and of no value at all; stocking them may have high costs, though. The fact that some specific property has been given away shows that it is not essential to the proceeding and there is no use in protecting it through the stay, which will remain in force to preserve exclusively the assets remaining in the estate.

The motives are irrelevant; in such situations the stay is not necessary anymore, because the items that have been traded or discarded must not be considered anymore part of the estate and as such do not need to enjoy further protections. The stay will remain in force and will protect the remaining property until discharge is granted or denied, or the case is closed or dismissed, whichever occurs first.[1369]

6.4 Lifting the stay

Conflicts between creditors and debtors give rise to much debate about the use and the effects of such a powerful injunction, especially in those situations in which a complicated case may be of long duration. The length of proceedings, in the end, is a major headache in bankruptcy.

[1363] See **Penn Terra ltd. V. Dept. of Envtl. Res**., 733 F.2d 267 (3d Cir. 1984).
[1364] **Morgan Guar. Trust Co. of New York v. American Sav. & Loan Ass'n** (9th Cir. 1986) 804 F2d 1487, 1490-1491.
[1365] § 362 (c) (1).
[1366] § 362 (c).
[1367] § 554.
[1368] This is a particularly emotional topic for practitioners. Anybody whom has had to clear entire storage areas full of worthless, damaged junk; or who has had to carry up or down stairs those lovely printers from the early nineties; or who had to move voluminous property among different offices knows this bright side of our profession.
[1369] § 362 (c) (2).

Therefore, a creditor may petition and, in certain instances, succeed in having the stay lifted in the following situations[1370]:

- Courts enjoy broad discretion in granting such relief "for cause" (for example, in the case of lack of "adequate protection");
- Upon proving that the specific item of property is unnecessary for a reorganization process, if the debtor has no equity left in the property;
- In a single-asset real estate case worth less than four million dollars.

The stay may be lifted "for cause" on motion of a party in interest (usually a creditor trying to retrieve collateral). Courts enjoy broad discretion in determining "cause". The Code mentions the case in which a secured creditor proves the "lack of adequate protection".[1371] "Adequate protection" concerns the value of a secured creditor's lien in collateral which may depreciate due to numerous circumstances. Consider, for example, the situation in which the collateral is a car. It is easy to imagine how the value of a vehicle may quickly decrease during a lengthy liquidation in a fast-moving market that always offers new options to a decreasing number of buyers. Depreciation may be caused also by the use of the collateral (for example, an office copy machine) that loses value through wear and tear. In general, aging is a factor that adversely affects the value of the asset, increasing its illiquidity and adversely affecting the interests of the creditors.

In Aall these situations the stay may be kept in place by protecting the interest of the secured creditor. A common way to achieve such a goal is to make cash payments to compensate for the portion affected by loss of value.[1372] For example, if property depreciates $30.000 a month, the debtor may compensate such a sum at his expense (without affecting the creditors through the use of his exempted property). The debtor may also provide an additional lien[1373] in some other property with available value, granting recovery for the secured creditor without need to lift the stay.[1374]

If such remedies are not available, the creditor may be allowed by the court to foreclose and sell the item before too much value is lost.

[1370] § 362 (d).

[1371] § 362 (d): "On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay (1) for cause, including the lack of adequate protection of an interest in property of such party in interest; (2) with respect to a stay of an act against property under subsection (a) of this section, if (A) the debtor does not have an equity in such property; and (B) such property is not necessary to an effective reorganization; (3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later (A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or (B) the debtor has commenced monthly payments that (i) may, in the debtor's sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before, on, or after the date of the commencement of the case by or from the property to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien); and (ii) are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate; or (4) with respect to a stay of an act against real property under subsection (a), by a creditor whose claim is secured by an interest in such real property, if the court finds that the filing of the petition was part of a scheme to delay, hinder, or defraud creditors that involved either (A) transfer of all or part ownership of, or other interest in, such real property without the consent of the secured creditor or court approval; or (B) multiple bankruptcy filings affecting such real property.
If recorded in compliance with applicable State laws governing notices of interests or liens in real property, an order entered under paragraph (4) shall be binding in any other case under this title purporting to affect such real property filed not later than 2 years after the date of the entry of such order by the court, except that a debtor in a subsequent case under this title may move for relief from such order based upon changed circumstances or for good cause shown, after notice and a hearing. Any Federal, State, or local governmental unit that accepts notices of interests or liens in real property shall accept any certified copy of an order described in this subsection for indexing and recording."

[1372] § 361 (1).

[1373] § 362 (2).

[1374] § 362 (3).

Other sources of cause include those cases in which court finds that bankruptcy is not the best forum to adjudicate a matter, such as in the case of divorce, upon determining the property available for the liquidation or the reorganization process.

The stay may be successfully lifted also in the case of a reorganization proceeding, when the property holds no equity and is of no use to an effective reorganization.[1375] Under such a two-prong test, relief will not be granted unless the whole value of the property is covered by encumbrances, since any portion of it remaining available would have to be distributed. Since a debtor in possession is allowed to use assets to continue operations, it will also be necessary to prove that the specific item is of no use in the plan; or that the plan, as it has been formulated, will not be effective.[1376] Section 362 (d) (3) lists also the specific case of a single-asset real estate case.[1377]

6.5 Prevention of abuse by both debtors and creditors

It is not uncommon for (often irate) creditors to commit acts in violation of the stay.[1378] Not all of them may be malicious, though. It is not always possible, in fact, for a creditor to be informed of the bankruptcy case at the moment in which the violation is committed. In such instances, the creditor is usually required to fix any alteration that may have been caused to the status quo.[1379] If the case of a willful violation of the stay, debtors recover actual damages, costs, attorney's fees, and eventually punitive damages.

As we have already mentioned, in 2005 BACPA additions to the Code attempted to prevent an individual debtor from gaining an undue and abusive advantage through the stay in the case where a petition is filed twice within the same year; in such a case the stay would end 30 days from the day of filing the petition. Such a rule does not apply to those situations in which re-filing may be necessary, such as when a previous case has been dismissed under § 707 (b), forcinga determined debtor to seek protection elsewherein Chapters 11, 12, or 13.[1380] [1381]

Other causes of cessation of the stay may derive from failure to comply with specific regulations, such as the failure to file the Statement of Intentions upon filing for relief under Chapter 7, which automatically ends the protection at the very beginning of the case.[1382]

6.6 The stay in § 524 as a "post-discharge injunction"

It is relevant to mention the protection awarded by section 524 of the Bankruptcy Code, which comes into effect once a debtor is discharged. Obtaining a discharge, in fact, relieves a debtor from personal liability for all debts that are dischargeable in the bankruptcy case. Moreover, in order to ensure that the former debtor can take advantage of its fresh start, Section 525 provides a stay, preventing further actions from creditors.[1383]

[1375] § 362 (d) (2) if they result in the realization of the indubitable equivalent of the creditor's interest in the collateral. In re Muriel Holding Co 75 f.2d 941PA 256.

[1376] A further issue is whether an effective plan is possible. 11 USC 362(d)(2).

[1377] Blum Brian A., "Bankruptcy and Debtor/Creditor", Sixth Edition, Wolters Kluwer Law & Business, New York, ISBN 9781454833918, (2014), at 273.

[1378] **In re Stonegate Security Services, Ltd.** (ND IL 1986) 56 BR 1014, 1020; **Matter of National Service Corp.** (5th Cir. 1984) 742 F2d 859, 862, stating that a sign stating that a debtor is bankrupt and not paying his debts is not considered offensive but within the right of free speech.

[1379] See for example **Commercial Credit Corp. v. Reed**, 154 B.R. 471 (E.D. Tex. 1993).

[1380] § 362 (c) (3).

[1381] **Gray Carlson David**, "Junior Secured creditors and the automatic stay", 6 am bankr. Inst. L. rev. 249. It is also in the powers of the court to exceptionally lift the stay or expand its term upon petition of parties, such as a trustee moving for the stay to last more than 30 days.

[1382] The document must be filed within 30 days of filing the petition (see § 521(a)(2). See also § 362 (h); 521 (a) (2)), unless the court grants an extension for cause, § 521(a)(2)(B).

[1383] § 524 (a) (1).

7. The property of the estate

An immediate consequence of filing for the commencement of a bankruptcy case is the creation of an estate.[1384] The U.S. Bankruptcy Code gives powers for the creation, administration, and protection of an "ample" estate which, as suggested by the World Bank's List in Principle C8, includes the debtor's assets.

Not all assets will, though, be used by the proceeding. Relevant exclusions of property from the estate are:

a) the abandonment of property;

b) exempted property in the case of natural persons.

Moreover, the destiny of certain items of property may vary depending on the Chapter the case is filed under. Post-petition wages and earnings in a Chapter 7 liquidation, for example, are not part of the estate. By choosing this option, the debtor relinquishes the property owned at the moment of filing for the benefit of the creditors and to obtain a quick discharge; while, as we have been discussing in Chapter II, they are the key asset made available in reorganizations and rehabilitations under Chapters 11, 12[1385], and 13.[1386]

7.1 The bankruptcy estate

Under the Bankruptcy Code, the estate acquires title to "all legal or equitable interests of the debtor in property as of the commencement of the case"[1387], no matter where the property is located[1388], who holds it[1389], or the right of an individual to claim the property as exempt[1390]. Whether filing is voluntary, joint, or involuntary is irrelevant and so is the Chapter the case is filed under.

The estate acquires whatever right the debtor owned. Hence, there is a deep correlation in this aspect of bankruptcy law between federal and state rules under the protection of § 362, the automatic injunction that prevents actions from creditors and preserves the status quo at the time of filing. Federal rules determine the inclusion and administration of the property in bankruptcy, state rules the origin and extension of the right. For example if a debtor, and therefore the estate, may own in a particular case a fee simple absolute or not often depends on local statutes.[1391]

The Code preempts any contractual restriction to the transfer of property to the estate[1392], with the only exception of interests deriving from spendthrift trusts as long as they are enforceable under state laws.[1393] As we will discuss later in this section, it may not be reasonable to retain some items of property which may be abandoned.[1394]

[1384] § 541 (a); see on the topic Plank Thomas E., "The Outer Boundaries of the Bankruptcy Estate", 47 Emory L.J. 1193 (1998).

[1385] § 1207 (a) (2).

[1386] § 1306 (a) (2).

[1387] § 541 (a) (1).

[1388] The property may be located in another city, state or even dimension if we consider an internet website. For example, see **In re Paige**, 443 B.R. 878 (D. Utah) 2011.

[1389] The Bankruptcy Code defines a "custodian" in § 101 (11): The term "custodian" means (A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title; (B) assignee under a general assignment for the benefit of the debtor's creditors; or (C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.

[1390] See on the topic **Gray Carlson David**, "*Bankruptcy's organizing principle*", 26 Fla. St. U. l. Rev. 549, (2014). Discussing the evolution and different views of the creation of the estate and rights of the trustee (or debtor in possession) to manage the included property of the debtor: **Plank Thomas E.**, "*The outer boundaries of the bankruptcy estate*", 47 Emory L.J., 1993, (1998).

[1391] **In re First Protection, Inc.** (9th Cir. BAP 2010) 440 BR 821, 828.

[1392] § 541 (c) (1) (A).

[1393] § 541 (c) (2); an invalid trust will not be protected; see for example the limitation in recognition of "self-settled" trusts applied by many states.

[1394] We will not discuss the matter extensively. The abandonment of items of property is, however, an extremely interesting topic. A relevant case on this topic is **Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection,** 474 U.S. 494, 503, 106 S. Ct. 755, 88 L. Ed. 2d 859, 13 Bankr. Ct. Dec. (CRR) 1262, 13 Bankr. Ct. Dec. (CRR)

While in Chapter 7 a trustee is appointed to manage the liquidation of the property[1395], in a reorganization Chapter the debtor is, usually, allowed to remain "in possession". In the first case the Chapter 7 debtor is deprived (in the case of filing occurring voluntarily, since they are the most common form of filing in the US, it could be said he voluntarily relinquishes) of the control his non-exempt assets to satisfy the claims of creditors. In a reorganization proceeding, the debtor may continue to exercise possession and control over the property, but the commencement of the case creates a fracture as to his rights, which are not anymore the one of sole proprietor but of a fiduciary administrator.

7.2 Items of property included in the estate

The property included in the estate is comprehensive of a vast variety of prepetition and post petition items.

The estate is composed of all the legal and equitable interests owned by the debtor at the time of filing, some specific items of property acquired within 180 days after commencement of the case, and property recovered by the trustee (or the DIP) using the avoiding powers.

Exempt property is part of the estate until it is removed from it through the exercise of a valid right of the debtor[1396] or abandoned under § 554.

Property that is not anymore in possession of the debtor as it has been lawfully repossessed also becomes part of the estate.[1397]

Property subjected to third party rights is acquired to the extent of the rights the debtor had in the property at the time of filing[1398]; perfected security interests, for example, are protected despite the collateral entering the estate.

Property that is hidden upon filing is also included automatically in the estate even if its existence is unknown.[1399] A debtor may not necessarily omit assets from the schedules filed with court in bad faith; it may be that she forgot about some property deposited with a third party – see, for example, some old videogames, toys, or records of her childhood that are now valuable collectibles for the voracious online market, left at her parents' place. HOwever, willfully failing to include assets should not be taken lightly, for it may cause the debtor to lose his discharge under 11 U.S.C. 727 (a) (2) or to be held criminally liable under §18 U.S.C. 152 (1).

Legal and equitable interests in the property held by the debtor at the time case is commenced[1400] tend to include a vast variety of items:

- bank or escrow accounts or funds in which a debtor holds a beneficial interest at the time of commencement of the case[1401]:
- stock, bonds, or other financial instruments;
- interests in intangibles such as a corporate name[1402], copyrights, patents;
- licenses (such as a liquor license)[1403].

1269, 13 Collier Bankr. Cas. 2d (MB) 1355, 23 Env't. Rep. Cas. (BNA) 1913, Bankr. L. Rep. (CCH) P 70923, 16 Envtl. L. Rep. 20278 (1986), which ultimately concluded that a bankruptcy Court does not have the powers to allow the abandonment of property in violation of state or federal statutes for the protection of public health and safety without ensuring conditions that will adequately protect public health and safety. This is a case in which a clear, and reasonable, limitation is posed on the administration and development of a bankruptcy proceeding. See also **In re Smith-Douglass**, Inc, 856 F.2d 12 (4th Cir. 1988), stating that such limitation, in any case, is narrow and applies when there is an imminent danger to the public's health or safety.

[1395] §§ 542; 543. See **United States v. Whiting Pools**, Inc. (1983) 462 US 198, 202-209, 103 S.Ct. 2309, 2312-2315.

[1396] **In re Hernandez** (9th Cir. BAP 2012) 483 BR 713, 724-72.

[1397] **In re Coleman** (BC ND IL 1999) 229 BR 428, 430.

[1398] **In re Coupon Clearing Service, Inc.** (9th Cir. 1997) 113 F3d 1091, 1099.

[1399] **In re Blixseth** (9th Cir. 2012) 684 F3d 865, 871.

[1400] § 541 (a) (1).

[1401] **In re Rosenshein** (BC SD NY 1992) 136 BR 368, 372-373.

[1402] See **In re Golden Plan of Calif., Inc.** (BC ED CA 1984) 37 BR 167, 169-170.

[1403] See **In re Johns-Manville Corp**., 40 B.R. 219 (S.D.N.Y. 1984).

A variety of pre-petition claims such as personal injury claims[1404] or malpractice claims arising against the debtor's attorney for negligently filing the case[1405] may also be transferred to the estate and commenced or continued by the trustee even if they are not assignable by state law.[1406]

So does real estate property, or other property that is in control of the debtor, while occupying it or having exclusive use of it (see for example rights of possession arising under an unexpired lease[1407]).

A partnership interest becomes part of the estate, although such fact has no impact on the assets managed by the partnership per se.[1408]

Post-petition tax refunds in most cases become property of the estate[1409] and so does property included in a revocable trust.[1410]

Community property interests of the debtor or the debtor's spouse, if those interests are under the management and control of the debtor, or if the property is liable under relevant community property law or claims against the debtor[1411] (joint tenancy, tenancy in common to the extent of the debtor's rights under state law).

Other items that may compose the estate include:

- property recovered by the trustee or the debtor in possession from third parties using the avoiding powers[1412];
- excessive attorney compensation paid pre-petition;
- property interests preserved for the benefit of the estate[1413];
- certain property acquired by debtor within 180 days after commencement of the case, if the property would have been part of the estate if it was owned by the debtor at the time of filing as: a) bequest, devise ,or inheritance[1414], b) as result of a property settlement or divorce decree, or c) as property acquired through a life insurance policy or death benefit plan[1415];
- proceeds, products, rents or any kind of profits generated by property of the estate during the administration of the case[1416];
- property acquired by the estate itself after commencement.[1417]

The creation of the estate supersedes any contractual provision aimed to trump transfers to third parties upon debtor's insolvency, filing of a bankruptcy case or the appointment of a trustee for the administration of the estate.[1418] Such *ipso facto* clauses[1419] would automatically prevent the administration of items of property upon filing, harming the creditors. Only a few exceptions to this rule apply and they

[1404] **Tignor v. Parkinson**, 729 F. 2d 977 (4th Cir. 1984).

[1405] **In re Alvarez**, 224 F. 3d 1273 (11th Cir. 2000).

[1406] See for example personal injury claims **In re Cottrell** (6th Cir. 1989) 876 F2d 540, 542-543; emotional distress claims **Sierra Switchboard Co. v. Westinghouse Elec. Corp.** (9th Cir. 1986) 789 F2d 705, 707-709; wrongful termination claims **Auday v. Wet Seal Retail, Inc.** (6th Cir. 2012) 698 F3d 902, 904; legal malpractice claims **In re Pace** (BC D AK 1991) 132 BR 644, 646.

[1407] **Tel-A-Communications Consultant Inc**. 50 B.R. 250 (Bankr. D. Conn. 1985).

[1408] **In re Cutler** (BC D AZ 1994) 165 BR 275, 280.

[1409] **In re Intelligent Direct Marketing** (ED CA 2014) 518 BR 579, 590.

[1410] **In re Harris** (BC ED CA 1989) 101 BR 210, 215-216.

[1411] **Plank Thomas, E.**, "*the outer boundaries of the bankruptcy estate*", 47 Emory L. J. 1193, (1998). If community property becomes part of the estate a post petition state court division judgment is not enforceable **In re Willard** (9th Cir. BAP 1981) 15 BR 898, 900-901.

[1412] § 362 (a) (2) (3) (4); See **Gray Carlson David**, "*Bankruptcy's organizing principle*", 26 Fla. St. U. l. Rev. 522, (2014), at 522.

[1413] §§ 510 (c) 551.

[1414] § 541 (a) (5) (A).

[1415] § 541 (a) (5); **In re Chenoweth**, 3 F. 3d 1111 (7th Cir. 1993).

[1416] § 541 (a) (6).

[1417] § 541 (a) (7).

[1418] The debtor, custodians of property and any other person or entity holding property of the estate must turn it over for accounting. See § 542 (a); § 543 (a), (b), (d).

[1419] § 541 (c) (1) (A).

protect correctly-formed spendthrift trusts to the extent of the corpus of the trust (exceptions do not apply to income paid or owed to the debtor within 180 days from filing)[1420] and qualified pension plans.

Property can cease to be part of the estate through abandonment or disbursement only.[1421] It takes, therefore, a voluntary, lawful act to terminate the automatic creation of the estate and all protections deriving from it before some property can return to being available.

7.3 items of property excluded from the estate

The exclusion of certain items of property is determined by policies enumerated in § 541 (b). Guidelines may vary depending on the Chapter under which the case is filed.

Among them we can list:

a) any power that the debtor may exercise solely for the benefit of an entity other than the debtor (such as acting as trustee[1422]);

b) the debtor's interest as a lessee under a nonresidential real property lease that expired by its own terms pre-petition, or expires by its own terms during the bankruptcy proceeding, does not constitute property of the estate[1423];

c) the debtor's eligibility to participate in programs authorized under the Higher Education Act of 1965 (20 USC § 1001 et seq.; 42 USC § 2751 et seq.) or the debtor's accreditation status or state licensure as an educational institution.[1424]

Moreover, with certain exceptions and under certain circumstances:

d) any interest of the debtor in liquid or gaseous hydrocarbons[1425];

e) funds placed in an educational individual retirement account (as defined in section 530 (b) (1) of the Internal Revenue Code of 1986), no later than 365 days before the date of the filing of the petition in a case under this title[1426];

f) funds used to purchase tuition credit or certificates or contributed to an account in accordance with section 529 (b) (1) (A) of the Internal Revenue Code of 1986 under a qualified state tuition program, no later than 365 days before the date of filing.[1427]

8. A brief overview of the treatment of contractual obligations and avoiding actions[1428]

8.1 The right to set off

Principle C10.4 of the World Bank’s list discusses an important topic: the right of parties to set off reciprocal debts and credits. This ancient principle supports transactions within the market but, as we will see, causes conflicts or a certain degree of uncertainty in the field of bankruptcy law. Given the important policies it supports, though, the World Bank advocates that such a right should be upheld and preserved.

[1420] § 541 (a) (5); **In re Hecht**, 54 B.R. 379 (Bankr. S.D.N.Y. 1985).

[1421] §§725-726. Abandonment of property cannot, though, occur risking to harm the health or safety of the public in violation of federal or state laws. Cases in which environmental interests are at stake are a good example of this policy; think, for example, of all those cases in which removing certain items of property of no value would constitute an expense (and a burden for the creditors) yet keeping them in place may contaminate the soil on which they are placed. For a discussion and cases on the topic see **Theuman John E.**, "*Right and Power of Trustee in Bankruptcy or Debtor in Possession to Abandon, Under 11 U.S.C.A. § 554(a), Property Which is "Burdensome" Because of Existence of Environmental Conditions Requiring Cleanup—Midlantic and Its Progeny*", American Law Reports, 103 A.L.R. Fed. 72 (Originally published in 1991).

[1422] § 541 (b) (1).

[1423] § 541 (b) (2).

[1424] § 541 (b) (3).

[1425] § 541 (b) (4); § 101 (21A).

[1426] § 541 (b) (5).

[1427] § 541 (b) (6).

[1428] See on the topic **Jackson Thomas H.**, "*Avoiding Powers in Bankruptcy*", 36 Stan. L. Rev. 725 (1984).

We will have a brief look into some of the relevant aspects regarding setoffs before commencing the intricate discussion about avoiding transactions and fraudulent transfers.

Set-offs protect an original balance against subsequent alterations in the interests of parties whose mutual[1429] claims[1430] arose before filing.[1431] The Bankruptcy Code relies on local statutes to provide set-off rules and allows them to operate within the insolvency framework.[1432] The characteristics of this element don't match the matrix of bankruptcy, which becomes a source of subsequent alteration and therefore can lead to conflicts.

> Example 1: on the 10th of October, a debtor who installs elevators buys $30.000,00 worth of parts from a supplier. On November 1, the supplier asks the debtor to build a new elevator in his office. The debtor agrees and the final cost is estimated to be $35.000,00. The supplier agrees to wait on collecting the amount owed for the previous purchase made by the debtor, since he will soon owe a greater amount. The elevator is done on December 15, and the debtor is forced to file bankruptcy under Chapter 7 on the 19th. Both claims arose, therefore, before the commencement of a case.
> In this case the supplier, who thought he would ultimately pay about $5.000,00 for the job, would owe the full $35.000,00 to the proceeding while holding a $30.000,00 unsecured claim which will be ultimately paid off for a fraction of its value.
>
> Example 2: in a second, very common situation, the same elevator company owes a bank $300.000,00 and owns a bank account holding a credit in its favor of $100.000,00. Upon commencing a bankruptcy proceeding, the bank will, under several statutes, become a secured creditor for the amount of $100.000,00, hence improving its position from the one of unsecured creditor for the whole amount.[1433]

In order for the evaluation of set-off rights to occur correctly in bankruptcy, it is important to apply tests to determine all of the elements that have been mentioned. The claims must be mutual and must arise before the commencement of the case. Of course, they must not originate from fraudulent behaviors or from attempts to trick the bankruptcy system.

Some exceptions apply to limit the right to set-offs. State laws may give a right to creditors to set off pre-petition debts and credits incurred with the debtor, unless:

- the bankruptcy court disallows the claim of the creditor against the debtor[1434]; when the debtor is insolvent and the claim has been transferred by an entity other than the debtor after filing or within 90 days

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[1429] "A post-petition obligation may not be set-off against a pre-petition obligation of the debtor, because there is no mutuality of obligation" See **Standard Oil Company of New Jersey v. Elliott**, 4th Cir.1935, 80 F.2d 158; **In re Shoppers Paradise, Inc.,** 8 B.R. 271, 277-78 (Bkrtcy.S.D.N.Y., 1980); **Framingham Winery, Inc. v. J.A.G. Inc**., 7 B.R. 624, 626-27 (Bkrtcy.D.Mass., 1980); **Nelson v. First National Bank and Trust Company of El Dorado**, 6 B.R. 248, 249-50 (Bkrtcy.D.Kan., 1980); **Big Bear Supermarket No. 3 v. Princess Baking Corporation**, 5 B.R. 587, 590-91 (Bkrtcy.S.D.Cal., 1980); **In re Howell**, 4 B.R. 102, 108 (Bkrtcy.M.D.Tenn., 1980); **In re Braniff Airways**, Inc. 42 B.R. 443 (Bankr. N.D. Tex. 1984).

[1430] "Recoupment" is a particular case in which the claims arises from the same transaction. It differentiates itself from set-offs as it is not bound to the automatic stay. About the bank's right to set off on bank accounts up to the amount owed see **In re Strumpf** 516 US 16 (1995).

[1431] § 553 (a): "Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that […]".

[1432] There is no independent federal bankruptcy right to set off. See **In Feltman v. Noor Staffing Grp., LLC (In re Corp. Res. Servs. Inc.)**, 564 B.R. 196 (Bankr. S.D.N.Y. 2017).

[1433] Our discussion on this topic is, of course, limited. This topic, just as all the others that are discussed in this section, is extremely complex. The examples present basic situations to show some of the main difficulties faced in frameworks in finding effective and efficient balances.

[1434] Set-offs are within the discretion of a Court's equitable powers. If the behavior of the parties constitutes bad faith it can be denied; § 553 (a) (1).

from filing[1435] – under a statutory presumption that, in such case, the debtor had been insolvent during that period[1436];

- the debt has been created for set-off purposes, hence with the intent to alter the equilibrium of the proceeding[1437];
- the creditor improves his position through the set-off.[1438]

In general, nevertheless, the framework protected the right to set off. The most common consequence of the commencement of a case is often limited to delays in “fixing the accounting” among parties due to the automatic stay. This is reasonable since the administrators of a case may need time to evaluate the countless issues of a proceeding.

8.2 Avoidable transactions – the “avoiding powers”

The bankruptcy code holds to the logic that a debtor who cannot repay his debts cannot be allowed to give away his few assets easily, and so allows ample powers to contrast this not-so-uncommon occurrence. The temptation of resorting to unauthorized transactions upon understanding one’s economic difficulties remains a temptation even in a particularly friendly framework.

We will not be able to write in great depth in this area for a number of reasons. First of all, the upcoming sections are very detailed and complex; moreover, they often refer to, or interact with, state statutes and the local frameworks involved, which differ greatly from each other.

We will, nevertheless, try to give a meaningful overview of some of the most relevant topics in this area without straying too far from the main focus of our discussion. We have mentioned the desire to strategically transfer part of the debtor’s remaining assets to other persons and the consequences of such acts in several traditional frameworks. Most situations in which avoiding powers apply are standardized and have been discussed in Chapter IV:

a) One or more creditors may receive property in a preferential manner, either by threatening the debtor or forcing the transfer upon him so that they can enjoy a higher share of repayment in contrast to what they would receive at the end of the proceeding (hence harming the other creditors).
b) It also happens that debtors may voluntarily (and without any real intent to harm other parties, or understanding that harm may derive from his behavior) make a payment to one or more specific creditors on the verge of filing a bankruptcy petition just because he thinks that those payments deserve higher protection. The reason of this belief may be connected to, for example
   - matters of honor,
   - other reasons deriving from history of deals that occurred among parties,
   - the desire to keep good connections for the future in light of a probable discharge.
c) The petitioner may also decide to entrust assets, property, or liquidity to family members and friends, most of the tims hoping to keep the assets under some control and eventually to have them returned.[1439]

Briefly analyzing the logic applied by the Code will be useful and important for our comparative analysis.

What may be a “fraud” in bankruptcy varies greatly based on local parameters. We can anticipate a topic that will be discussed in greater depth in the section on natural persons: as we will see, the American insolvency framework is unique in its generosity and grants several exemptions protecting the assets owned by debtors who are natural persons. Debtors may, then, attempt to obtain even greater benefits, planning strategically and converting their non-exempt assets into exempted ones, for example.[1440] Such

[1435] § 553 (a) (1).
[1436] § 553 (c).
[1437] § 553 (a) (3).
[1438] Avoidable within 90 days § 553 (b) (1).
[1439] **Williams Jack E.**, "*The Fallacies of Contemporary Fradulent Transfer Models as Appllied to Intercorporate Guaranties: Fraudulent Transfer Law as a Fuzzy System*", 15 Cardozo L. Rev. 1403 (1994), at 1404.
[1440] See 12.2.2 and in particolar point [B].

behavior, which raises ample ethical questions (and which would certainly find much opposition in more stigmatizing systems), has been placed under scrutiny and deemed acceptable.

Nevertheless, to ensure fairness in the proceeding, trustees (usually in a Chapter 7 liquidation, unless appointed in a reorganization) and Debtors in Possession (in reorganization Chapters) are granted, upon filing for bankruptcy, several “avoiding powers” to set aside as unfair a variety of transactions that may have occurred and that are the cause of alterations in the case. They may be allowed to avoid, for example: fraudulent transfers[1441]; debtor-creditor agreements in the forms of transactions[1442] or set-offs[1443]; liens[1444]; and certain preferences.[1445]

8.3 Avoiding pre-petition, preferential transfers

A first relevant power is embodied in Section 547, which allows a trustee or a debtor in possession to avoid certain pre-petition, preferential[1446] transfers concerning a pre-existing debt[1447] which would adversely affect the organization mandated by the Code and alter the final distribution of the available property.

Voidable transfers of interests[1448] under Section 547 regard antecedent debts[1449] and are made within 90 days of the date of filing (one year if the beneficiary is an insider[1450])[1451], voluntarily or involuntarily, by an insolvent[1452] debtor, to benefit[1453] a creditor[1454] who, consequentially, obtains payment of a larger share than what may have been paid under a Chapter 7 liquidation proceeding[1455], for, or on account of, a pre-

[1441] § 548.
[1442] § 549.
[1443] § 553.
[1444] § 545.
[1445] § 547.
[1446] The elements of a “preference” are defined in § 547 (b).
[1447] § 547 (b) (2).
[1448] By mentioning the transfer of any interest, the Code does not limit § 547 to specific items of property such as money; it includes all voluntary and involuntary transfers of tangible or intangible property, see § 101 (54) (D): “The term “transfer” means (A)the creation of a lien;(B)the retention of title as a security interest;(C)the foreclosure of a debtor’s equity of redemption; or (D)each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with (i)property; or (ii)an interest in property." “Interest” is not defined by the Code; for a definition see **Bergier v. IRS**, 496 U.S. at 53-58 (1990).
[1449] A preference is directly connected with the status of the receiver as creditor in the case, hence, to a pre-petition claim. If the transfer occurs in connection to a post-petition claim § 547 does not apply, although the transaction may still be avoided, for example, as a fraudulent transfer.
[1450] § 101 (31).
[1451] § 547 (b) (4) (A), (B). “Timing, is essential in deploying this power, see 547 (e) determining “when” a transfer is “made” for purposes of this section: “(1)For the purposes of this section (A)a transfer of real property other than fixtures, but including the interest of a seller or purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee; and (B)a transfer of a fixture or property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee. (2)For the purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made (A)at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 30 days after, such time, except as provided in subsection (c)(3)(B); (B)at the time such transfer is perfected, if such transfer is perfected after such 30 days; or (C)immediately before the date of the filing of the petition, if such transfer is not perfected at the later of (i)the commencement of the case; or (ii)30 days after such transfer takes effect between the transferor and the transferee. (3)For the purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred."
[1452] § 547 (b) (3).
[1453] Creditors can be the direct beneficiaries of the preferential transfer or they can be indirectly benefitted by it.
[1454] § 547 (b) (1).
[1455] § 547 (b) (5).

existing obligation (owed by the debtor to the creditor before the transfer was made).[1456] Such a transfer reduces the amount of assets available for distribution, hence damaging the creditors.

It is worth making a brief digression now to point out that this is one of the few areas in which the insolvency of the debtor remains relevant within the Code. This is congruent with the best practices included in the World Bank's Principles. Insolvency in modern statutes, therefore, remains a important element to fighting frauds and to protecting a framework, but it loses most of its traditional relevance as the dominant access requirement.[1457]

During the statute's reach-back period of 90 days (as we will see, the term becomes one full year in the case where the debtor is an "insider"[1458] [1459]), a presumption of insolvency applies.[1460] "Insolvency"[1461], under this section, is defined as a scarcity of available assets ultimately resulting in a negative balance if compared to the outstanding debts (the so-called "balance sheet" test). The presumption makes things easier for the administrator of the case and it is on the receiver to provider evidence on the legality of the transfer.

A transfer made to an insider is defined in § 101 (31) as:

> "(31)The term "insider" includes (A)if the debtor is an individual (i) relative of the debtor or of a general partner of the debtor; (ii) partnership in which the debtor is a general partner; (iii) general partner of the debtor; or (iv) corporation of which the debtor is a director, officer, or person in control;
> (B)if the debtor is a corporation (i) director of the debtor; (ii) officer of the debtor; (iii) person in control of the debtor; (iv) partnership in which the debtor is a general partner; (v) general partner of the debtor; or (vi) relative of a general partner, director, officer, or person in control of the debtor;
> (C)if the debtor is a partnership (i) general partner in the debtor; (ii) relative of a general partner in, general partner of, or person in control of the debtor; (iii) partnership in which the debtor is a general partner; (iv) general partner of the debtor; or (v) person in control of the debtor;
> (D)if the debtor is a municipality, elected official of the debtor or relative of an elected official of the debtor;
> (E)affiliate, or insider of an affiliate as if such affiliate were the debtor; and
> (F)managing agent of the debtor."

This raises the period to a full year, compared to the standard 90 days of any other receiver.

In evaluating single transaction, courts will analyze if the benefit reached by the single creditor amounts to receiving a larger share than what may have been distributed in a liquidation proceeding. Chapter 7 remains, therefore, the default scenario and a necessary parameter to keep in mind to establish the general good of the creditors.

The exceptions[1462] listed in section 547 (c) further limit this avoiding power; not all transfers that meet the above-stated requirements may be avoided. The trustee[1463] cannot avoid those transfers:

1) intended to be, by debtor and creditor, for the substantially contemporaneous exchange of new value given to the debtor – in this case the value of the estate is not diminished and no harm comes to the other creditors;

2) to repay a debt incurred in the ordinary course of business;

[1456] § 547 (b) (2).
[1457] See introduction to Chapter V.
[1458] § 547 (b) (4).
[1459] § 101 (31).
[1460] § 547 (f) the debtor may be presumed to be insolvent for 90 days only even ifshe is an insider; moreover, this presumption is rebuttable; the creditor may succeed in contrasting the trustee's or DIP's action to avoid the transfer, § 547 (g).
[1461] § 101 (32).
[1462] § 547 (c) (1) – (9).
[1463] The section mentions the "trustee" but in reorganization Chapters, unless a trustee is actually appointed, the powers are vested in the debtor who remains in possession.

3) that create security interests in property acquired by the debtor that are perfected up to 30 days after the debtor receives possession of such property;

4) to or for the benefit of a creditor to the extent that the debtor receives new value;

5) in which a security interest in inventory or receivables is perfected if it does not improve the creditor's position damaging other creditors;

6) in which a statutory lien is perfected and such lien is not avoidable under section 545;

7) for the bona fide payment of alimony or support obligations;

8) for the transfer of property of less than $600 in value, involving an individual debtor with primarily consumer debts;

9) in cases filed by an individual debtor whose debts are not primarily consumer, in which the aggregate value of all property that is transferred or affected by the transaction is less than $ 6.225.

Moreover, the trustee may not avoid payments made as part of alternative repayment schedules approved by a nonprofit budget and counseling agency; of course, this is a 2005 BACPCA addition.[1464]

An in-depth analysis of each exception would not serve our discussion, but it is worth mentioning that the exceptions come from general policies to preserve valuable interests that have to be balanced with the ones of the proceeding. See, for example, the second exception, which protects the market (otherwise, suppliers would cut business with buyers in bankruptcy upon perceiving the slightest risk of financial difficulty); or the eighth, regarding small amounts of debts contracted by consumers, which are unlikely to impact distribution positively and may cause disproportionate costs in recovering.

8.4 Avoiding fraudulent transfers[1465]

Section 548 allows the trustee or DIP to avoid any actual or constructive fraudulent transfers that occurred within two years before filing the petition.[1466]

As we have discussed several times in previous Chapters, frauds are the main headache in bankruptcy. They damage the proceeding and the trust that people have in the bankruptcy system as a whole. Despite the illiquidity of a debtor, valuable items of property or interests are often still present in the estate and raise much interest in a number of potential buyers, such as competitors (who may be interested in some low-cost, secondhand machinery); general investors (who may be trying to make a margin from a financial debacle);and other creditors (who interested in recovering as much of their credit as possible before the rules of the proceeding worsen their position).

Of course, frauds are just as old as human interactios. Still, a starting point of fraudulent conveyance laws in common law countries is usually placed in England in 1570 with the "Act Against Fraudulent Deeds, Alienations"[1467], which was punished transactions incurred with the "intent to hinder, delay, or defraud creditors", a definition that is still in use in modern statutes.

[1464] § 547 (h).

[1465] See on the topic **Baird Douglas G. & Jackson Thomas H**., "*Fraudulent Conveyance Law and Its Proper Domain*", 38 Vand. L. Rev. 829, 829 (1985); **Markell Bruce A**., "*Toward True and Plain Dealing: a Theory of Fraudulent Transfers Involving Unreasonably Small Capital*", 21 Ind. L. Rev. 469 (1988); **Williams Jack E.**, "*The Fallacies of Contemporary Fradulent Transfer Models as Applied to Intercorporate Guaranties: Fraudulent Transfer Law as a Fuzzy System*", 15 Cardozo L. Rev. 1403 (1994).

[1466] § 548 (a).

[1467] 13 Eliz., ch. 5 (1570): "91. Fraudulent and Covinous Conveyances- For the avoiding of feigned, covinous and fraudulent feoffments, gifts, grants, alienations, bonds, suits, judgments and executions, as well of lands and in tenements, as of goods and chattels, more commonly used and practised in these days than hath been seen or heard of heretofore; which feoffments, gifts, grants etc have been and are devised and contrived of malice, fraud, covin, collusion or guile to the end, purpose and intent to delay, hinder or defraud creditors and others of their just and lawful actions, suits, debts, etc; not only to the let or hindrance of the due course and execution of law and justice, but also to the overthrow of all true and plain dealing, bargaining and chevisance between man and man, without the which no commonwealth or civil society can be maintained or continued.

92. Declared Void- Be it therefore declared, ordained and enacted, that all and every feoffment, gift, grant, alienation, bargain and conveyance of lands, tenements, hereditaments, goods and chattels, or any of them, by writing or otherwise, and all and every bond, suit, judgment and execution at any time had or made to or for any intent or purpose before declared and expressed, shall be from henceforth deemed and taken, only as against that person or

Two statutes on the topic are relevant at the state level in the US:

- the Uniform Fraudulent Conveyance Act (UFCA) of 1918;
- Uthe niform Fraudulent Transfer Act (UFTA) of 1984, enacted today in the vast majority of states.

Local laws on the topic are relevant, for they can be deployed by the trustee under section 544 (b). A trustee in a federal bankruptcy case, therefore, can elect between the state remedy under § 544 (b) or the Code's remedy of § 548; states and federal laws on the topic coordinate to ensure that such behaviors are contained.

The UFTA and § 548 move from the same premises and attempt to achieve similar goals; they both sanction fraudulent transfers that are made with actual intent to defraud creditors (actual frauds), and behaviors that, even lacking such intent to defraud, cause harm (constructive frauds). The analogies are many; relevant differences, which make it reasonable to make both tools available to the trustee or DIP, lie in the respective reach-back periods and standings.

Section § 548 has a reach-back period of two years from the date the petition is filed. The UFTA (or the UFCA where still enacted) is a statute subject to modifications depending on the different state setting in which it is enacted. Hence, the reach-back period may vary, although it usually is longer than the Code's. It usually amounts to four years, but some states such as Alabama have extended it up to ten years. Moreover, section 9 (a) extends such periods in the case of actual fraud to "within one year after the transfer or the obligation was or could have been discovered by the claimant".

Despite the advantage of a longer reach-back period, the UFTA under § 544 (b) is not as easy to trigger as § 548, since in the latter case the trustee has standing to set aside fraudulent actions while in the first the action is derivative of the creditor's. The trustee, in fact, has the rights of a hypothetical lien creditor; in contrast, 11 USC 544(b) requires that there be an actual pre-petition creditor who could have employed the state remedy. If no creditor has standing under state laws to set aside a certain transaction, then the trustee will not be able to do it either.

8.4.1 Actual and constructive fraud

It is interesting to compare the relevant sections of the UFTA and of the Bankruptcy Code on the topics of actual and constructive frauds:

[A] Actual fraud

Bankruptcy Code U.S. Title 11 § 548 (a) (1) (A)	(a) (1)The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily (A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted;
UFTA § 4 (a) (1)	A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred , if the debtor made the transfer or made the obligation: (1) with actual intent to hinder, delay, or defraud any creditor of the debtor

Section 548 (a) allows the trustee or DIP to avoid all transfers made or obligations incurred with actual intent to "hinder, delay, or defraud creditors. "[1468] Moreover, all transactions (or obligations incurred) in

persons, his or their heirs, successors, executors, administrators and signs of every of them, whose actions, suits, debts, etc; by such guileful, covinous or fraudulent devices and practices, as is aforesaid, are, shall or might be in anywise disturbed, hindered, delayed or defrauded, to be clearly and utterly void, frustrate, and of none effect, any pretence, color feigned consideration, expressing of use or any other matter or thing to the contrary notwithstanding." Quoted in Hotchkiss William A., "A Codification of the Statute Law of Georgia Including the English Statutes of Force", Published by John M. Cooper, New York, (1845); see also § 7 of the Uniform Fraudulent Conveyance Act.

[1468] § 548 (a) (1) (A).

which the debtor received less than reasonably equivalent value in exchange at a time in which a) the debtor was insolvent on the date of the transfer (or in which the obligation was incurred) or became insolvent as a result of the transfer (or of incurring the obligation); or, b) the debtor is left with unreasonably little assets; or, c) the debtor intended to incur or believed she would incur a level of outstanding debts beyond her capacity to repay them as they matured; or, d) the transfer occurred for the benefit of an insider under an employment contract and not in the ordinary course of business.[1469]

Exceptions apply to charitable contributions[1470] that account to less than 15% of the gross annual income in the year in which such a transfer occurs, or that are consistent with the practices of the debtor in making charitable contributions.[1471]

Proving intent may be tricky. A key English case from the seventeenth century, Twyne's case[1472], started a tradition of proving this element through circumstantial evidence that demonstrates strong likelihood of deceitful intent. The UFTA in section 4 (b) codified a non-inclusive list of factors that can serve as guidelines in determining if a fraud occurred:

> "In determining actual intent under subsection (a)(1), consideration may be given, among other factors, to whether:
> (1) the transfer or obligation was to an insider;
> (2) the debtor retained possession or control of the property transferred after the transfer;
> (3) the transfer or obligation was disclosed or concealed;
> (4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;
> (5) the transfer was of substantially all the debtor's assets;
> (6) the debtor absconded;
> (7) the debtor removed or concealed assets;
> (8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;
> (9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
> (10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and
> (11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor."

[B] Constructive fraud[1473]

Bankruptcy Code U.S. Title 11 § 548 (a) (1) (B)	(B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and (ii) (I)was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation; (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or (IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.
UFTA § 4 (a) (2)	Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor: (i) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business transaction; or (ii) intended to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her] ability to pay as they became due.

[1469] § 548 (a) (1) (B) (I)-(IV).
[1470] Made to qualified charitable or religious organizations.
[1471] § 548 (a) (2) (A)- (B).
[1472] 3 Coke 80b, 76 Eng.Rep. 809 (Star Chamber 1601).
[1473] **Markell Bruce A**., "*Toward True and Plain Dealing: a Theory of Fraudulent Transfers Involving Unreasonably Small Capital*", 21 Ind. L. Rev. 469 (1988), 471-2.

Constructive frauds do not require the intent of the debtor who caused great harm to his creditors. The statutes refer to a debtor, who is insolvent or facing great difficulties that put him at risk of becoming insolvent, who transfers property and receives "less than reasonable equivalent value" in exchange.

Courts apply a totality of circumstances test to verify that the outcome of the transaction may be considered adequate. The Code and the UFTA also regulate other situations in which frauds can cause harm to creditors, such as:

- the creation of obligations or guarantees;
- forging documents to alter the results of distribution;

We will not address such issues further. We will limit ourselves to mentioning that some protections apply for those parties that joined the transaction in good faith.

Immediate transferees usually enjoy few safeguards and must return assets, although they may have the right to retain a lien for the amount paid in good faith except to the extent that the transfer is also voidable under other sections of the Code, such as §544, § 545, § 547.[1474] Such protection is extended to subsequent or more remote transferees in good faith.[1475] Further protections are awarded to transferees that make improvements to property in good faith. They may recover the lesser of (a) costs of improvements less amounts of any profits realized, or b) the increase of value in the property as a result of the improvement.[1476]

8.5 The "strong harm" power

Section 544 (a), also called "strong arm" power, is probably the most iconic of the avoiding powers under the Code.[1477] It gives the trustee of the status of a hypothetical[1478] judicial lien creditor[1479] under state law. By doing so it gives the trustee the power to have priority over all transfers that did not reach a higher priority as of the day of filing.[1480] Moreover, the trustee will be able to avail himself of this power even in the absence of other participants to the bankruptcy case that may claim it.

As such, this is yet another area of bankruptcy in which the correlation between state and federal law is fundamental. The effects of the strong arm power depend on the rules applied at the state level, since it is the state statute that determines if, in a specific instance, a right has been "perfected" and, hence, has achieved a higher priority than the one that is allowed to the trustee or the debtor in possession in the bankruptcy case.

As an example, outcomes will vary depending on the form in which Article 9 of the UCC has been enacted in the state. The specific rights awarded in the statute to a judicial lien creditor determine the trustee's capacity to avoid a transfer. Hence, 544 (a) works indirectly. It does not give a "priority" per se; the possibilities of success of the trustee's action will depend on the framework in which it is applied.

The strong arm clause remains, nevertheless, a powerful tool; since a security interest must be fully perfected in order to take priority over a judicial lien and the filing of a bankruptcy case prevents most unperfected liens at the time of filing from reaching perfection, this trick makes a number of transfers avoidable in favor of the proceeding, allowing for more property to be retained by the estate for the benefit of all the creditors.

[1474] § 548 (c).

[1475] 550 (b) (2).

[1476] 550 (d) (1); (d) (2).

[1477] See on the topic **Gray Carlson David**, "*Bankruptcy's Organizing Principle*", 26 Fla. St. U. L. Rev. 549 (1999).

[1478] **Wind power sys. Inc. v. Cannon-Group Inc**. 841 F.2d 288, 292 (9th cir. 1988).

[1479] § 544 (a) (1) "The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by […] a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists."

[1480] The date of filing is an essential to determine the applicability of the power and some limitations apply depending on state laws. Some statutes, for example, allow retroactive perfection, hence protecting some specific categories of creditors or transactions outside of bankruptcy law.

§ 544 a (2) gives the trustee the powers of a hypothetical creditor who has provided credit to the debtor upon commencement of the case while acquiring a lien on all permitted property under state bankruptcy laws. (There is an exception when state law allows for retroactive perfection).

Under § 544 (a) (3)[1481], trustees and DIPs also acquire the status of a hypothetical bona fide purchaser of real estate, hence affecting in most cases mortgages that have been improperly executed or not recorded in a timely manner.

Moreover, although a fully perfected lien will not be avoidable under this clause, the trustee may still be able to deploy other powers against and reach a favorable result for the proceeding.

§ 544 (b)[1482] gives power to trustee to avoid all transactions that would be voidable under state laws by unsecured creditors of the debtor. This section, therefore, does not vest the trustee with a hypothetical status in order for the administrator of a case to bring an action. He will have to find a creditor that may be entitled to it under state laws and subrogate himself to him.

Exceptions apply. Under § 544 (b) (2), for example, the strong arm power does not apply to certain transfers for charitable contributions.

8.6 Avoiding post-petition transactions

Section 549 allows the administrator of a bankruptcy case to avoid a post-petition transaction aimed to alienate property from the estate[1483] unless it is authorized under the Code or by the bankruptcy court.[1484] It is evident how such protection is necessary to guarantee the capacity of the proceeding to organize relations between the debtor, the creditors, and the insolvency administrator. Since medieval times, one of the main prerequisites of bankruptcy has been, as we have already observed, that the debtor would lose control of all of his property so that impartial authorities could make it available for distribution to the creditors.

The same rationale applies here, although with the evolution of the bankruptcy tool (which includes the fact that the debtor is not always dispossessed of all of his properties) a few functional exceptions apply; in particular, the Code protects the following post-petition transactions:

a) good faith post-petition transfers concerning a transferor who has no knowledge of the proceeding. Consider, for example, the case of a bank which would not be liable although the transaction may still be avoidable under § 549 (a) (2) (A);

b) in the case of an involuntary filing, transactions incurred during the gap period (after the filing of the case but before the order of relief). Such exception excludes the perfection or satisfaction of pre-petition debts;

c) the purchase of real estate by a bona fide purchaser without knowledge of the proceeding and who pays present, fair equivalent value.[1485]

[1481] § 544 (a) (3) "The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by […]a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists."

[1482] § 544 (b) (1) "Except as provided in paragraph (2), the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.(2) Paragraph (1) shall not apply to a transfer of a charitable contribution (as that term is defined in section 548(d)(3) that is not covered under section 548(a)(1)(B), by reason of section 548(a)(2). Any claim by any person to recover a transferred contribution described in the preceding sentence under Federal or State law in a Federal or State court shall be preempted by the commencement of the case."

[1483] § 549 (a).

[1484] § 549 (b).

[1485] § 549 (c) includes exception.

8.7 Avoidance of statutory liens

This is an intricate issue that we will just mention to further show the importance of the interaction between state and federal statutes in bankruptcy.

Statutory liens[1486] are usually protected under the code, but under certain circumstances the trustee or the DIP may be able to avoid the fixing of some of them, divided into three main groups: liens enforced based on the debtor's difficult financial conditions; liens enforced upon commencement of the bankruptcy case; and liens for rents.

§ 545 states that the trustee may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien:

> (1) first becomes effective against the debtor
> (A)when a case under this title concerning the debtor is commenced;
> (B)when an insolvency proceeding other than under this title concerning the debtor is commenced;
> (C)when a custodian is appointed or authorized to take or takes possession;
> (D)when the debtor becomes insolvent;
> (E)when the debtor's financial condition fails to meet a specified standard; or
> (F)at the time of an execution against property of the debtor levied at the instance of an entity other than the holder of such statutory lien;
> (2) is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such a purchaser exists, except in any case in which a purchaser is a purchaser described in section 6323 of the Internal Revenue Code of 1986, or in any other similar provision of state or local law;
> (3)is for rent; or
> (4) is a lien of distress for rent.

§ 545 (2) is subject to other laws, state or federal, allowing the retroactive perfection of a particular lien.

This section was enacted to prevent states from altering entitlements in a manner that would conflict with the Code's policies. If it were possible for statutes to impose the perfection of liens exclusively on the basis that a case in bankruptcy has been filed, the federal scheme of priorities would be jeopardized.

8.8 Recovering Property

As a practical note it is worth mentioning that once a power is successfully deployed, re-acquiring the property may require an actual action to get it back (or at the least its equivalent in money) if a transfer was complete, or a declaratory judgment by the court if the property is still under the control of the estate[1487]; the transfer is not automatic.

Situations vary and depend on the forum, which brings us back to the relevant issue of limiting coordination efforts between different systems, as they may cause great delays. As a general rule, if an item of property different from a cash payment is contested, the trustee or the Debtor in Possession may move to acquire the equivalent value at the time of transfer instead of the item per se.[1488] Recovery of an avoided transfer may also involve others and not just the initial transferee.[1489]

[1486] Liens created by the effect of Federal or of State Statutes.

[1487] § 550 (a) "Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545,547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any immediate or mediate transferee of such initial transferee."

[1488] § 550 (a).

[1489] § 550 (a) (1)-(2).

8.9 A brief overview of limitations on avoiding powers

We have already mentioned in the previous paragraphs that several limitations apply to balance the ample powers awarded to insolvency administrators. We will not address this issue in great depth for it is very specific and it would take us far from the main goals of our discussion. Since we have been discussing the relevance of avoiding powers, it is worth briefly mentioning some of the main sections that apply to exclude them.

Not all transfers within the realm of the powers are avoidable, since avoiding actions deployed without controls could affect commerce. Limitations, therefore, apply.

The balance between the protection of the interests of transferees, purchasers, creditors, debtors, and all other participants is often bound to the specific situation in which the transaction occurred. Outcomes may vary deeply. Hence, some limitations are generic while others are more specific, depending on the power that is being used.

Section 546, entitled "Limitations on Avoiding Powers", addresses the issue.

A first, major, limitation is the statute of limitations. Two sections are relevant on this point: § 546 (a) *"an action or proceeding under section 544* (including the strong arm clause*), 545* (statutory liens)*, 547* (preferences)*, 548* (fraudulent transfers)*, or 553 of this title may not be commenced after the earlier of (1) the later of (A) 2 years after the entry of the order for relief; or (B) 1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (A); or (2) the time the case is closed or dismissed."* And, in the case of post-petition transactions § 549 (d) "*an action or proceeding under this section may not be commenced after the earlier of (1) two years after the date of the transfer sought to be avoided; or (2) the time the case is closed or dismissed*."

Hence, if the trustee or the debtor in possession do not meet such specific statutory limits, they will not be successful.

By § 546 (b) (1) (A), the Code allows the creditor to perfect its interest even post-petition for as long as the term (in this case, 20 days). Usually, such a rule is contained in Section 9-317 (e) of the UCC, entitled "Purchase-money security interest", as applied in the single-state setting, which provides:

"Except as otherwise provided in Sections 9-320 and 9-321, if a person files a financing statement with respect to a purchase-money security interest before or within 20 days after the debtor receives delivery of the collateral, the security interest takes priority over the rights of a buyer, lessee, or lien creditor which arise between the time the security interest attaches and the time of filing."

Such protection applies, of course, exclusively if the perfection applies within the term set by the state statute.

Under § 546 (b) (1) (B), another UCC provision entitled "Effect of filing continuation statement" embodied in § 9-515 (e) comes into play and protects the effectiveness of an initial financing statement and the right to file continuation statements to maintain the status quo.[1490]

Further limitations are embodied in:

a) § 546 (c) (see UCC § 2-702 (2)[1491]), allowing a seller to reclaim goods sold to an insolvent buyer prevailing over the powers of sections 544 (a); 545; 547 and 549;

[1490] UCC § 9-515 (e) "Effect of filing continuation statement: Except as otherwise provided in Section 9-510, upon timely filing of a continuation statement, the effectiveness of the initial financing statement continues for a period of five years commencing on the day on which the financing statement would have become ineffective in the absence of the filing. Upon the expiration of the five-year period, the financing statement lapses in the same manner as provided in subsection (c), unless, before the lapse, another continuation statement is filed pursuant to subsection (d). Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the initial financing statement."

[1491] See UCC § 2-702 (2) "Sellers' remedies upon finding of buyer's insolvency: Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay."

b) Similarly, § 546 (d) allows the reclamation of grain sold to a grain storage facility or fish sold to a fish processing facility owned or operated by an insolvent debtor;

c) § 546 at letters (e), (f), (g), (h) (i) and (j). They are not of great relevance to our discussion.

Protections for good faith transfers may apply while bad faith always results in the protection of the estate's interests.

A trustee or a debtor in possession may be unable to recover property that is taken for value, in good faith and without knowledge of the voidability of the transfer[1492] or a successive transferee.[1493]

Moreover, Section 550 (e) allows a bona fide transferee to recover the lesser of the costs sustained of any improvements[1494] made after the transfer (deducted any profit realized or accruing from the same property)[1495] and any increase in the value of transferred assets.[1496]

9. Claims and Priorities[1497]

9.1 Introduction

Several relevant topics regarding the area of claims have already been mentioned in the previous sections. In the part analyzing the automatic stay, for example, we discussed the special treatment that may be enjoyed by secured creditors. We also examined how the evolution of the distribution process from medieval times to modern ones has seen an important modification: in the beginning, the vast majority of creditors enjoyed equal rights and received an equal share, and very few were entitled to a sort of "priority"; a major issue in modern frameworks is effectively balancing countless policies aimed to protect certain classes of claims over others, creating various tiers of privileged statuses.

Principle C12 addresses this topic within the World Bank's List.

A relevant topic that the World Bank does not mention is the difficult interaction within the hierarchy of different local statutes in the process of formation of claims. As we are about to discuss, this is an area of American bankruptcy law in which state regulations have a relevant impact. The rules for the acquisition of perfected, secured rights, just to mention some relevant ones, may vary from state to state, causing different outcomes and impacting cases.

This is a point that will inevitably acquire great significant to the process of refounding European bankruptcy systems, given the great discrepancies not just between local insolvency systems, but also between local legal frameworks and European societies in general. It will be necessary, therefore, to pay great attention upon crafting rules aimed at achieving higher levels of uniformity in this area, or else it will be impossible to create a functional structure.

The following paragraphs are mostly concerned with clarifying the basic structure of claims in the US insolvency framework. We will not analyze all the rules of the American system in depth. We will focus on those sections included in the Code which give the structure for cataloguing and ranking claims and on the subsequent distribution process. This is a topic that is heavily interconnected with local statutes and policies.

9.2 Claims in the Code

A claim is defined in the Code as the right to payment, whether or not such right is reduced to judgment, liquidated, un-liquidated, fixed, contingent, matured, un-matured, disputed, undisputed, legal, equitable, secured, or unsecured; or the right to an equitable remedy for breach of performance in case such breach gives rise to a right to payment[1498]:

[1492] § 550 (b) (1).

[1493] § 550 (b) (2).

[1494] "Improvements" include: A) physical additions or changes to the property transferred; B) repairs to such property; C) payment of any tax on such property; D) payment of any debt secured by a lien on such property that is superior or equal to the rights of the trustee, and E) preservation of such property. § 550 (e) (2).

[1495] § 550 (e) (1) (A).

[1496] § 550 (e) (1) (B).

[1497] See on the topic: **Jackson Thomas H.**, "*Bankruptcy, Non-Bankruptcy Entitlements, and the Creditor's Bargain*", 91 Yale L.J. 857 (1982).

[1498] § 101 (5) (A); (B).

"(5) The term "claim" means (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured."

Claims are, therefore, the other side of the debt coin.[1499] Congress intended for the meaning of "claim" to be broad to make it easier for the insolvency framework to provide relief through discharge.[1500] Courts interpreted it in order to grant pre-petition rights value in bankruptcy even if such rights may have not yet accrued.

The right to receive a payment itself does not, of course, guarantee that the payment will be executed. The proceeding must have knowledge of and evaluate the different claims in order to organize them and distribute the estate effectively. In practice, this is a complicated issue in a number of settings; at times, creditors become unreachable or encounter difficulties in communicating with the administrator.

In general, the trustee or the debtor in possession will do everything possible to give notice of the proceeding while creditors[1501] deemed to have a right to join the distribution should file a timely[1502] proof of claim or interest. If they do not, the debtor or the trustee may do it based on the schedules filed at the commencement of the case[1503] for the amounts that have been disclosed, unless contingent or disputed.

In order to avoid complications, a good rule to follow may be to always file an independent proof of claim substantiated by all the necessary documentation, especially in the case of unsecured creditors, for they are the most likely to suffer damage if they do not take timely action to join the proceeding. Filing a proof of claim, though, can also present the creditor with some risks, since it can constitute consent to bankruptcy jurisdiction and waiver of the right to a jury trial in some instances.

Filing occurs with different timing depending on the Chapter.

Chapters 7, 12, and 13 set a bar 90 days after the first date set for the § 341 meeting.[1504] In a Chapter 11, the deadline is set by the Court and late filing is permitted exclusively due to excusable neglect (governmental claims may be filed up to 180 days after the order for relief, unless bankruptcy rules provide a longer time). While upon the conversion of a case this is not an issue and all claims that have been filed in Chapters 11, 12 or 13 are considered automatically transferred to the new Chapter 7 case.

A timely and properly-filed proof of claim is allowed, unless a party in interest objects.[1505] If an objection is filed the court, after notice and hearing, shall adjudicate the matter and determine the value "in lawful currency" unless any element to disallow or limit it is found under § 502 (b).[1506]

[1499] See also the definition of "debt" at § 101 (12) and the one of "creditor" under § 101 (10).

[1500] See **Ohio v. Kovacs**, 469 U.S. 274 (1985); **Penn. Dep't of Pub Welfare v. Davenport**, 495 U.S. 552 (1990), in which it is stated that the broad definition of "claims" aims to support broad discharges.

[1501] Or other allowed claimants, see § 501 (a): "A creditor or an indenture trustee may file a proof of claim. An equity security holder may file a proof of interest."

[1502] Statutes of limitations vary. Chapters 7, 12 ,and 13, 90 days from the meeting of § 341; rule 3002 c. In a Chapter 11, courts set a deadline (3003 c 3, 2002 a 7 – exceptions 3003 c 3, 3002 c 2, 3, 4 excusable neglect, amendments after the bar date 128-9).

[1503] § 501 (b): "If a creditor does not timely file a proof of such creditor's claim, the debtor or the trustee may file a proof of such claim."

[1504] § 341 disciplines the meetings of creditors and equity security holders.

[1505] § 502 (a): "A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under Chapter 7 of this title, objects."

[1506] § 502 (b): "(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that (1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured; (2) such claim is for unmatured interest; (3) if such claim is for a tax assessed against property of the estate, such claim exceeds the value

Claims can be briefly divided into two categories: "secured" and "unsecured". The latter either enjoys a priority ranking or not, making it a "general unsecured claim".

Secured creditors will enjoy the benefits of having a higher degree of protection of their interests through a lien[1507] on specific property of the debtor, called "collateral"; in the end they will either recover the collateral or its value. If the value of the collateral is not found sufficient or if the secured creditor decidse to waive, partially or fully, his protection, the claim will become unsecured for that portion; while if the value of the collateral is consistently higher than the debt, the "over-secured" creditor will be in the best position in the proceeding.

Although the value of a secured claim may enjoy higher protections in bankruptcy, other negative effects may still arise from filing. The automatic stay prevents foreclosures and the creditor has to wait before exercising an action to recover. Moreover, in a reorganization Chapter the debtor may reschedule payments, causing delays and loss of interests. Another time-consuming activity would be the use the collateral while the proceeding is pending.

Unsecured creditors will face higher risks of a reduced payment of the total value of their claims due to lack of residual value in the estate (which in bankruptcy is more of a certainty than an eventuality, or else the case itself would probably not exist). Some creditors inthis category enjoy, due to a variety of policies, a priority ranking and have higher chances of receiving a payment; general unsecured creditors usually hold a compromised position.

Three "super priorities" exist to protect particularly significant unsecured claims.

9.2.1 Super priorities

Some claims enjoy a "super-priority" status. They are paid before the priorities that we will list in the next point and before all the remaining general unsecured creditors. The super priorities are:

a) **Adequate protection (§ 507 (b))**: This is the case, for example, of a supplier of machinery used by the DIP to operate his business during a Chapter 11 case. The DIP is often entitled to continue using the collateral; if he did not, the whole reorganization might be impossible. At the same time, the assets will lose value by depreciation.
   In those cases in which the collateral does not cover the outstanding secured debt anymore, the creditor may be granted "adequate protection" in the form of an increase in collateral so that it will be less likely that he will suffer losses;
b) **Post-petition credit (§ 364 (c) (1))**: helps ensuring repayment to those entities willing to award necessary credit to the proceeding (hence, post-petition). Courts can award superpriority status at the inception of the post-petition lending relationship to support the debtor. If such special protection was not included in the Code, obtaining unsecured credit would be impossible.

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of the interest of the estate in such property; (4) if such claim is for services of an insider or attorney of the debtor, such claim exceeds the reasonable value of such services; (5) such claim is for a debt that is unmatured on the date of the filing of the petition and that is excepted from discharge under section 523(a)(5) of this title; (6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds— (A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of— (i) the date of the filing of the petition; and (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus (B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates; (7) if such claim is the claim of an employee for damages resulting from the termination of an employment contract, such claim exceeds— (A) the compensation provided by such contract, without acceleration, for one year following the earlier of— (i) the date of the filing of the petition; or (ii) the date on which the employer directed the employee to terminate, or such employee terminated, performance under such contract; plus (B) any unpaid compensation due under such contract, without acceleration, on the earlier of such dates."

[1507] Different types of liens exist; they can be, for example, consensual or judicial, voluntary or involuntary. The way the lien is created has very limited relevance in the Code, which provides the following definitions in § 101 (37). The term "lien" means a charge against or interest in property to secure payment of a debt or performance of an obligation; § 101 (36): "The term 'judicial lien' means lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding."

Moreover, a somewhat higher status is given to expenses in which a case is converted from a reorganization to a liquidation under Chapter 7, which means that, despite the effort, it was impossible to continue operating the business. In this case, administrative expenses under § 503 have already accrued and § 727 (b) provides for the payment of the Chapter 7's expenses before all others to ensure that the liquidation will be successfully concluded.[1508]

9.2.2 Priority claims

Section 507 lists a number of specific groups of claims that enjoy a priority and will be paid first, using the property of the estate that isn't needed to satisfy secured creditors. Priority unsecured creditors, must be paid before general unsecured creditors.

If the available assets are not sufficient, payments are made starting from the first priority and descending the ladder group by group until one class is not paid in full. That group will receive a pro rata payment, meaning that the remaining liquidity will be divided in equal parts among claimants, who will receive a percentage of their credit; the remaining part will, ideally, be discharged, and so will other unpaid credits. One important de facto exception applies: § 507 (a) (1) lists as first priority "domestic support obligations"; the rationale for doing so is self-explanatory, for it is such an important interest to protect. The second priority, "administrative expenses", though, is often considered more important due to a simple practical necessity: if trustees and the other expenses incurred in the case are not paid first, the whole system may be jeopardized. It is unlikely that somebody would want to face the intricacies of bankruptcy and administer a case for free.[1509]

The priorities of § 507 (a) are ranked as follows:

1. **Domestic support obligations** – this group includes two categories; the first, Section 507 (a) (1) (A), concerns:

   > "Allowed unsecured claims for domestic support obligations that, as of the date of the filing of the petition in a case under this title, are owed to or recoverable by a spouse, former spouse, or child of the debtor, or such child's parent, legal guardian, or responsible relative, without regard to whether the claim is filed by such person or is filed by a governmental unit on behalf of such person, on the condition that funds received under this paragraph by a governmental unit under this title after the date of the filing of the petition shall be applied and distributed in accordance with applicable non-bankruptcy law."

   The second, in § 507 (a) (1) (B), concerns the same obligations assigned to governmental units.
2. **Administrative expenses:** under § 503 (b), they were entitled the highest priority before the enactment of the BACPA; today they come second but, as we just mentioned, they are *de facto* paid first to allow the proceeding to exist. They include, among others, the post-petition costs to preserve the estate, post-petition taxes, wages for employees, and funds to search for and recover concealed property.[1510]
3. **Ordinary course of business expenses in the "gap period"**: expenses that were rightfully incurred between filing and an order for relief. In an involuntary case, the debtor is allowed to continue the administration until an order for relief is entered and a trustee is appointed. Expenses incurred in the ordinary course of business are included in § 502 (f).
4. **Wages and salaries**: includes a wide variety of expenses (even vacations), but is limited to \$12.850[1511] on each claim. Remuneration must have been earned within 180 days from the petition or 180 days of the business closing. If a claim exceeds the dollar amount granted priority then it becomes unsecured.

[1508] See 11 USC 726(a)(1)(A) and 11 USC 507(a)(1)(C).

[1509] See § 507 (a) (1) (C) "If a trustee is appointed or elected under section 701, 702, 703, 1104, 1202, or 1302, the administrative expenses of the trustee allowed under paragraphs (1)(A), (2), and (6) of section 503(b) shall be paid before payment of claims under subparagraphs (A) and (B), to the extent that the trustee administers assets that are otherwise available for the payment of such claims."

[1510] § 503 (b).

[1511] 12.475 until April 1st, 2016. The dollar amount is regularly adjusted under 11 U.S.C.A. § 104.

5. **Employees' benefits**: this is connected to the above-mentioned priority and includes contributions to benefit plans and life insurances. The same dollar limits apply.
6. **Certain claims of farmers and fishermen.**
7. **Deposits for consumer goods or services.**
8. **Various tax claims:** it is common to give taxes some sort of priority status. Section 507 (a) protects several of them:

> "**(A)** a tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition— **(i)** for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition; **(ii)** assessed within 240 days before the date of the filing of the petition, exclusive of— **(I)** any time during which an offer in compromise with respect to that tax was pending or in effect during that 240-day period, plus 30 days; and**(II)** any time during which a stay of proceedings against collections was in effect in a prior case under this title during that 240-day period, plus 90 days; or **(iii)** other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;
> **(B)** a property tax incurred before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition;
> **(C)** a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;
> **(D)** an employment tax on a wage, salary, or commission of a kind specified in paragraph (4) of this subsection earned from the debtor before the date of the filing of the petition, whether or not actually paid before such date, for which a return is last due, under applicable law or under any extension, after three years before the date of the filing of the petition;
> **(E)** an excise tax on **(i)** a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or **(ii)** if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;
> **(F)** a customs duty arising out of the importation of merchandise **(i)** entered for consumption within one year before the date of the filing of the petition; **(ii)** covered by an entry liquidated or reliquidated within one year before the date of the filing of the petition; or **(iii)** entered for consumption within four years before the date of the filing of the petition but unliquidated on such date, if the Secretary of the Treasury certifies that failure to liquidate such entry was due to an investigation pending on such date into assessment of antidumping or countervailing duties or fraud, or if information needed for the proper appraisement or classification of such merchandise was not available to the appropriate customs officer before such date; or
> **(G)** a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss. An otherwise applicable time period specified in this paragraph shall be suspended for any period during which a governmental unit is prohibited under applicable nonbankruptcy law from collecting a tax as a result of a request by the debtor for a hearing and an appeal of any collection action taken or proposed against the debtor, plus 90 days; plus any time during which the stay of proceedings was in effect in a prior case under this title or during which collection was precluded by the existence of 1 or more confirmed plans under this title, plus 90 days."

While some of the above groups of priorities may not apply to all cases (a corporation does not owe child support, for example, while not all debtors will owe to farmers or fishermen), tax debts are a common issue. Such a broad list of prioritized fiscal impositions greatly jeopardizes the chance of receiving any payment from this point on; moreover, a number of tax credits enjoy further protections and are non-dischargeable, which means that they must be paid in full, unless the they are reduced by the claimant authority.

9. **Claims arising out of federal depository insurance.**

10. **Claims for wrongful death or personal injury:** resulting from debtor driving while intoxicated.

9.2.3 General unsecured claims

General unsecured creditors hold a variety of different claims; all the ones that are allowed by policies and laws to take part to the case without enjoying a secured or priority status. The formation of the claim makes little difference, though; they are all grouped together and receive a pro rata share of whatever is left; hence they are the least likely to be paid in full, if at all, in the proceeding.[1512]

10. Reorganization proceedings

> "A robust, effective, and efficient bankruptcy system rebuilds companies, preserves jobs, and facilitates economic growth with dynamic financial markets and lower costs of capital."[1513]

As observed in Chapter I, the shift from liquidations to reorganization and rehabilitation proceedings has become, with time, a cornerstone of the process of refounding European insolvency frameworks.

Europe is attempting to support an economy based on risk-taking and entrepreneurship, just like the American one.[1514] It believes in rewarding debtors, in giving them an opportunity to obtain a second chance. The ultimate hope is to achieve the same positive results after years of difficulties.

Reorganization frameworks have therefore been empowered and included also in the cross-border model. Much is being done to make them the primary tool to solve bankruptcy issues for both business and non-business debtors.

Our analysis of medieval systems in Chapter IV showed that this is not the first time in which such proceedings have become a tool to bet on within the European scenario. We mentioned the example of Venetian statutes and their innovative approach. We also analyzed the conflicts that arose between neighboring city-states. Finding a balance between change and uniformity among the different local models of Member States is still a great challenge today.

The success of the structure of reorganizations in the United States is one of the features of the Bankruptcy Code that has been most envied at theEuropean level. Chapter 11 has been used as comparator in European studies and several tools have been, over time, transplanted into foreign systems in an attempt to bring swift improvements.

However, progress appears to be slow and uneven.

In this part we will briefly discuss the main features of Chapter 11. We will mention its structure in the contemporary U.S. framework and projects for future modifications. We will discuss some of the elements that are most frequently transplanted in foreign systems (including European ones) and we will briefly mention specific formula applied to small businesses (just as Europe suggests).

Before we examine this particular Chapter, though, we will briefly mention the characteristics of the whole reorganization and rehabilitation framework in the Bankruptcy Code, which consists of four Chapters concerning a great variety of debtors. This brief introduction will be a prologue to our discussion on the American insolvency framework for natural persons and non-business debtors.

10.1 Brief overview of the different reorganization and rehabilitation Chapters

The success of reorganization and rehabilitation proceedings in the United States did not come overnight. In our overview of the evolution of the American bankruptcy framework we mentioned how the first reorganization models were enacted in the 1800s with the goal of supporting railroads facing financial

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[1512] **Pacitti Dominic E.** and **Herbert J. Michael**, "*Down and out in Richmond Virginia: the Distribution of Assets in Chapter 7 Bankruptcy Proceedings Closed During 1984-87*", 22 U. Rich. L. Rev., (1988).

[1513] **American Bankruptcy Institute**, Commission to Study the reform of Chapter 11, V.V.A.A., 2012-2014, final report and recommendations sponsored by the Anthony H.N. Schnelling Endowmnent Fund", at 2
http://commission.abi.org/full-report

[1514] **Martin Nathalie**, "*The role of history and culture in developing bankruptcy and insolvency systems: the perils of legal transplantation*", 28 B.C. Int'l & Comp. L. Rev. 1, (2005).

difficulties[1515] [1516], and societies from the harsh consequences of such massive liquidations. With time, this tool was applied in a wider range of scenarios and lost its purely business focus.

The first steps in this direction were made with the Chandler Act[1517]; then the system followed in this path, expanding the number of Chapters devoted to reorganization and rehabilitation while broadening access criteria in order to allow a wider pool of business and non-business debtors to find an alternative within the Bankruptcy Code. Nowadays, proceedings to reorganize or adjust debts are listed in four different Chapters:

- Chapter 9 – focusing on the adjustment of debts of municipalities;
- Chapter 11 – mostly, although not exclusively, focusing on business cases;
- Chapter 12 – focusing on the adjustment of debts of family farmers and fishermen only (which started as a temporary Chapter and ultimately became permanent);
- Chapter 13 – focusing on the adjustment of debts of individuals with regular income (within certain parameters).

Different options are, therefore, presented to debtors depending on their characteristics. Some petitioners may be able to choose among different Chapters and will do so depending on which would seem to better fit their situation and provide them with the highest benefits. Choosing is not a right, though, but a privilege.

In case of abuse or dishonesty, reorganization and rehabilitation proceedings can be dismissed or converted to other Chapters. A case filed under Chapter 11, for example, may be converted to Chapter 7 or dismissed for cause by petition of the US trustee, of the bankruptcy administrator, or of a party in interest:

> "Substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation; (B) gross mismanagement of the estate; (C) failure to maintain appropriate insurance that poses a risk to the estate or to the public; (D) unauthorized use of cash collateral substantially harmful to 1 or more creditors; (E) failure to comply with an order of the court; (F) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this Chapter; (G) failure to attend the meeting of creditors convened under section 341(a) or an examination ordered under rule 2004 of the Federal Rules of Bankruptcy Procedure without good cause shown by the debtor; (H) failure timely to provide information or attend meetings reasonably requested by the United States trustee (or the bankruptcy administrator, if any); (I) failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief; (J) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court; (K) failure to pay any fees or charges required under Chapter 123 of title 28; (L) revocation of an order of confirmation under section 1144; (M) inability to effectuate substantial consummation of a confirmed plan; (N) material default by the debtor with respect to a confirmed plan; (O) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and (P) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition."[1518]

The conversion of a case can occur voluntarily[1519] or may require the approval of the debtor.[1520].This is a topic we will not discuss in depth. Our goal in mentioning these aspects is limited to showing that the system is supervised and structured to prevent abuses.

[1515] Through equity receiverships. See **Skeel David A**., "*Debt's Dominion. A History of Bankruptcy Law in America*", Published by Princeton University Press, in 2004.

[1516] Today the reorganization of railroads presents some differences from other Chapter 11 cases, see § 1161-1174.

[1517] Chapter 11 is the evolution of Chapters X and XI of the Chandler Act which were merged in 1978.

[1518] § 1112 (b) (2) (b) (A).

[1519] § 1112 (a), a Chapter 11 case may be converted to Chapter 7 voluntarily as long as a trustee has not been appointed in the Chapter 11 case; the case has not originally been filed involuntarily or that a conversion to Chapter 11 has not already occurred.

[1520] 1112 (d).

We will focus now on Chapter 11 and business liquidations in greater depth due to the relevance of this topic in shaping the modern European insolvency environment.

10.2 Chapter 11 of the U.S. Bankruptcy Code

Chapter 11 of the Bankruptcy Code focuses mainly on business reorganizations, although it must be pointed out that, in a residual number of cases, (wealthier) natural persons may also have access and be eligible debtors due to the limits placed to their access under Chapter 13. This Chapter is one of the most notable exports of the Bankruptcy Code abroad; several elements have been the object of legal transplants in foreign systems:

> "For more than 35 years the U.S. Bankruptcy Code has served these purposes, and its innovative debtor in possession Chapter 11 process, which allows a company to manage and direct its reorganization efforts, is emulated around the globe. As with any law or regulation, however, periodic review of U.S. bankruptcy laws is necessary to ensure their continued efficacy and relevance."[1521]

In passing the Bankruptcy Code, Congress believed that:

> "the purpose of a business reorganization case [under Chapter 11] ... is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders."

Chapter 11 is, therefore, devoted to the rescue and preservation the debtor. While in liquidations the irreparable default of a business is "cured" by a piecemeal liquidation of the available assets to repay debts, in reorganizations an attempt is made to obtain more benefits for the creditors, the debtor, and society. Reorganization proceedings preserve the debtor's business operations and its going concern value.

Debtors are, therefore, offered a concrete an opportunity to resolve their difficulties and remain active in the market. Creditors enjoy a chance to obtain higher payments of their pre-petition claims and to make future income. Society in general is also believed to benefit from this balance; preventing the dismemberment of a debtor, in fact, protects communities from unemployment and supports high levels of entrepreneurship.

Statistics show that debtors seem to believe in the positive effects of Chapter 11, a fact that appears to be proven by the very limited number of involuntary petitions filed:

> "The financially distressed company is typically the party that commences the Chapter 11 case by filing a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. Although creditors may file an involuntary Chapter 11 petition against a company under section 303 of the Bankruptcy Code, creditors rarely invoke this remedy. One study reported that involuntary bankruptcies "have represented less than one-tenth of one per cent of all U.S. liquidation bankruptcy cases for over a decade." Creditors may consider an involuntary Chapter 11 filing during their prepetition negotiations with a debtor. It is most common, however, for the debtor to then file a voluntary case or for the parties to reach an out-of-court resolution."[1522]

Filing voluntarily, and deciding to be part of an insolvency proceeding, is not always easy, though:

> "Companies do not undertake a Chapter 11 filing lightly. A company's management is commonly concerned about the public nature of a Chapter 11 case and the potential distractions to the business caused by enhanced oversight from the court, the U.S. Trustee, creditors, and other parties in interest. In fact, some commentators and

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[1521] **American Bankruptcy Institute**, Commission to Study the reform of Chapter 11, V.V.A.A., 2012-2014, final report and recommendations sponsored by the Anthony H.N. Schnelling Endowmnent Fund", at 2 http://commission.abi.org/full-report

[1522] *Id.,* at 20.

practitioners suggest that financially distressed companies tend to wait too long to file a Chapter 11 case, which makes it more difficult to use the restructuring tools of Chapter 11 in an effective manner. Regardless, Chapter 11 provisions should help companies achieve a "soft landing" in bankruptcy — *i.e.*, minimize business disruptions to foster reorganization prospects — and develop a feasible restructuring strategy that benefits all stakeholders."[1523]

10.2.1 Structure and goals of reorganizations

Principle C14 of the World Bank's list of 2015 focuses on the structure of business reorganizations. At point 1 it states that an effective and efficient framework 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.

The Bankruptcy Code attempts promote a successful balance in all such areas. Our discussion will briefly cover its most notable elements. We will analyze the:

- goals of Chapter 11;
- debtor in possession model;
- plan's formulation and approval;
- plan's implementation and amendment;
- award of discharge and its effects;
- plan's revocation and closure.

We will also discuss the framework designed for SMEs and the process of reform that is being implemented to update this Chapter.

10.2.2 Management of the case – the DIP (debtor in possession)

Principle C62 of the World Bank's lists three preferred approaches in structuring the governance of a case:

C.6	C6.2 There are typically three preferred approaches in reorganization proceedings: ♣Exclusive control of the proceeding is entrusted to an independent insolvency representative; or ♣Governance responsibilities remain invested in management; or ♣Supervision of management is undertaken by an impartial and independent insolvency representative or supervisor. Under the second and third approaches, complete administrative power should be shifted to the insolvency representative if management proves incompetent or negligent or has engaged in fraud or other misbehavior.

The U.S. Bankruptcy Code opts for a unique balance which relies heavily on the support and cooperation of debtors. In Chapter 11 debtors remain "in possession"[1524] [1525] and manage the business through the proceeding with all the powers and duties of a trustee (except the right to compensation and the duty to investigate the debtor, which would be redundant)[1526]:

[1523] *Id.*

[1524] DIP: debtor in possession. § 1107 (a): "Subject to any limitations on a trustee serving in a case under this Chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2)".

[1525] §§ 1101 (1), 1108.

[1526] In operating the business the "business judgment" rule applies: the DIP has the authority to make reasonable decisions on ordinary affairs undisturbed unless allegations of fraud or abuse, arise.

> “A fundamental feature of Chapter 11 of the Bankruptcy Code is the “debtor in possession” concept. This feature allows the financially distressed company to remain in control of its assets and to continue to operate its business after commencing the Chapter 11 case. Accordingly, on the petition date, the company assumes the new legal capacity of a “debtor in possession.”[1527]

This model aims to containing costs while improving the chances of success through cooperation:

> “Proponents of the debtor in possession model highlight the knowledge and expertise of the debtor’s prepetition directors, officers, or similar managing persons concerning the debtor’s business and financial affairs. The ability of the debtor in possession to continue to operate through its prepetition management team facilitates the company’s seamless transition into Chapter 11 and allows the debtor to avoid the additional time, cost, and resulting inefficiencies of bringing in an outsider who is not familiar with the debtor’s business specifically or the debtor’s industry generally. The prepetition management team may also have industry relationships or “know-how” that would benefit the debtor’s restructuring efforts. Critics of the debtor in possession model note that the debtor’s financial or operational difficulties may relate, at least in part, to the conduct or decisions of the debtor’s prepetition directors and officers. Some critics argue that allowing the management team that was in charge during the debtor’s financial decline to remain in control rewards subpar performance and undermines confidence in the reorganization process for the debtor’s stakeholders. Some critics also worry that prepetition management may be motivated by factors not necessarily aligned with the best interests of the estate, such as retaining their jobs or downplaying prepetition events that may implicate them in the debtor’s financial distress.”[1528]

An external insolvency administrator or a trustee[1529] is not appointed under this Chapter absent “cause”, meaning that an interested party must show through clear and convincing evidence[1530] that the appointment of an impartial insolvency administrator is necessary.[1531] Cause is constituted by the commission of acts of:

- fraud;
- dishonesty;
- incompetence; or
- gross mismanagement of the affairs of the debtor

by the current management, either before or after the commencement of the case.[1532]

The DIP model presents some evident drawbacks.[1533] The previous management is, in the end, the one that caused the default and this leaves room for doubt not just on the possibility that frauds may be committed but on its very capacity to conduct the business.

[1527] **American Bankruptcy Institute**, Commission to Study the reform of Chapter 11, V.V.A.A., 2012-2014, final report and recommendations sponsored by the Anthony H.N. Schnelling Endowmnent Fund”, at 21 http://commission.abi.org/full-report

[1528] *Id.,* 22-23

[1529] A disinterested person appointed by the United States Trustee, see § 1104 (d).

[1530] See **In re Sharon Steel Corp**., 871 F.2d 1217 (3d Cir. 1989).

[1531] §1104 (a) (1). The party petitioning for appointment of a trustee must show such need by clear and convincing evidence.

[1532] See 1104 (a) (1). A general mismanagement or making bad decisions is not sufficient due to a strong presumption that the debtor should remain in possession. See **In re Adelphia Commc’n Corp**., 342 B.R. 122 (S.D.N.Y. 2006)

[1533] **Douglas Baird G.** and **Rasmussen Robert K**., “*The end of Bankruptcy”*, 55 Stan. L. Rev. 751 (2002); **LoPucky Lynn M**., “*The Debtor in full control –Systems failure under Chapter 11*”, 101 Yale L.J. 1043 (1992).

The appointment of external management, though, is an expensive and difficult operation. New directors have to learn about the business and to adapt quickly. This, in a situation of financial difficulties where the relationships with clients, suppliers, and employees may have been already compromised.

In cases in which irregularities may be feared, the Code allows for a first, less intrusive step to be taken to verify the management's behavior. An examiner can be appointed to investigate the operations of the DIP and verify the presence of cause to appoint a trustee.[1534] An exception applies in those cases in which the debtor's unsecured debts exceed five million dollars; in such major cases, the appointment of an examiner will occur automatically.[1535]

If trustee is appointed in a Chapter 11 case, her duties, which are listed in section 1106 (a), will match the ones of sections 704 (2); (5); (7); (8) and (9) as applied to liquidations. Further obligations regarding mostly the duty to investigate the debtor's conduct and operations are added in sections 1106 (a) (3) to (7).

10.2.3 The Chapter 11 plan

As discussed in Chapter II the World Bank lists several key points and best practices to increase the levels of effectiveness and efficiency of a reorganization system. They all find ample room in the formula applied by the Bankruptcy Code.

As it is customary in this area of insolvency law, the Chapter 11 plan is the linchpin of the reorganization framework proposed by Chapter 11.

A Chapter 11 plan can be filed by the debtor or by other parties in interest.[1536] A debtor can file a plan at any time, and in voluntary cases the plan can even be joined to the petition for the commencement of the case. Debtors also enjoy an "exclusivity period" in which they retain an exclusive right to file. Such period applies to cases in which a trustee has not been appointed and lasts 120 days after the date of the order for relief.[1537]

Other parties in interest[1538] may file a plan:

- at any time after the appointment of a trustee[1539];
- upon the passing of the exclusivity period[1540];
- if the debtor has not filed a plan that has been accepted by each class of claims or interests that is impaired under the plan, before 180 days after the date of the order for relief.[1541]

Upon petition by a party in interest showing cause, the 120 day and the 180 day periods of time may be shortened or lengthened by court after notice and hearing.[1542]

Some parts of a plan are mandatory[1543] [1544] and their absence may cause the failure of the reorganization. A plan, for example, could not operate effectively if it did not classify claims and interests;

[1534] The examiner would investigate all allegations of fraud, dishonesty, incompetence, misconduct, incompetence, or irregularity in the management of the affairs of the debtor. See § 1104 (c).

[1535] § 1104 (c) (2).

[1536] § 1121 (c): "Any party in interest including the debtor, the trustee, a Creditors' committee, an equity security holder committee, a creditor; an equity security holder, or an indenture trustee may file a plan…"

[1537] § 1121 (b).

[1538] With the exception of US Trustees, see § 307.

[1539] § 1112 (c) (1).

[1540] § 1112 (c) (2).

[1541] § 1112 (c) (3).

[1542] § 1112 (d).

[1543] 1123 (a) (1)/(8): "§ 1123. Contents of Plan. (a) Notwithstanding any otherwise applicable bankruptcy law, a plan shall (1) designate, subject to section 1122 of this title, classes of claims, other than claims of a kind specified in section 507(a)(2), 507(a)(3), or 507(a)(8) of this title, and classes of interests; (2) specify any class of claims or interests that is not impaired under the plan; (3) specify the treatment of any class of claims or interests that is impaired under the plan; (4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest; (5) provide adequate means for the plan's implementation, such as (A) retention by the debtor of all or any part of the property of the estate; (B) transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan; (C) merger or consolidation of the debtor with one or more persons; (D) sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any

specify those classes that would be impaired; and establish the method for its implementation. Section 1123 (b) lists other relevant provisions that are not mandatory[1545], such as: the impairment or unimpairment of classes; the settlement of claims or interests; and the liquidation of all or parts of the estate.

To be confirmed, a plan must meet the requirements of § 1129. The plan must:

- be filed in good faith[1546] and comply with the requirements in the Code as to its structure and to the disclosure process[1547];
- ensure that all taxes and expenses that have been approved by court are regularly paid[1548];
- meet the "best interests of creditors test": each creditor whose rights are impaired under the plan must have either accepted it or be guaranteed to receive property with a present value of no less than what would be obtainable in a liquidation[1549];
- be approved by the majority of the creditors.

Obtaining the approval of the plan by the majority of the creditors is the ultimate goal of a proponent and a vital objective for the debtor. All creditors and equity or security holders that have been allowed to take part in the proceeding can vote and accept, or reject a plan in good faith. Expressing a vote in bad faith or soliciting rejection of a plan without following the procedure may lead to disqualification.[1550]

In order to make decisions on a plan, voters must be informed.

In the reorganization scenario, creditors enjoy a more active role in a Chapter 11 than in liquidations. A committee that includes the seven largest unsecured claims[1551] [1552] is formed to engage in various activities.

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part of the property of the estate among those having an interest in such property of the estate; (E) satisfaction or modification of any lien; (F) cancellation or modification of any indenture or similar instrument; (G) curing or waiving of any default; (H) extension of a maturity date or a change in an interest rate or other term of outstanding securities; (I) amendment of the debtor's charter; or (J) issuance of securities of the debtor, or of any entity referred to in subparagraph (B) or (C) of this paragraph, for cash, for property, for existing securities, or in exchange for claims or interests, or for any other appropriate purpose (6) provide for the inclusion in the charter of the debtor, if the debtor is a corporation, or of any corporation referred to in paragraph (5)(B) or (5)(C) of this subsection, of a provision prohibiting the issuance of nonvoting equity securities, and providing, as to the several classes of securities possessing voting power, an appropriate distribution of such power among such classes, including, in the case of any class of equity securities having a preference over another class of equity securities with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default in the payment of such dividends (7) contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor to such officer, director, or trustee; an (8) in a case in which the debtor is an individual, provide for the payment to creditors under the plan of all or such portion of earnings from personal services performed by the debtor after the commencement of the case or other future income of the debtor as is necessary for the execution of the plan."

[1544] Although we are focusing on business debtors, it is worth mentioning also § 1123 (c): "In the case concerning an individual, a plan proposed by an entity other than the debtor may not provide for the use, sale, or lease of property exempted under section 522 of this title, unless the debtor consents to such use, sale, or lease".

[1545] "Subject to subsection (a) of this section, a plan may (1) impair or leave unimpaired any class of claims, secured or unsecured, or of interests; (2) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section; (3) provide for (A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate; or (B) the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest; (4) provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests; (5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; and (6) include any other appropriate provision not inconsistent with the applicable provisions of this title."

[1546] 1129 (a) (3).

[1547] 1129 (a) (2) – (3).

[1548] 1129 (a) (4).

[1549] 1129 (a) (7) (A), an exception applies in case the creditor made the election under section 1111 (b).

[1550] § 1126 (e).

[1551] § 1102 (a) (1), (b) (1).

Aside from monitoring the debtor's operations, it also operates as an advisor, as an investigative body, and as a tool of coordination of the other creditors (the committee, for example, ensures the availability of all the necessary documents and information to make decisions and evaluate the state of the proceeding).[1553] Upon the court's approval they may appoint consultants, attorneys, or accountants (these expenses may enjoy priority ranking as "administrative expenses"[1554]), as long as they do not have adverse interests.[1555]

Moreover, the Bankruptcy Code requires that "adequate information" is made available:

> "§ 1125. Postpetition Disclosure and Solicitation
> (a) in this section
> (1) 'adequate information" means information of a kind, and in sufficient detail, ad far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, including a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case, that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan, but adequate information need not include such information about any other possible or proposed plan and in determining whether a disclosure statement provides adequate information, the court should consider the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing additional information…"

A list of those elements that constitute adequate information has been included in a variety of cases.[1556] The court in *Metrocraft*[1557] recapped them in an inclusive list:

> "Case law under § 1125 of the Bankruptcy Code has produced a list of factors disclosure of which may be mandatory, under the facts and circumstances of a particular case, to meet the statutory requirement of adequate information. Disclosure of all factors is not necessary in every case. Conversely, the list is not exhaustive, and a case may arise in which disclosure of all these enumerated factors is still not sufficient to provide adequate information for the creditors to evaluate the plan. Nevertheless, these factors provide a useful starting point for the Court's analysis of the adequacy of the disclosure statement. The Court will address the Committee's objections with an eye toward these enumerated factors as they pertain to this debtor's business and the proposed Chapter 11 plan of reorganization.
> Factors (1) through (11) are taken from the case of In re A.C. Williams Co., 25 B.R. 173 (Bkrtcy.N.D.Ohio 1982). Factors (12) through (13) and (14) through (15) appear in In re William F. Gable Co., 10 B.R. 248 (Bkrtcy.N.D.W.Va.1981), and In re Adana Mortg. Bankers, Inc., 14 B.R. 29 (Bkrtcy.N.D.Ga.1981), respectively. This Court adds factors (16) through (19) in response to objections raised in the instant proceeding.
> Relevant factors for evaluating the adequacy of a disclosure statement may include:
> (1) the events which led to the filing of a bankruptcy petition;
> (2) a description of the available assets and their value;
> (3) the anticipated future of the company;
> (4) the source of information stated in the disclosure statement;
> (5) a disclaimer;
> (6) the present condition of the debtor while in Chapter 11;
> (7) the scheduled claims;

[1552] Additional committees also of equity holders can be appointed by the United States Trustee to ensure adequate representation § 1102 (b) (2); a committee of security holders can be also appointed.
[1553] § 1103 (c) (1)-(5).
[1554] § 1103.
[1555] § 1103 (b).
[1556] See for example **In re A.C. Williams Co**., 25 B.R. 173 (Bkrtcy.N.D.Ohio 1982); **In re William F. Gable Co**., 10 B.R. 248 (Bkrtcy.N.D.W.Va.1981); **In re Adana Mortg. Bankers, Inc**., 14 B.R. 29 (Bkrtcy.N.D.Ga.1981).
[1557] **In re Metrocraft Publishing Services, Inc**., 39 B.R. 567 8Bankr. N.D. Ga. 1984).

> (8) the estimated return to creditors under a Chapter 7 liquidation;
> (9) the accounting method utilized to produce financial information and the name of the accountants responsible for such information;
> (10) the future management of the debtor;
> (11) the Chapter 11 plan or a summary thereof;
> (12) the estimated administrative expenses, including attorneys' and accountants' fees;
> (13) the collectibility of accounts receivable;
> (14) financial information, data, valuations or projections relevant to the creditors' decision to accept or reject the Chapter 11 plan;
> (15) information relevant to the risks posed to creditors under the plan;
> (16) the actual or projected realizable value from recovery of preferential or otherwise voidable transfers;
> (17) litigation likely to arise in a nonbankruptcy context;
> (18) tax attributes of the debtor; and
> (19) the relationship of the debtor with affiliates."

In order to express their vote, creditors may be divided in classes grouping "substantially similar"[1558] claims or interests. This is one of the most critical aspects of a Chapter 11 plan.[1559] Some priority unsecured claims (administrative expenses, gap claims in involuntary cases, tax claims) are excluded from this requirement, as they have to be paid in full.[1560] Others may suffer from different treatment compared to a Chapter 7 liquidation. For example, they may still be paid in full, but in installments or over a longer time[1561], in which case they are entitled to take part to the voting process to accept or reject the plan.

Classes may be "impaired"[1562] or "unimpaired"[1563]:

> "Except as provided in section 1123(a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan
> **(1)** leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest; or
> **(2)** notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default—
> **(A)** cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365(b)(2) of this title or of a kind that section 365(b)(2) expressly does not require to be cured;
> **(B)** reinstates the maturity of such claim or interest as such maturity existed before such default;
> **(C)** compensates the holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law;
> **(D)** if such claim or such interest arises from any failure to perform a nonmonetary obligation, other than a default arising from failure to operate a nonresidential real property lease subject to section 365(b)(1)(A), compensates the holder of such claim or such interest (other than the debtor or an insider) for any actual pecuniary loss incurred by such holder as a result of such failure; and
> **(E)** does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest."

[1558] **In re AOV Industries, Inc**., 792 F.2d 1140 (D.C. Cir. 1986).
[1559] § 1123 (a) (1).
[1560] 1129 (a) (9) (A).
[1561] 1129 (a) (9) (B) (i); 1129 (a) (9) (C) (i).
[1562] Their rights are modified by the plan.
[1563] Their rights are not modified by the plan. See 1124; a specific provision, section 1126 (f), sets a presumption of acceptance for all those unimpaired classes under the plan.

How to effectively create classes has been the object of much discussion. In general, secured claims tend to be different one from another and therefore often occupy individual classes.[1564] Unsecured claims and interest are often grouped based on similar legal rights. In general, claims within a single class must enjoy equal treatment and must be paid at the least the liquidation value.[1565]

The subdivision in a multitude of classes for the sole reason of obtaining favorable votes and approval of a plan is defined as "gerrymandering" and considered improper.[1566] Section 1125 (c) requires all members of a class to receive the same disclosure statement; diverging disclosure statements may be sent to different classes, though, as long as they all provide the necessary information.

Having received the necessary information, creditors and classes can express their votes. Under section 1126 (c):

> "A class of claims has accepted a plan id such plan has been accepted by creditors […] that hold at least two-thirds in amount and more than one-half in number of the allowed claims […]";

Under section 1126 (d):

> "A class of interests has accepted the plan if such plan has been accepted by holders of such interests […] that hold at least two-thirds in amount of the allowed interests […]".

If a class does not give its approval it does not automatically mean that the plan will not be confirmed. Section 1129 (a) (8) states that:

> "With respect to each class of claims or interests
> (A) Such class has accepted the plan; or
> (B) Such class is not impaired under the plan."

Rejection by one of more classes can, in fact, be cured by the "cram-down" section 1129 (b) (1):

> "Notwithstanding section 510 (a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claim or interests that is impaired under, and has not accepted the plan."

The test for "unfair discrimination" has been discussed by courts. Factors that are taken into consideration are: a) whether the plan can be implemented without discrimination; b) whether the plan is being presented in good faith; c) how the class is treated within the plan.[1567]

The most relevant effects deriving from the definitive confirmation of a plan are:

- The fact that, from that moment, all creditors and interests or equity holders will be bound to it whether they accepted it or not[1568];
- discharge from pre-petition debts.

Discharge in Chapter 11 is available to all debtors including corporations and partnerships. It is not, therefore, limited to individual debtors.[1569]. A few exceptions apply, regarding mainly[1570]:

[1564] A few specific rules apply to secured, and partially secured, claims in Chapter 11 cases, see § 1111 (b); they are very specific and they will not be discussed.

[1565] 1129 (a) (7) (A).

[1566] **In re Machne Menachem, Inc**., 233 Fed. Appex. 119, 2007 WL 1157015 (3d Cir. Apr. 19, 2007 (Pa.); **In re Greystone III Joint Venture**, 995 F.2d 1274 (5th Cir. 1991).

[1567] **In re Ratledge**, 31 B.R. 897 (Bankr. E.D. Tenn. 1983).

[1568] § 1141 (a).

[1569] § 1141 (d) (1) (A).

a) in cases in which the debtor is an individual, those non-dischargeable debts listed in section 523 of the Code;
b) claims that have willfully been omitted and excluded from the proceeding; in such cases the creditor will retain the right to commence an action against the debtor.

10.2.4 Chapter 11 reorganizations of small businesses[1571]

Chapter 11 includes a simplified framework for "small businesses" as defined in section 101 (51 D):

> "(51)(51D) The term "small business debtor"— (A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning or operating real property or activities incidental thereto) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than $2,566,050 (excluding debts owed to 1 or more affiliates or insiders) for a case in which the United States trustee has not appointed under section 1102(a)(1) a committee of unsecured creditors or where the court has determined that the committee of unsecured creditors is not sufficiently active and representative to provide effective oversight of the debtor; and (B) does not include any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $2,566,050 (excluding debt owed to 1 or more affiliates or insiders)."

For the most part, small businesses and major corporations have to follow the same rules and meet the same requirements to reorganize under Chapter 11. There are, however, some special provisions for small business debtors that can help them "fast track" through the Chapter 11 process and reduce legal and other restructuring expenses. The most relevant peculiarities of this sub-framework are:

- in a small business case, the creditors' committee may not be appointed;
- the debtor enjoys a longer exclusivity period to propose a plan.[1572]

10.2.5 The ongoing process of revising Chapter 11

The process for the revision and reform of the American insolvency framework is continuous. In the previous pages we have discussed several of the phases which have brought to the radical changes over the past two hundred years. American reorganization frameworks have implemented, over time, innovative solutions that have found wide applications also in foreign legal frameworks.[1573]

The whole framework continues to be revised to this very day:

> "Whether by design or chance, efforts to review and assess U.S. business reorganization laws are undertaken approximately every 40 years. Such efforts have led to federal legislation effecting meaningful revisions to business reorganization laws in 1898, 1938, and 1978. It may be that four decades is the maximum amount of time that any financially driven regulation can remain relevant. Markets and financial products, as well as industry itself, often evolve far more quickly than the regulations intended to govern them. It may be that significant economic crises tend to occur cyclically and encourage reevaluation of the federal bankruptcy laws. Regardless, the general consensus among restructuring professionals is that the time has come once again to evaluate U.S. business reorganization laws. Accordingly, the American Bankruptcy Institute (the "***ABI***")

[1570] Further exceptions regard "liquidation plans" which do not lead to discharge and those instances in which discharge would be denied in Chapter 7, see § 727 (a).

[1571] See **Carlson Thomas E.,** "*The small busin.ess provisions of the 2005 Bankruptcy Amendments*", 79 Am. Bankr. L.J. 645, (2005); **Hon. Haines James B., Jr.** and **Hendel Philip J**., "*No easy answers: small business bankruptcies after BAPCPA*", 47 B.C. L. Rev. 71 (2005).

[1572] § 1121 (e); § 1122 (e).

[1573] See **Wessels Bob**, "*Towards a reform of Chapter 11 U.S. Bankruptcy Code*", at: http://leidenlawblog.nl/Articles/towards-a-reform-of-Chapter-11-u.s.-bankruptcy-code

established the Commission to Study the Reform of Chapter 11 (the "***Commission***") for this precise purpose."[1574]

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The BAPCPA had ann important impact on the American bankruptcy system and on reorganizations. American society felt it necessary in 2005 to check the balance between a debtor's need to rehabilitate and the rights of the creditors:

"BAPCPA and the prior amendments affecting Chapter 11 tried to address perceived deficiencies in the Bankruptcy Code, but have in some respects altered the Bankruptcy Code's original careful balance between a debtor's need to rehabilitate and its creditors' rights to recoveries on their claims against the debtor. In addition, the amendments have introduced perceived inequities among different creditor constituencies. These factors, combined with the changing economic environment and other externalities discussed below, have diluted the effectiveness of Chapter 11 for many companies and their stakeholders. Reminiscent of the time preceding the work of the Commission on Bankruptcy Laws, companies once again are working to find alternatives to filing bankruptcy cases, potentially at the expense of their creditors, shareholders, and employees. Accordingly, after more than 35 years of experience under Chapter 11, many practitioners and commentators agree that it is again time for reform."[1576]

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cases, potentially at the expense of their creditors, shareholders, and employees.40 Accordingly, after more than 35 years of experience under Chapter 11, many practitioners and commentators agree that it is again time for reform."[1577]

The current structure of Chapter 11 (and of the whole Code), is, therefore, continuously tested to ensure it meets the requirements of the American society and economy. Interesting enough, in 2005 Europe moved to enforce less stigmatizing approaches and pushed to increase levels of entrepreneurship, while the Code moved, to a certain extent, in the opposite direction, to prevent what were perceived as potentially excessive levels of fraud and abuse.

[1574] **American Bankruptcy Institute**, Commission to Study the reform of Chapter 11, V.V.A.A., 2012-2014, final report and recommendations sponsored by the Anthony H.N. Schnelling Endowmnent Fund, at 2
http://commission.abi.org/full-report
[1575] *Id.,* at 1.
[1576] *Id*., at 11.
[1577] *Id*., at 12.

The EU and the US did move forward on the same path in some relevant areas. Recently, for example, the ABI Commission has been focusing on the following main areas in reforming reorganizations:

> "Chapter 11 works to rehabilitate companies, preserve jobs, and provide value to creditors only if distressed companies and their stakeholders actually use the Chapter 11 process to facilitate an in court or out-of-court resolution of the company's financial distress.4 Chapter 11 in turn needs to offer tools to resolve a debtor's financial distress in a cost-effective and efficient manner. To that end,
> the recommended principles seek to, among other things:
> • Reduce barriers to entry by providing debtors more flexibility in arranging debtor in possession financing, clarifying lenders' rights in the Chapter 11 case, disclosing additional information about the debtor to stakeholders, and providing a true breathing spell at the beginning of the case during which the debtor and its stakeholders can assess the situation and the restructuring alternatives;
> • Facilitate more timely and efficient diligence, investigation, and resolution of disputed matters through an estate neutral — *i.e.*, an individual that may be appointed depending on the particular needs of the debtor or its stakeholders to assist with certain aspects of the Chapter 11 case, as specified in the appointment order;
> • Enhance the debtor's restructuring options by eliminating the need for an accepting impaired class of claims to cram down a Chapter 11 plan and by formalizing a process
> to permit the sale of all or substantially all of the debtor's assets outside the plan process, while strengthening the protection of creditors' rights in such situations;
> • Incorporate checks and balances on the rights and remedies of the debtor and of creditors, including through valuation concepts that potentially enhance a debtor's liquidity during the case, permit secured creditors to realize the reorganization value of their collateral at the end of the case, and provide value allocation to junior creditors when supported by the reorganization value; and
> • Create an alternative restructuring scheme for small and medium-sized enterprises that would enable such enterprises to utilize Chapter 11 and would enable the court to more efficiently oversee the enterprise through a bankruptcy process that incentivizes all parties, including enterprise founders and other equity security holders, to work collectively toward a successful restructuring."[1578]

This follows the EU's approach. The US has also focused on structuring better-tailored frameworks to ensure effective support to different kinds and sizes of businesses, especially small ones:

> "The Commissioners did not generally believe, however, that a "one-size-fits-all" approach to Chapter 11 is the best approach. In addition to the mega cases, the Commissioners found that the general reform principles being proposed identified and responded to key issues for the more established, upper-middle-market and larger company cases. These cases often struggled with liquidity early in the process, timing issues surrounding their exit strategy and value allocation, and case-specific investigations, litigation, or negotiations. These debtors also typically benefit from the advice and counsel of restructuring professionals and have more experienced management teams."[1579]

This approach seems to look back to the original structure of reorganization frameworks. Under earlier Acts, Chapter X focused specifically on the needs of large public companies and Chapter XI was tailored for smaller firms. These Chapters were merged in 1978 in a unique Chapter 11. The definition of small businesses seems to differ from the European one, where these entities seem to be much smaller in size:

> "For purposes of these principles, the term "***small or medium-sized enterprise***"

[1578] *Id.,* at 4.
[1579] *Id.,* at 284.

("***SME***") means a business debtor with (i) No publicly traded securities in its capital structure or in the capital structure of any affiliated debtors whose cases are jointly administered with the debtor's case; and
(ii) Less than $10 million in assets or liabilities on a consolidated basis with any debtor or nondebtor affiliates as of the petition date. A debtor purporting to qualify as an SME under this definition must file a balance sheet reflecting a good faith estimate of its assets and liabilities as of the petition date with its Chapter 11 petition."[1580]

11. The insolvency of natural persons in the U.S.

11.1 Introduction

As discussed in Chapter II, the U.S. framework has been innovative in including parts dealing specifically with the insolvency of non-business debtors or natural persons. Today the American system is used as a model by countries that are in the process of structuring their own laws to tackle the problem of over-indebtedness. As mentioned in Chapter I, recently the European Union has also included this field of insolvency law within the process of refoundation.

In the next sections, we will discuss of the most relevant aspects of the Bankruptcy Code in this particular area. We will focus in particular on:

- liquidations, reorganizations and rehabilitations – different proceedings made available to natural persons;
- the costs of proceedings;
- the value of education requirements;
- available exemption statutes at the state and federal level;
- discharge rules;
- prevention of abuses (a topic directly connected with the management of stigma).

11.2 The available options

Preliminarily, it is worth mentioning that the framework embodied in the Bankruptcy Code allows natural persons to avail themselves of both liquidation and reorganization/rehabilitation proceedings. Based on certain characteristics they are eligible debtors under several Chapters.

Chapter 7 remains available as a liquidation option. It allows honest debtors that have no alternatives to swiftly go through bankruptcy and obtain a fresh start.

Chapters 12 and 13 support the debtor's efforts in reorganizing and rehabilitating themselves.

Chapter 12 was specifically designed to support family farmers and fishermen[1581]; this Chapter was introduced as a temporary measure in the eighties, but it was then re-enacted several times until 2005, when it was made a permanent component of the Code[1582]. A case under this Chapter can be commenced by voluntary petitions only, by those debtors (natural persons but also partnerships and corporations[1583]) eligible for relief. A monetary threshold applies[1584]: aggregate debts must not exceed $4.153.150.[1585]

"**(18)** The term "family farmer" means—
(A) individual or individual and spouse engaged in a farming operation whose aggregate debts do not exceed $4,153,150 and not less than 50 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse unless such debt arises out of a farming

[1580] *Id.,* at 275.
[1581] See § 101 (18) (B); 101 (19) (A); 101 (7).
[1582] **Porter Kathrine M.,** "*Phantom Farmers: Chapter 12 of the Bankruptcy Code*", 79 Am. Bankr. L.J. 729, (2005), at 730-733.
[1583] Corporations qualify if: a) 50% of the stock or equity is held by one family and the relatives or members of such family, and the family conducts farming operations; b) more than 80% of the debts must be connected to farming operations. The corporation cannot be publicly traded. See § 101 (18) (B); 101 (45).
[1584] A lower limit applies to "family fishermen": $ 1.924.550. See $ 101 (19A).
[1585] Amount modified in 2016, see 101 (18) (B) (ii).

operation), on the date the case is filed, arise out of a farming operation owned or operated by such individual or such individual and spouse, and such individual or such individual and spouse receive from such farming operation more than 50 percent of such individual's or such individual and spouse's gross income for—
(i) the taxable year preceding; or
(ii) each of the 2d and 3d taxable years preceding;
the taxable year in which the case concerning such individual or such individual and spouse was filed; or
(B) corporation or partnership in which more than 50 percent of the outstanding stock or equity is held by one family, or by one family and the relatives of the members of such family, and such family or such relatives conduct the farming operation, and
(i) more than 80 percent of the value of its assets consists of assets related to the farming operation;
(ii) its aggregate debts do not exceed $4,153,150 and not less than 50 percent of its aggregate noncontingent, liquidated debts (excluding a debt for one dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a farming operation), on the date the case is filed, arise out of the farming operation owned or operated by such corporation or such partnership; and
(iii) if such corporation issues stock, such stock is not publicly traded."

Debtors must prove they are able to make payments under the repayment plan, that their income is stable and predictable. This is not an easy requirement given the markets in which farmers and fishermen operate. The reorganization process needs, though, to operate on future income and on a feasible plan.[1586]

Chapter 13[1587] is the main rehabilitation Chapter made available to individuals[1588] (both business and non-business debtors can file) with regular[1589] income.[1590] A few exceptions apply:

a) corporations and partnerships are excluded;
b) fishermen and farmers should file under Chapter 12;
c) stock brokers and commodity brokers cannot file under Chapter 13[1591];
d) individuals whose case was dismissed within 180 days are ineligible if the dismissal was caused by willful noncompliance with court orders, if the debtor failed to appear before court, or by a party successfully obtaining a lift of the automatic stay.[1592]

Moreover, a monetary threshold prevents some wealthy debtors from obtaining discharge under this Chapter. Debtors who owe, on the date of filing, more than $394.725 in unsecured, and more than $1.184.200[1593] in secured, noncontingent, liquidated debts[1594] have to reorganize under Chapter 11. The rehabilitation process allows honest debtors to retain their assets, to obtain a discharge of portions of their debts, and to solve their financial difficulties through a payment plan structured over the time of three to five years.

The stay in Chapter 13 has even wider scope. It is not limited to the protection of § 362. Section 1301 (a) allows a special protection against civil actions to collect a consumer debt from any individual that is

[1586] § 1225 (a) (6).
[1587] **Dixon Timothy W., Epstein David G**., "*Where Did Chapter 13 Come From and Where Should it Go?",* 10 Am. Bankr. Inst. L. Rev. (2002).
[1588] Joint cases are permitted for married couples, see § 109 (e); 302 (a).
[1589] In the Bankruptcy Act only wage earners could be rehabilitated; today any debtor that can prove to own enough income or resources to finance the plan can avail himself of Chapter 13. See **Ferriell Jeffrey T., Janger Edward J**., "*Understanding Bankruptcy – third edition*", Lexis Nexis, ISBN 9780769859200, (2013), at 645.
[1590] § 101 (30).
[1591] § 109 (e).
[1592] § 109 (g).
[1593] Dollar amounts changed April 1st 2016.
[1594] In joint cases the debts of both spouses are aggregated. To be eligible each spouse must meet the thresholds of 109 (e), see **In re Werts**, 410 B.R. 67 (Banrkr. D. Kan. 2009).

liable on such debt with the debtor or that secured the debt[1595]; the so-called “co-debtor” stay. The estate is also mrore comprehensive than in a Chapter 7 case, for it includes portions of the future earnings that the debtor will collect over the three or five years of duration of the plan. This is, usually, the most significant asset available in the plan for the payment of claims and it is handed over to the trustee in the case for this purpose.

Chapter 13, therefore, effectively supports debtors in their reorganization efforts. Many, though, preferred filing a simpler Chapter 7 aiming for a quick liquidation; this behavior was common even among debtors that could pay more to their creditors and therefore, with time, was perceived as an abuse. The reform of 2005 aimed to ensure that Chapter 7 would not be available to those debtors that could pay greater portions of their debts through future earnings.

11.3 Preventing abuses through means testing: § 707 (b)

The American framework is extremely supportive of natural persons and non-business debtors in general. It provides honest debtors with a path to liquidate swiftly and with different opportunities to structure rehabilitation or reorganization proceedings tailored on their characteristics. Conflicts arose with time, though.

As discussed several times in the previous pages, through history societies have, in general, not been inclined to forgive those that accumulated excessive amounts of debts. The American system developed a different approach for the benefit of the economy; supporting honest debtors crushed by the pressure of the market was considered beneficial for the whole system. Balancing the system proved tricky, though; providing too ample and too easy relief would lead to reckless behaviors and to abuses of the framework.

At the time of the enactment of § 707 (b) in 1984, the primary purpose was reducing the number of consumer bankruptcy filings under Chapter 7, which were consistently growing.[1596] Courts applied the following criteria to determine whether awarding relief in a case could constitute an abuse or not:

> “1. Whether the debtors have a likelihood of sufficient future income to fund a Chapter 13 plan which would pay a substantial portion of the unsecured claims;
> 2. Whether the debtors' petition was filed as a consequence of illness, disability, unemployment or some other calamity;
> 3. Whether the schedules suggest the debtors incurred cash advances and consumer purchases in an excess of their ability to repay them;
> 4. Whether the debtors' proposed family budget is excessive or extravagant;
> 5. Whether the debtors' statement of income and expenses is misrepresentative of their true financial condition.”[1597]

In 2005 the BAPCPA, in its attempt to make the framework more efficient and debtors more responsible, modified this subsection introducing an objective test (called “means testing”) to assess if a debtor’s financial conditions had deteriorated enough to make the award of a swift liquidation under Chapter 7 reasonable and legitimate, or if he should be pushed to give more through a plan under a rehabilitation or reorganization Chapter.[1598] The extensive language of the code and the presence of math (which is not always a lawyer-friendly topic) make a first approach to this topic complex.

The essence of means testing is to ensure fairness. Under § 707 (b) (2), when a petition is filed under Chapter 7 it is subject to the test to prevent wealthier, dishonest debtors who may be capable of repaying higher portions of their debts through a reorganization Chapter to take advantage of discharge through a quick, carefree liquidation. Hence, if the debtor fails to meet the required prongs, she will see her case dismissed, or with her consent, converted to a different proceeding under Chapters 13 or 11 (in those cases in which the debtor does not meet the necessary eligibility requirements under Chapter 13).[1599]

[1595] Exceptions are listed at § 1301 (a) (1) – (2); relief from the stay can be awarded under § 1301 (c).
[1596] **Neustadter Gary**, "*2005 A consumer Bankruptcy Odyssey*", 39 Creighton L. Rev. 225 (2006), at 271-300.
[1597] **In re Newsom**, 69 B.R. 801 (Bankr. D.N.D. 1987).
[1598] *Id.*, see also **In re Kress**, 57 B.R. 874 (Bankr.N.D.1985); In re Grant, 51 B.R. 385 (Bankr.N.D.Ohio 1985); **In re Bryant**, 47 B.R. 21 (Bankr.W.D.N.C.1984).
[1599] § 707 (b) (1).

In order to assess if a presumption of abuse[1600] arises under the test, it is necessary to:

- estimate "the petitioner's monthly income" as defined in § 101 (10) (A):

> "The term "current monthly income" (A) means the average monthly income from all sources that the debtor receives (or in a joint case the debtor and the debtor's spouse receive) without regard to whether such income is taxable income, derived during the 6-month period ending on— (i) the last day of the calendar month immediately preceding the date of the commencement of the case if the debtor files the schedule of current income required by section 521(a)(1)(B)(ii); or (ii) the date on which current income is determined by the court for purposes of this title if the debtor does not file the schedule of current income required by section 521(a)(1)(B)(ii); and (B) includes any amount paid by any entity other than the debtor (or in a joint case the debtor and the debtor's spouse), on a regular basis for the household expenses of the debtor or the debtor's dependents (and in a joint case the debtor's spouse if not otherwise a dependent), but excludes benefits received under the Social Security Act, payments to victims of war crimes or crimes against humanity on account of their status as victims of such crimes, and payments to victims of international terrorism (as defined in section 2331 of title 18) or domestic terrorism (as defined in section 2331 of title 18) on account of their status as victims of such terrorism".

- estimate the debtor's monthly expenses under subsections (b) (2) (A) (ii), (I), (II), (III), (IV), (V):

> "The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the spouse is not otherwise a dependent. Such expenses shall include reasonably necessary health insurance, disability insurance, and health savings account expenses for the debtor, the spouse of the debtor, or the dependents of the debtor. Notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts. In addition, the debtor's monthly expenses shall include the debtor's reasonably necessary expenses incurred to maintain the safety of the debtor and the family of the debtor from family violence as identified under section 302 of the Family Violence Prevention and Services Act, or other applicable Federal law. The expenses included in the debtor's monthly expenses described in the preceding sentence shall be kept confidential by the court. In addition, if it is demonstrated that it is reasonable and necessary, the debtor's monthly expenses may also include an additional allowance for food and clothing of up to 5 percent of the food and clothing categories as specified by the National Standards issued by the Internal Revenue Service.
> **(II)** In addition, the debtor's monthly expenses may include, if applicable, the continuation of actual expenses paid by the debtor that are reasonable and necessary for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family (including parents, grandparents, siblings, children, and grandchildren of the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case who is not a dependent) and who is unable to pay for such reasonable and necessary expenses. Such monthly expenses may include, if applicable, contributions to an account of a qualified ABLE program to the extent such contributions are not excess contributions (as described in section 4973(h) of the Internal Revenue Code of 1986) and if the designated beneficiary of such account is a child, stepchild, grandchild, or stepgrandchild of the debtor.
> **(III)** In addition, for a debtor eligible for Chapter 13, the debtor's monthly expenses may include the actual administrative expenses of administering a Chapter 13 plan for the district in which the debtor resides, up to an amount of 10 percent of the projected plan

[1600] Charitable contributions made to any religious or charitable entity or organization are not to be taken into consideration in evaluating if awarding relief would be an abuse. See § 707 (b) (1).

payments, as determined under schedules issued by the Executive Office for United States Trustees.
(IV) In addition, the debtor's monthly expenses may include the actual expenses for each dependent child less than 18 years of age, not to exceed $1,925 per year per child, to attend a private or public elementary or secondary school if the debtor provides documentation of such expenses and a detailed explanation of why such expenses are reasonable and necessary, and why such expenses are not already accounted for in the National Standards, Local Standards, or Other Necessary Expenses referred to in subclause (I).
(V) In addition, the debtor's monthly expenses may include an allowance for housing and utilities, in excess of the allowance specified by the Local Standards for housing and utilities issued by the Internal Revenue Service, based on the actual expenses for home energy costs if the debtor provides documentation of such actual expenses and demonstrates that such actual expenses are reasonable and necessary."

- know the "median family income" of the state (the differences between states in defining such parameter may cause forum shopping[1601]) the petition is filed in[1602]:

"§ 101 (39A) The term "median family income" means for any year
(A) the median family income both calculated and reported by the Bureau of the Census in the then most recent year; and
(B) if not so calculated and reported in the then current year, adjusted annually after such most recent year until the next year in which median family income is both calculated and reported by the Bureau of the Census, to reflect the percentage change in the Consumer Price Index for All Urban Consumers during the period of years occurring after such most recent year and before such current year."

If a debtor's income (as correctly filed and calculated) is below the median, no presumption of abuse arises[1603] and the debtor is not bound to means testing. Challenges[1604] are not permitted unless the Court or the US Trustee may infer bad faith under a totality of the circumstances approach.[1605]

If the outcome is above the median it undergoes the following test:

a) the debtor's monthly income minus the debtor's monthly expenses equals the "disposable monthly income";

b) disposable monthly income is multiplied by 60 (sixty months in a five-year plan) and compared to the standards set forth in the code.

There will be presumption of an abuse and the petition will be dismissed or converted to a reorganization Chapter (with the debtor's consent[1606]) upon petition by Court, the U.S. Trustee, or the bankruptcy Trustee[1607], if the result is not less than the lesser of[1608]:

a) the greater of 25% of the debtor's non-priority secured claims in the case, or $7.700, whichever is greater; or

b) $12.850.[1609]

[1601] **Hanover National Bank v. Moyses**, 186 U.S. 181 (1902) – it is acceptable if the law defers some parameters to state laws, hence preventing the statute from being completely uniform as long as the law is uniform in its general operation. See also **Schultz v. United States** (6th Cir. 2008) 529 F3d 343, 352.
[1602] Meaning the state in which debtor resides at the time of filing; in the case of multiple possible residences, the state in which most family members reside; as a last possibility in case of plurality of residences, the state of residence of the spouse of higher income. United States Trustee program's statement of position.
[1603] This does not mean that the case may not be dismissed under other parameters set forth in the Code.
[1604] §§ 707 (b) (2) if there is abuse, filing is allowed within 30 days from the U.S. Trustee's statement; 707 (b) (3).
[1605] § 707 (b) (6).
[1606] § 707 (b) (1); FRBP § 107 (e).
[1607] §§ 704 (b) (2), 707 (b) (1); FRBP 1017 (e).
[1608] §§ 707 (b) (2) (B) (iv) (I) – (II).

The office of U.S. Trustees reviews petitions and assesses if there have been abuses, but the system seems to place the balance in favor of petitioners.

It is interesting to note that discovery before making a determination upon dismissal has been rejected by Courts as to determine a presumption of good faith on the information provided by the debtor; while discovery has been granted upon dismissal of the petition.[1610]

Moreover, the U.S. Trustee's assessment of abusive filing must be made in a timely manner under § 707 (b) (3) or else it will be barred from going into effect[1611] (while there is no term or limitation concerning bad faith analysis under a totality of the circumstances approach). If such a determination cannot be made, meaning that there is no clarity on whether there may be something incorrect in the petition, the Trustee will be barred from dismissing it under § 707 (b) (2)[1612].

11.4 The costs of bankruptcy: paying the fees

The costs of bankruptcy have been a main headache over the centuries under several points of view. We will discuss this topic in the section on natural persons, considering this issue is more problematic when the debtor is an indigent individual compared to a broke company:

> "Even if all these obstacles to a discharge of debt in bankruptcy could be overcome by a low-income debtor, another obstacle was emphasized by Parliament's Select Committee on Debtors (Imprisonment) of 1909. According to the Select Committee, a bankruptcy discharge was unavailable to most low-income debtors simply because a debtor's petition for bankruptcy cost ten pounds, which the debtor usually could not afford."[1613]

In the US, individual debtors face an assortment of user fees and costs[1614] [1615] despite the fact that a very relevant percentage of cases are opened by individuals with income below poverty levels.[1616] It has been analyzed, in fact, that over 90% of debtors have incomes below the national median and a third of them have an income below the poverty level.[1617] The consequences of omitting payments vary: not paying the necessary fees when filing voluntarily is a cause of dismissal of the case under § 707 (a) (2).[1618]

Payment of fees has, therefore, become a particularly debated topic due to the limitations it poses on individuals in great need to seek protection.[1619]

[1609] § 707 (b) (2) (A) (i); if the debtor passes the test the petition is dismissed as long as the proper forms have been filed correctly and in good faith. If alterations have been made in order to meet a more favorable result the case may still be dismissed under § 707 (b) (3).

[1610] **In re Perrotta** (BC D NH 2007) 378 BR 27, 28-30.

[1611] **In re Reed** (CD CA 2009) 422 BR 214, 223-224.

[1612] **In re Perrotta** (BC D NH 2007) 378 BR 434, 438.

[1613] **Ware J. Stephen**, "*A 20th Century Debate About Imprisonment for Debt*", 54 Am. J. Legal Hist. 351 (2014), at 354

[1614] See U.S.C. Title 28 § 1930; **Lupica Lois R**., "*The Consumer Bankruptcy Fee Study: Final Report*", 20 Am. Bankr. Inst. L. Rev. 17 (2012); **Flynn Ed**, "*Is Bankruptcy the Red-Headed Stepchild of the Judiciary*", 34 Am. Bankr. Inst. J. 36 (2015).

[1615] "Total bankruptcy case filing fees averaged about *$375 million* per year between Fiscal Years 2010-14", **Flynn Ed**, "*Is Bankruptcy the Red-Headed Stepchild of the Judiciary*", 34 Am. Bankr. Inst. J. 36 (2015), at 36.

[1616] **MacArthur Andrew P.**, "*Pay to Play: the Poor's Problems in the BAPCPA*", 25 Emory Bankr. Dev. J. 407 (2009), at 407.

[1617] See **Sousa Michael D.**, "*Legitimizing Bankruptcy Petition Preparers: A Sociolegal Prescription for Change*", 89 American Bankruptcy Law Journal 269, (2015), at 271, quoting **Katherine Porter**, "*Bankrupt Politics: The Credit Industry's Business Model for Postbankruptcy Lending*", 93 IOWA L. REV. 1369, 1390 (2008).

[1618] Although the 1898 Act allowed for free access to bankruptcy to indigent debtors *in forma pauperis,* filings of bankruptcy petitions were abolished by the Referee's Salary bill of 1946, which made paying fees mandatory for over 50 years. See **Markham Michael C**., **Scharrer Bethann**, "*In Forma Pauperis: an Unnecessary Privilege in Bankruptcy*", 2 Am. Bankr. Inst. L. Rev. 73 (1994), at 75.

[1619] See, pre BACPA enactment, **United States v. Kras**, 409 U.S.- 434. 446 (1973), stating that bankruptcy fresh start is not a fundamental right and limitations may apply against BACPA's partial waivers for those individuals that have an income "less than 150% of the income official poverty line" FRBP 1006(c); or the possibility for individual debtors to structure an installment plan 28 USC § 1930(a); FRBP 1006(b); see also as a general discussion of the constitutionality

Filing and administrative fees are not very high per se if compared to the benefits that discharge may bring. They amount to about[1620]:

- $310.00 USD – $335.00 in a Chapter 7 or a Chapter 13[1621];
- $270.00 in a Chapter 12;
- $1,700.00 for a Chapter 11.[1622] [1623]

Debtors may nevertheless be unable to pay them.[1624] It must also be considered that petitioners incur other costs, such as paying for mandatory credit counseling[1625], which usually amounts to an extra $20 -100.[1626] Individual debtors in Chapter 7 are particularly exposed to such difficulties, since they often don't own any assets at all, making it impossible for them to comply with all the requirements imposed.[1627]

> "Indeed, efforts have been made to help these particularly distressed debtors to overcome an ironic challenge. Given their depressed financial condition, these debtors might well be unable to afford the administrative costs of seeking relief, at least in systems that charge fees to debtors for access to insolvency relief. In one relatively new system, for example, barely 150 insolvency cases were opened for natural persons seeking discharge during the first three-and-a-half years of the new law, most likely because cases there are dismissed if the debtor's income is insufficient to cover the anticipated insolvency representative's fees. More established systems have struggled to find solutions to problems like this. Volunteer lawyers in one country often agree to waive their fees—the most substantial cost in this country's insolvency system—for low-income debtors, and another system allows low-income debtors to delay paying the administrative costs of the insolvency case until after they have completed the six-year "good behavior period." Authorities in another country have recently developed a formal solution for this particular problem. The multi-option menu of debt-relief processes now includes a low-cost alternative for destitute debtors. For individual debtors with limited debts, little income, and few assets, a low-cost administrative proceeding is available from the state authority charged with overseeing the insolvency system. By reducing the formalities and expenses of the court-based "insolvency" procedure, the new administrative process was specifically designed to make relief available to low- and no-income debtors for whom court costs would otherwise have been a barrier to relief." [1628]

Such obstacles have been partially removed in recent years by allowing debtors to pay filing fees for voluntary petitions in installment payments[1629]; or by having them forfeited when the debtor's income is less than 150 percent of the poverty line[1630] [1631]:

> "Rule 1006. Filing Fee

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of fees applied to indigent citizens, **Rose Henry**, "*The Constitutionality of Government Fees as Applied to the Poor*", 33 N. Ill. U. L. Rev. 293 (2013)293-304.

[1620] http://www.insb.uscourts.gov/sites/insb/files/FeeSchedule.pdf

[1621] See § 28 U.S.C. 1930 (a) – (b).

[1622] **Flynn Ed**, "*Is Bankruptcy the Red-Headed Stepchild of the Judiciary*", 34 Am. Bankr. Inst. J. 36 (2015), at 36.

[1623] Just an example: the mandatory pre-filing counseling requirements for Chapter 7 and 13 do not come for free regardless of, and cumulative to, the bankruptcy filing fees.

[1624] **Sousa Michael D.**, "*Legitimizing Bankruptcy Petition Preparers: A Sociolegal Prescription for Change*", 89 American Bankruptcy Law Journal 269, (2015), at 270.

[1625] Discussed in the next section.

[1626] See **Flynn Ed**, "*Is Bankruptcy the Red-Headed Stepchild of the Judiciary*", 34 Am. Bankr. Inst. J. 36, (2015).

[1627] "One-third of all bankruptcies are filed by individuals whose income is below the poverty level", **MacArthur Andrew P.**, "*Pay to Play: the Poor's Problems in the BAPCPA*", 25 Emory Bankr. Dev. J. 407 (2009), at 407.

[1628] **Vv. Aa., The World Bank**, "*Insolvency and Creditor/Debtor regimes task force – working group on the treatment of the insolvency of natural persons – report on the treatment of the insolvency of natural persons*", (2013).

[1629] Fed. R. Bankr. P. 1006 (b).

[1630] Fees cannot be forfeited in the case of involuntary proceedings.

[1631] 28 U.S.C.S. § 1930 (f).

(a) GENERAL REQUIREMENT. Every petition shall be accompanied by the filing fee except as provided in subdivisions (b) and (c) of this rule. For the purpose of this rule, "filing fee" means the filing fee prescribed by 28 U.S.C. §1930(a)(1) –(a)(5) and any other fee prescribed by the Judicial Conference of the United States under 28 U.S.C. §1930(b) that is payable to the clerk upon the commencement of a case under the Code.
(b) PAYMENT OF FILING FEE IN INSTALLMENTS.
(1) Application to Pay Filing Fee in Installments. A voluntary petition by an individual shall be accepted for filing, regardless of whether any portion of the filing fee is paid, if accompanied by the debtor's signed application, prepared as prescribed by the appropriate Official Form, stating that the debtor is unable to pay the filing fee except in installments.
(2) Action on Application. Prior to the meeting of creditors, the court may order the filing fee paid to the clerk or grant leave to pay in installments and fix the number, amount and dates of payment. The number of installments shall not exceed four, and the final installment shall be payable not later than 120 days after filing the petition. For cause shown, the court may extend the time of any installment, provided the last installment is paid not later than 180 days after filing the petition.
(3) Postponement of Attorney's Fees. All installments of the filing fee must be paid in full before the debtor or Chapter 13 trustee may make further payments to an attorney or any other person who renders services to the debtor in connection with the case.
(c) WAIVER OF FILING FEE. A voluntary Chapter 7 petition filed by an individual shall be accepted for filing if accompanied by the debtor's application requesting a waiver under 28 U.S.C. §1930(f), prepared as prescribed by the appropriate Official Form."

Allowing spouses to file jointly is alsoof aid since the system allows them to pay fees once for both.

Fees and costs become relevant again upon filing an involuntary petition. They become further expenses to be added to the already outstanding debts, causing further potential losses. Moreover involuntary fees enjoy a less beneficial treatment for they may be waived under certain circumstances but cannot be paid in installments.[1632] Hence small claim holders, even if they meet all statutory requirements, may be unwilling to pay the price of bankruptcy.

As such, the costs of involuntary filing may affect the petitioner's choices. Almost all involuntary proceedings are, therefore, filed under Chapter 7 (where the filing fees are much lower), although the debtor can move to convert the case under another Chapter, even one for which the involuntary petition may not be originally filed, such as Chapters 11, 12, or 13[1633] (provided that the debtor may be a debtor under such Chapter, of course).[1634]

11.5 Supporting debtors with education: mandatory credit counseling requirements

Mandatory credit counseling was introduced as a requirement for all[1635] individual debtors by the BAPCPA in 2005. It applies to two different, critical phases of the proceeding: "pre-filing"[1636] under any[1637] Chapter in which the debtor may be eligible and "post-filing" to obtain discharge under Chapters 7 and 13.

Pre-filing an individual must receive credit counseling from a nonprofit budget and credit counseling agency approved by the Department of Justice's Trustee Program[1638] during the 180 days preceding the petition[1639] (it is not required that the meeting happens in person, nor individually or in English; the

[1632] FRBP 1006.
[1633] § 706 (a).
[1634] § 707 (d).
[1635] This means that in a joint case both spouses must meet the requirements.
[1636] § 109 (h) (1).
[1637] Counseling is mandatory under Chapters 7, 11, 12 and 13.
[1638] Except in Alabama and North Carolina where court officials approve the counseling services.
[1639] § 109 (h) (1) "ending on"… the necessary counseling requirement can be fulfilled up to the day of filing the petition. The requirement is not met if the counseling ends after filing **In re Francisco** (10th Cir. BAP 2008) 390 BR 700, 705.

requirement can be fulfilled individually, in a group, online – which is a quite common option – on the phone, and in one of the available languages[1640]):

> "An individual may not be a debtor under this title unless such individual has, during the 180-day period ending on the date of filing of the petition by such individual, received from an approved[1641] nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis."

The duty placed on debt relief agencies is very onerous and detailed. Agencies must give notice as to:
- alternatives in bankruptcy under the different Chapters, including costs;
- alternatives outside of bankruptcy;
- information and warnings about the consequences of
  - fraudulent behaviors such as bad faith filing;
  - the omission of required information;
  - the concealment of assets, etc.[1642]

Section 527 (b), on disclosure, includes the following language (often in capital letters and bold) that must be used in an attempt to ensure a high degree of effectiveness and efficiency in transmitting the necessary information:

> "(b) A debt relief agency providing bankruptcy assistance to an assisted person shall provide each assisted person at the same time as the notices required under subsection (a)(1) the following statement, to the extent applicable, or one substantially similar. The statement shall be clear and conspicuous and shall be in a single document separate from other documents or notices provided to the assisted person:
> "IMPORTANT INFORMATION ABOUT BANKRUPTCY ASSISTANCE SERVICES FROM AN ATTORNEY OR BANKRUPTCY PETITION PREPARER.
>
> If you decide to seek bankruptcy relief, you can represent yourself, you can hire an attorney to represent you, or you can get help in some localities from a bankruptcy petition preparer who is not an attorney. THE LAW REQUIRES AN ATTORNEY OR BANKRUPTCY PETITION PREPARER TO GIVE YOU A WRITTEN CONTRACT SPECIFYING WHAT THE ATTORNEY OR BANKRUPTCY PETITION PREPARER WILL DO FOR YOU AND HOW MUCH IT WILL COST. Ask to see the contract before you hire anyone.
>
> The following information helps you understand what must be done in a routine bankruptcy case to help you evaluate how much service you need. Although bankruptcy can be complex, many cases are routine.
>
> Before filing a bankruptcy case, either you or your attorney should analyze your eligibility for different forms of debt relief available under the Bankruptcy Code and which form of relief is most likely to be beneficial for you. Be sure you understand the relief you can obtain and its limitations. To file a bankruptcy case, documents called a Petition, Schedules, and Statement of Financial Affairs, and in some cases a Statement of Intention, need to be prepared correctly and filed with the bankruptcy court. You will have to pay a filing fee to the bankruptcy court. Once your case starts, you will have to attend the required first meeting of creditors where you may be questioned by a court official called a 'trustee' and by creditors.

[1640] § 109 (h) (1).
[1641] See https://www.justice.gov/ust/list-credit-counseling-agencies-approved-pursuant-11-usc-111
[1642] §§ 342 (b), 527 (a) (2); Bankruptcy Form B (2010).

> If you choose to file a Chapter 7 case, you may be asked by a creditor to reaffirm a debt. You may want help deciding whether to do so. A creditor is not permitted to coerce you into reaffirming your debts.
>
> If you choose to file a Chapter 13 case in which you repay your creditors what you can afford over 3 to 5 years, you may also want help with preparing your Chapter 13 plan and with the confirmation hearing on your plan which will be before a bankruptcy judge.
>
> If you select another type of relief under the Bankruptcy Code other than Chapter 7 or Chapter 13, you will want to find out what should be done from someone familiar with that type of relief.
>
> Your bankruptcy case may also involve litigation. You are generally permitted to represent yourself in litigation in bankruptcy court, but only attorneys, not bankruptcy petition preparers, can give you legal advice."

All documents must be kept available for a period of two years after counseling. Intentional or negligent non-compliance[1643] with §§ 526-8 may cause the imposition sanctions such as civil damages and attorney's fees.[1644]

"Post-filing personal financial management courses" (or Debtor Education) are mandatory for individuals that wish to receive discharge of debts under Chapter 7 and 13 and focus on teaching debtors how to budget responsibly and how to manage finances more successfully in the future.[1645] The requirement must be fulfilled within the 60th day after the first date set for the meeting of creditors in Chapter 7 or before the last installment payment in a Chapter 13. Not obtaining the necessary certification may cause discharge not to be issued.

Credit counseling can be fully or partially waived in very limited circumstances, such as[1646]:

a) The debtor resides in a district for which the United States Trustee (or the bankruptcy administrator, if any) determines that the approved nonprofit budget and credit counseling agencies for such district are not reasonably able to provide adequate services.[1647] The situation must be reassessed at the least annually.[1648]
b) The court grants a temporary exemption due to "exigent circumstances"[1649] as to allow a debtor to file the petition (hence enjoying the benefits of filing) before having fulfilled the requirement.[1650] § 109 (h) (3) allows just an extension of time and does not waive the duty *tout court*; the case may be dismissed unless the debtor files the certificate within the new deadline.[1651] The debtor must also show he was unable to obtain counseling in the seven-day period beginning on the day he made the request despite his best effort, or else the petition may be rejected despite the actual existence of "exigent circumstances".[1652] The exemption may last up to thirty days from the day of filing, such term may be delayed for cause for a maximum of an extra fifteen days[1653];

[1643] See also § 342 (b).
[1644] § 526 (c) (2) (3) (5).
[1645] § 727 (a) (11); 1328 (g) (1).
[1646] §109 (h) (2), (3), (4).
[1647] §109 (h) (2) (A).
[1648] §109 (h) (2) (B).
[1649] Imminent sale of debtors house, **In re Hedquist** (8th Cir. BAP 2006) 342 BR 295, 298, and incarceration, **In re Bourgeois** (8th Cir. BAP 2013) 488 BR 622, 627-628, are most often not meeting the "exigent circumstances requirement".
[1650] §109 (h) (3).
[1651] §109 (h) (3) (B).
[1652] §109 (h) (3) (A) (ii); **In re Taal** (1st Cir. BAP 2014) 504 BR 682, 685-686.
[1653] §109 (h) (3) (B).

c) The court may waive the counseling requirement completely if the debtor is affected by incapacity[1654], disability, or is in active military duty in a combat zone.[1655]

The policies supporting the enactment of mandatory counseling requirements are valid and quite similar to the ones that the EU theoretically wishes for in discussions on the benefits of increasing levels of education (for debtors and entrepreneurs in general). Knowledge should help debtors in being successful in honestly taking advantage of the opportunities provided by the framework. At the same time, increasing awareness should help decreasing the number of petitions among consumers[1656]; teaching individuals how to manage their finances more effectively should help them prevent future defaults.[1657] [1658]

Yet, the results that have been achieved up to now have not met initial expectations.[1659]

In particular, the new system did not direct the teaching effort sufficiently well by clearly detailing the areas and concepts to be explored.[1660] Moreover, the new requirement added to the already tormented array of necessary costs prior to filing[1661] and to the costs of the proceeding in general[1662], which plays a relevant role in a situation of default[1663] and harms poorer debtors[1664]. It has been observed that such mandatory barrier preliminary to any filing for relief is an inadequate[1665], expensive burden[1666] that operates as an “expensive draconian gate-keeping requirement” and a “procedural hurdle without value or consequence”[1667] [1668], while the objectives to be reached through “post-filing” bankruptcy counseling have proven vague and lacking in definiteness.[1669] [1670]

Another factor that is worth mentioning is that counseling sessions often last between one hour and 90 minutes; Debtor’s Education may last 2 hours. This time seems limited and insufficient to achieve the relevant goals set by the system.

[1654] Incapacity does not prevent bankruptcy filing; the Code does not restrain the application of its provisions to incompetent debtors or minors. **Elizabeth Warren**, “*Bankrupt Children*”, 86 Minn. L. Rev. 1003 (2002).

[1655] §109 (h) (4).

[1656] **Dickerson Mechele**, "*Can Shame, Guilt, or Stigma Be Taught? Why Credit-Focused Debtor Education May not Work*", Symposia Symposium on Bankruptcy Reform (1999), at 945.

[1657] *Id.,* at 946.

[1658] **Sousa Michael D**., “*Just punch my bankruptcy ticket: a qualitative study of mandatory debtor financial education*”, Marquette Law Review, Vol. 97, p. 391, (2013), at 397-8.

[1659] See **Martin Nathalie and Tama y Sweet Ocean**, "*Mind Games: Rethinking BAPCPA's Debtor Education Provisions*", 31 S. Ill. U. L.J. 517 (2007).

[1660] **Dickerson Mechele**, "*Can Shame, Guilt, or Stigma Be Taught? Why Credit-Focused Debtor Education May not Work*", Symposia Symposium on Bankruptcy Reform (1999), at 946.

[1661] **MacArthur Andrew P**., "*Pay to Play: the Poor's Problems in the BAPCPA*", 25 Emory Bankr. Dev. J. 407 (2009), at 419 and 425-433.

[1662] The average cost of pre-petition and post-petition courses offered online seems to range around $ 50.

[1663] Showing that only four out of the fifty-eight participants interviewed for the study found the courses helpful; the others found them to be of no help at all to them. **Sousa Michael D**., “*Just punch my bankruptcy ticket: a qualitative study of mandatory debtor financial education*”, Marquette Law Review, Vol. 97, p. 391, (2013), at 397-8.

[1664] **MacArthur Andrew P**., "*Pay to Play: the Poor's Problems in the BAPCPA*", 25 Emory Bankr. Dev. J. 407 (2009).

[1665] Counseling, in fact, is relevant at the time of contracting credit and not just upon becoming insolvent. See **MacArthur Andrew P**., “*Pay to play: the poor’s problems in the BAPCPA*”, 25 Emory Bankr. Dev. J. 407, (2008), at 426.

[1666] *Id.,* at 425-6.

[1667] **In re Elmendorf**, 345 B.R. 486 (Bankr (S.D.N.Y. 2006).

[1668] Recent studies show that just a little more than 3% of those whom obtained credit counseling opted for different options such as a debt repayment plan. **MacArthur Andrew P**., “*Pay to play: the poor’s problems in the BAPCPA*”, 25 Emory Bankr. Dev. J. 407, (2008), at 428.

[1669] Some guidance can be found in § 111(d) (1) (B).

[1670] See on the topic **Neustadter Gary**, "*2005 A consumer Bankruptcy Odyssey*", 39 Creighton L. Rev. 225 (2006); **Sousa Michael D**., “*Just punch my bankruptcy ticket: a qualitative study of mandatory debtor financial education*”, Marquette Law Review, Vol 97, p. 391, (2013), at 408-409.

12 Exemptions

12.1 Introduction

We already approached the interesting topic of exemptions and its relevance in Chapter II. The structure of this particular aspect of the American bankruptcy framework is of great interest. We will discuss U.S. rules to gain a better understanding of the use of this tool in practice and to make observations on the topic of uniformity.

As observed in Chapter I, achieving uniformity among insolvency models is one of the great barriers that delays the process of refounding European insolvency frameworks.

In this section, we will try to condense a very broad topic supported by over fifty statutes. We will therefore support our analysis with the use of specific tables which should help in comparing and contrasting the relevant aspects of the different regulations on this topic.

12.1.1 About the goals of exemptions in the modern American insolvency framework

Nowadays, federal and state exemptions may be available to individual debtors (exclusively; exemptions do not apply to corporations, partnerships, or other entities) in Chapters 7, 11, 12, and 13.

In the previous chapters and sections we observed how insolvency proceedings traditionally made good use of all of the assets of the debtor to repay the creditors, leaving nothing behind. Some systems went as far as selling the debtor himself into slavery so that he could take full responsibility for his actions and contribute to the repayment of all outstanding obligations.[1671]

With the passing of time, best practices evolved. Today they reject excessively aversive punishments, and instead incentivize allowing debtors to retain at least some basic assets which, depending on different local views, could be considered necessary for life. Doing so allows honest debtors to enjoy a true fresh start and to take advantage of a concrete second chance.

Early frameworks allowed very little value and few items to be spared from distribution. It is only in recent times that protections have been extended. The American insolvency framework contained in the Bankruptcy Code and in different state statutes went a step, or several steps, forward compared to others in the international scenario. As we are about to discuss, the American formula is complex and, under several aspects, unique in its debtor-friendly approach.

12.1.2 Balancing American exemptions

Implementing an effective and efficient system to support natural persons through exemptions forces lawmakers to balance several factors, such as:

- the treatment of honest and dishonest debtors – rules are usually set to exclude dishonest debtors from taking advantage of exemptions;
- protecting the interests of creditors - exemptions have a great impact on cases, since they allow debtors to retain[1672] a relevant amount of value, damaging unsecured creditors (in Chapter 7 cases in particular, it is not uncommon for exemptions to protect virtually all the remaining property in the estate);
- risks connected with forum shopping – as observed in the previous chapters, Debtors are tempted to move to states where exemptions grant them higher benefits. Lack of uniformity among statutes tempts debtors into relocating to achieve greater benefits and causes imbalances in the whole system.

In creating local formulas, legislatures have to provide tools tailored to the needs of local debtors. Each statute, therefore, differs greatly from the othersm depending a variety of factors such as:

- geographical location;
- economy;
- weather conditions;
- natural resources present in the territory.

[1671] See Chapter IV.

[1672] Other rules allow debtors to protect assets such as "redemption", which allow a debtor to pay to keep assets. See § 722.

North to South; East to West; from the beach to the mountains; in the great plains or on islands; different communities have different needs.

Exemptions in the U.S. have, therefore, historically been a state matter.[1673] Each state attempted to provide its citizens with the best possible formula. At the same time, though, to avoid forum shopping, local rules had to find their place within the national framework, a process that caused several difficulties.[1674] The Act of 1867 attempted to reduce forum shopping and to avoid conflicts by occupying the field. The newly imposed order, though, lasted only a few years.

The Code of 1898 allowed states to regulate the field and to determine the kind and measure of available relief based on local policies. Such approach renewed forum-shopping issues, with debtors attempting to file in the territory that would grant higher protection to their interests.

In 1978, the feeling was that the time to create a uniform list of federal exemptions had finally come. The process was successful, but the federal List was not imposed upon the states as an exclusive option. The field was not occupied as it was in 1867; a two-track system was created, often leaving petitioners with a choice among local and federal rules.

Such a bifurcated system of coexisting state and federal exemptions continues to exist under the modern Code, leading to the consequences we will discuss in the next pages.

12.2 The bifurcated system: the coexistence of federal and state statutes

Exempt property enjoys special protections in the proceeding; it is not available for the repayment of most pre-petition credits.[1675] Such special status is reserved to specific assets only, which are deemed necessary for the person of the debtor or for people depending from him. Retaining items allows the debtor to have a shot at a meaningful second chance.

As mentioned in the previous paragraphs, the American system today is designed as a *Janus Bifrons* which makes available to debtors sets of both federal and local state exemptions. A debtor cannot always elect among these two options, though. Sometimes he will be forced to avail himself of local rules. Several states[1676], in fact, have opted out of the federal system[1677], meaning that the federal exemptions offered in section 522 of the Code are not available to debtors filing in a particular area and that recourse to the state's list of exemptions are only allowed:

[1673] See the historical sections which form the introduction to this chapter.

[1674] An analogy could be drawn with Cleisthenean Athens where, in order to build an effective democracy representing all the people of the *polis* and their needs, a system of ten tribes covering all of the territory of the city state was enforced. Within each tribe three *tryttises* (one representing respectively the people of the coast, the people of the plains and the people of the city) would be constituted to give voice to all the components of a complex society. In this case, states from the plains, from the mountains, from the coasts all provide their own exemptions to support citizens in restarting.

[1675] § 522 (c): "Unless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose, or that is determined under section 502 of this title as if such debt had arisen, before the commencement of the case, except (1) a debt of a kind specified in paragraph (1) or (5) of section 523(a) (in which case, notwithstanding any provision of applicable nonbankruptcy law to the contrary, such property shall be liable for a debt of a kind specified in such paragraph); (2) a debt secured by a lien that is (A) (i) not avoided under subsection (f) or (g) of this section or under section 544, 545, 547, 548, 549, or 724(a) of this title; and (ii) not void under section 506(d) of this title; or (B) a tax lien, notice of which is properly filed; (3) a debt of a kind specified in section 523(a)(4) or 523(a)(6) of this title owed by an institution-affiliated party of an insured depository institution to a Federal depository institutions regulatory agency acting in its capacity as conservator, receiver, or liquidating agent for such institution; or (4) a debt in connection with fraud in the obtaining or providing of any scholarship, grant, loan, tuition, discount, award, or other financial assistance for purposes of financing an education at an institution of higher education (as that term is defined in section 101 of the Higher Education Act of 1965 (20 U.S.C. 1001))."

[1676] Alabama, Alaska, Arizona, California, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Mississippi, Missouri, Montana, Nebraska, Nevada, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Utah, Virginia, West Virginia, Wyoming.

[1677] See § 522 (b) (1); See **In re Sullivan**, 680 F.2d 1131 (7th Cir. 1982).

> "**§ 522 (b) (1)** Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (2) or, in the alternative, paragraph (3) of this subsection. In joint cases filed under section 302 of this title and individual cases filed under section 301 or 303 of this title by or against debtors who are husband and wife, and whose estates are ordered to be jointly administered under Rule 1015(b) of the Federal Rules of Bankruptcy Procedure, one debtor may not elect to exempt property listed in paragraph (2) and the other debtor elect to exempt property listed in paragraph (3) of this subsection. If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (2), where such election is permitted under the law of the jurisdiction where the case is filed. **(2)** Property listed in this paragraph is property that is specified under subsection (d), unless the State law that is applicable to the debtor under paragraph (3)(A) specifically does not so authorize."[1678]

In the remaining states, today a minority, debtors can freely elect among the two choices. The decision can be made strategically depending on the debtor's personal situation.[1679]

Any set of exemptions, though, is an exclusive option; it cannot be modified, mixed, or adjusted upon filing depending on how favorable single rules would be if they were to be extracted from their context. In states that have not opted out, therefore, the debtor is allowed to choose among the federal or the local set of exemptions, but she is not allowed to create her own personal list. Once either system is selected, the decision becomes final and it is not possible to make subsequent modifications.

In the next pages, we will discuss several issues caused by this model. We will analyze in particular:

- Forum shopping: an obvious and inevitable consequence of a system in which more than 50 different sets of exemption rules coexist and interact. The great differences among statutes tempt debtors (wealthy ones that have the capacity of moving and more assets to protect in particular) in planning ahead, taking the steps necessary to file under more benevolent jurisdictions that would maximize their benefits. Various attempts have been made in an attempt to contain debtors' migrations.
- Pre-bankruptcy conversions of assets: planning takes also the shape of "pre-bankruptcy conversion" of non-exempted items into exempted ones, which will be discussed in a later section.

We will analyze federal and state exemption sets, including federal rules that are not part of the Bankruptcy Code.

12.2.2 Exemptions in the American insolvency framework: federal bankruptcy exemptions; federal non-bankruptcy exemptions; state exemptions

Exemptions are the expression of a multitude of different policies; determining which items or categories of property may be necessary or just useful to protect to grant an effective fresh start is a demanding task. Federal and state statutes, despite their differences, share common goals and attempt to find the most effective balance.

Section 522 (d) of the Code provides the list of federal bankruptcy exemptions; while other Federal Titles and statutes provide more *non*-bankruptcy ones.

Local exemptions are included in states' statutes and constitutions.[1680]

[A] The Federal exemptions of Title 11 § 522

Federal bankruptcy exemptions can be claimed up to a certain dollar amount[1681], which means that a debtor will not usually be able to protect a multimillion homestead or a Ferrari, as it may happen under certain "friendlier" local statutes. They are listed in section 522 (d) of the Code, which protects the following eleven groups of assets:

[1678] *Id.*
[1679] § 522 (b) (1), (2).
[1680] See the "Tables" as examples of relevant rules.
[1681] The dollar amounts were last updated in 2016.

1) **Homestead exemption**
The debtor's aggregate interest, not to exceed $23,675 in value, in real property or personal property that the debtor or a dependent of the debtor **uses as a residence**, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor.
2) **Motor vehicle exemption**
The debtor's interest, not to exceed $3,775 in value, in one motor vehicle.
3) **Household goods, appliances, animals and crops and other items**
The debtor's interest, not to exceed $ 600 in value in any particular item or $12,650 in aggregate value, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor. The term household goods includes: (i) clothing; (ii) furniture; (iii) appliances; (iv) 1 radio; (v) 1 television; (vi) 1 VCR; (vii) linens; (viii) china; (ix) crockery; (x) kitchenware; (xi) educational materials and educational equipment primarily for the use of minor dependent children of the debtor; (xii) medical equipment and supplies; (xiii) furniture exclusively for the use of minor children, or elderly or disabled dependents of the debtor; (xiv) personal effects (including the toys and hobby equipment of minor dependent children and wedding rings) of the debtor and the dependents of the debtor; and (xv) 1 personal computer and related equipment. The term "household goods" does not include: (i) works of art (unless by or of the debtor, or any relative of the debtor); (ii) electronic entertainment equipment with a fair market value of more than $650 in the aggregate (except 1 television, 1 radio, and 1 VCR); (iii) items acquired as antiques with a fair market value of more than $500 in the aggregate; (iv) jewelry with a fair market value of more than $650 in the aggregate (except wedding rings); and (v) a computer (except as otherwise provided for in this section), motor vehicle (including a tractor or lawn tractor), boat, or a motorized recreational device, conveyance, vehicle, watercraft, or aircraft[1682].
4) **Jewelry**
The debtor's aggregate interest, not to exceed $1,600 in value, in jewelry held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.
5) **Wild card exemption**
The debtor's aggregate interest in any property, not to exceed in value $1,250 plus up to $11,850 of any unused amount of the exemption provided under paragraph (1) of this subsection.
6) **Tools of the trade**
The debtor's aggregate interest, not to exceed $2,375 in value, in any implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor.
7) **Life insurance and loan value or accrued interest in life insurance**
Any unmatured life insurance contract owned by the debtor, other than a credit life insurance contract. The debtor's aggregate interest, not to exceed in value $12,625 less any amount of property of the estate transferred in the manner specified in section 542(d) of this title, in any accrued dividend or interest under, or loan value of, any unmatured life insurance contract owned by the debtor under which the insured is the debtor or an individual of whom the debtor is a dependent.
8) **Health aids prescribed by a professional for the debtor or a dependant**
Professionally prescribed health aids for the debtor or a dependent of the debtor.
9) **Government benefits, alimony and pension plans**
The debtor's right to receive (A)a social security benefit, unemployment compensation, or a local public assistance benefit; (B)a veterans' benefit; (C)a disability, illness, or unemployment benefit; (D)alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor; (E)a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any

[1682] § 522 (f) (4A); (4B).

dependent of the debtor, unless— (i)such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the debtor's rights under such plan or contract arose; (ii)such payment is on account of age or length of service; and (iii)such plan or contract does not qualify under section 401(a), 403(a), 403(b), or 408 of the Internal Revenue Code of 1986.
10) Crime victim awards, wrongful death or pension injury awards The debtor's right to receive, or property that is traceable to (A)an award under a crime victim's reparation law; (B)a payment on account of the wrongful death of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor; (C)a payment under a life insurance contract that insured the life of an individual of whom the debtor was a dependent on the date of such individual's death, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor; (D)a payment, not to exceed $23,675, on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent; or (E)a payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.
11) Retirement funds Retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986.

A debtor will usually be able take advantage of Federal bankruptcy exemptions in three situations:

- by choice, upon filing in a state that did not opt out and that, therefore, that allows such option;
- by defaultm in those cases in which in which state exemptions are not available;
- as a default option in joint cases.

Spouses must elect the same exemption statute. If an agreement cannot be reached, the federal exemption list will be imposed upon them by default.

[B] Federal non-bankruptcy exemptions

Section 522 (d) exclusively lists federal bankruptcy exemptions. More may be available under other federal statutes.[1683] Not all exemptions are, in fact, included in the Bankruptcy Code. Such exemptions are the expression of several relevant policies that find protection under different titles of the United States Code.

A selection of relevant examples is presented here:

Section	TITLE and subsections	Beneficiary or category
5 USC § 8130	U.S. CODE TITLE 5 - Government Organization and Employees – Part III- Employees - Subpart G - Insurance and Annuities - Chapter 81 – Compensation for Work Injuries - SubChapter I – Generally - § 8130 - Assignment of claim	Death and disability benefits for government employees
5 USC § 8346	U.S. CODE TITLE 5 - Government Organization and Employees – Part III- Employees - Subpart G - Insurance and Annuities - Chapter 83 – Retirement - SubChapter III – Civil Service Retirement - § 8346 - Exemption from legal process; recovery of payments	Retirement benefits of Civil service employees
10 USC § 1035	U.S. Code: Title 10 – Armed Forces - Subtitle A - General Military Law - Part II – Personnel- Chapter 53 – Miscellaneous Rights and Benefits - §	Deposits and saving accounts of military

[1683] § 522 (b) (2) (A).

	1035 - Deposits of savings	personnel
10 USC § 1440	U.S. CODE TITLE 10 – Armed Forces - Subtitle A - General Military Law - Part II – Personnel - Chapter 73 – Annuities Based On Retired or Retainer pay - SubChapter I - Retired Serviceman's Family Protection Plan - § 1440 - Annuities not subject to legal process	Retirement benefits of military personnel
10 USC § 1450	U.S. CODE TITLE 10 – Armed Forces - Subtitle A - General Military Law - Part II – Personnel - Chapter 73 – Annuities Based On Retired or Retainer pay - SubChapter II - Annuities Based on Retired or Retainer Pay - § 1450 - Payment of Annuity: Beneficiaries	Survivor's benefits military personnel
15 USC 1673	U.S. Code Title 15 – Commerce and Trade - Chapter 41 – Consumer and Credit Protection - SubChapter II – Restrictions on Garnishment - § 1673 - Restriction on garnishment	Wages
22 USC § 4060	U.S. CODE TITLE 22 – Foreign Relations and Intercourse – Chapter 52 - Foreign Service – SubChapter VII - Foreign Service Retirement and Disability – Part I -Foreign Service Retirement and Disability System - § 4060 - Assignment and attachment of moneys	Retirement benefits of foreign service employees
25 USC § 410	U.S. CODE TITLE 25 – Indians - Chapter 12 – Lease, Sale, or Surrender of Allotted or Unallotted Lands - § 410 - Moneys from lease or sale of trust lands not liable for certain debts	Indian benefits
USC 25 § 543	U.S. CODE TITLE 25 – Indians - Code Chapter 14 – Miscellaneous - Code SubChapter X – Klamath Tribe: Disposition of Certain Tribal Funds - § 543 - Liability of judgment funds for debts	Klamath Indian Tribe benefits in Oregon
USC 25 § 545	U.S. CODE TITLE 25 – Indians - Code - Chapter 14 – Miscellaneous - SubChapter X - Klamath Tribe: Disposition of Certain Tribal Funds - § 545 - Liability of judgment funds for debts	Klamath Indian Tribe benefits in Oregon
28 USC § 376	U.S. CODE TITLE 28 – Judiciary and Judicial Procedure - Part I – Organization of Courts - Chapter 17 – Resignation and Retirement of Justices and Judges - § 376 - Annuities for survivors of certain judicial officials of the United States	Survivor's benefits of judicial officials
33 USC § 775	U.S. CODE TITLE 33 - Navigation and Navigable Waters - Chapter 16 – Lighthouses - § 775 - Payments nonassignable and exempt from process	Survivor's benefits of lighthouse workers
33 USC § 916	U.S. CODE TITLE 33 - Navigation and Navigable Waters - Chapter 18 – Longshore and Harbor Worker's Compensation - § 916 - Assignment and exemption from claims of creditors	Death and disability benefits for longshoremen and harbor workers
38 USC § 1562	U.S. CODE TITLE 38 - Veterans' Benefits – Part II - General Benefits – Pension for Non-Service –Connected Disability or Death Or for Service- Army Navy, Air Force, and Coast Guard Medal of Honor Roll- Special provisions relating to pension	Retirement benefits of military personnel in the Medal of Honor Roll
38 USC § 1970	U.S. CODE TITLE 38 - Veterans' Benefits – Part II - General Benefits - Chapter 19 – Insurance - SubChapter III – Service member's Group Life	Life insurance of military personnel

	Insurance - § 1970 - Beneficiaries; payment of insurance	
42 USC § 1717	U.S. CODE TITLE 42 – The Public Health and Welfare - Chapter 12 – Compensation for Injury, Death, or Detention of Employees of Contractors with United States Outside United States - SubChapter II – Miscellaneous Provisions - § 1717 - Assignment of benefits; execution, levy, etc., against benefits	Death and disability benefits
45 USC § 231	U.S. CODE TITLE 45 – Railroads – Chapter 9 - Retirement of Railroads Employees – SubChapter IV - Railroad Retirement Act of 1974 - § 231 - Assignability; exemption from levy	Retirement benefits of railroad workers
45 USC § 352	U.S. CODE TITLE 45 – Railroads - Chapter 11 – Railroad Unemployment Insurance - § 352 – Benefits	Unemployment benefits of railroad workers
46 USC § 11109	U.S. CODE TITLE 46 – Shipping - Subtitle II - Vessels and Seamen - Part G - Merchant Seamen Protection and Relief - Chapter 111 – Protection and Relief - § 11109 - Attachment of wages	Wages of seamen
46 USC § 11110	U.S. CODE TITLE 46 – Shipping - Subtitle II - Vessels and Seamen - Part G - Merchant Seamen Protection and Relief - Chapter 111 – Protection and Relief - § 11110 - Seamen's clothing	Seamen's' clothing
46 USC 11111	U.S. CODE TITLE 46 – Shipping - Subtitle II - Vessels and Seamen - Part G - Merchant Seamen Protection and Relief - Chapter 111 – Protection and Relief - § 11111 - Limit on amount recoverable on voyage	Debts of seamen incurred at sea

Non-bankruptcy Federal exemptions are available exclusively to those debtors that elect the state exemption system, even in the case of opt-out states.

[C] State exemptions

State statues are greatly diverse; they form a small cosmos of opportunities which makes forum shopping inevitable. The fifty states apply fifty different approaches (fifty-one if we count the fact that California offers two different local systems of exemptions among which a debtor may elect). It will not be possible for us, nor it would be useful, to draft an in-depth analysis of each single system; the task would be massive and would take us far from our goals.

We will, though, attempt to gain more information on the topic of uniformity though an overview of relevant state rules. In order to approach this broad topic effectively, tables have been provided. They are updated to June 2016 and include the different state statutes on relevant groups of exemptions such as:

- homestead;
- motor vehicle;
- wildcard;
- different items of personal property / tools of trade.[1684]

The approach that has been applied in drafting them differs. The first three tables focus on single topics which are of great significance to every individual's life and include relevant sections of local codes. The choice to reproduce the entire rules has been made to highlight with greater accuracy:

- differences in the construction of the rules – some statutes are lengthy and detailed, others provide much less guidance;
- differences in the allocation of the rules – the vast majority of exemptions are found in local statutes, but some are placed into the state's constitutions;

[1684] The property that would generally be used by an individual to make a living.

- differences in the definition of the assets exempted – the motor vehicle exemption, for example, protects cars, bicycles, bikes, etc.

It is only by having the text of a full section at hand, in fact, that it is possible to perceive the great number of apparently minor differences that can form the origin of forum shopping.

The last table is an attempt to merge data on a variety of different personal items, including tools of trade. In this case it would have been impossible (and not useful) to try to compare whole sets of rules. They have therefore been reduced to their essence, with a certain degree of necessary approximation, which is presented in quantities or dollar amounts. The goal of this process is to show:

- the variety personal items that may be protected under exemption statutes – which is deeply connected to the geography and location of the state;
- the fact that some items may not be protected as generic personal items but they may be protected as tools of trade;
- the different approaches taken among states – items may be protected by dollar value or quantity. They may be also protected individually or in groups (for example, when more categories of exemptions may be protected up to a certain dollar value in total).

A relevant procedural remark is necessary. Modifications to the rules may have occurred, or may be in the process of being enacted; moreover, some very specific rules may have been omitted to allow tables to serve the specific purposes of our analysis. The topic we have tried to summarize is, in fact, extremely vast and complex. It would take an entire manual to make a perfect description of the status quo, while we have to limit our observations and condense them in just a few pages.

However, this is, to a certain extent, irrelevant. The goal we are pursuing in our analysis is not to study in depth all of the American local exemption statutes or to create perfect reference manual. We are interested in the big picture, in understanding balance and causes and effects within the American society. We aim to understand the elements that constitute and craft different exemptions and their interaction within the broader insolvency and legal frameworks. We could have achieved this goal by creating 50 made-up statutes.

Our attempt to use the existing laws of the different American states is dictated by the desire to provide the lightest and most realistic tool possible. Our analysis is not, therefore, affected by those inevitable imperfections and simplifications that may have occurred in collecting information and in standardizing it.

12.2.2 Territorial differences in drafting exemptions

The information contained in the tables shows the different approaches followed by local governments and a very low degree of uniformity.

If we look at the "homestead exemption table" for example, some states such as Pennsylvania or New Jersey allow none at all[1685] [1686]; others allow one to exempt the entire value of the asset.[1687] In New York, differences apply by county (within, therefore, the very territory of the State!), while several statutes differentiate among the kind of items of property that enjoy protections.[1688] At times, instead of protecting a flat, an apartment, or a villa, the exemption will protect burial plots or mobile homes.[1689] Some states will increase protections for families or for elderly or disabled debtors.[1690]

Table 2 shows great variety also. States apply different definitions[1691] of "motor vehicles". Some, such as Oregon are very specific in listing the types of vehicles that may be exempted:

> "As used in this paragraph vehicle includes an automobile, truck, trailer, truck and trailer or other motor vehicle."

[1685] Pennsylvania, though, allows for a wildcard exemption (see Table 2) which may come to rescue debtors.
[1686] Some states allow married couples to double their exemption values.
[1687] See for example Oklahoma, Florida, Texas. Limitations apply at the federal level.
[1688] Washington and Alabama, for example, include mobile homes.
[1689] See Maine, for example, or South Carolina.
[1690] See for example California and Colorado.
[1691] Colorado includes bicycles; Massachusetts and New Hampshire are specific in defining "automobiles".

Several statutes do not include a specific exemption of this kind, but allow protections under the wildcard category or as tools of trade.[1692]

Table 3 lists wildcard exemptions. This particular category is often used by debtors to cover for the absence of other specific rules, such as motor vehicles or homestead exemptions. Values can vary greatly from a few hundred dollars to several thousand. Oregon places a specific limit on the use of this exemption:

> "The debtors interest, not to exceed $400 in value, in any personal property. However, this exemption may not be used to increase the amount of any other exemption."

Other states, such as Rhode Island, allow ample freedom:

> "In addition to the exemptions herein, a debtor in bankruptcy may exempt an additional six thousand five hundred dollars ($6,500) in any assets."

Protected personal property and tools of trade differ greatly among states. Such discrepancies often resemble the discordant needs of local communities which are bound to the geography of the state. Nevada, for example, is the only state to exempt mining equipment specifically; while others give protections to farm animals[1693] or fishing equipment.[1694] Some items may also fall under more exemptions or be grouped differently depending on the states. Kentucky, for example, joins:

- clothing;
- household goods and furnishing;
- jewelry; and
- watches for a total value of $3.000.

Some states use the same system but set more limitations. Idaho, for example, allows a total expense of $7.500 among a number of categories, but no single item can exceed the value of $750. Allowing the protection of a $7.500 violin would harm the creditors in a way that cannot be justified under local policies.

Another elementary example can be made with books, which could be personal property or tools of trade. Some specific books may be exempted as well under more categories. A state may exempt the Bible, for example, as a religious item or under a general book exemption or as a professional tool.[1695] [1696] The same situation may present itself upon exempting some animals that may be "pets" (personal property), or "farm animals" (tools of trade). Some items may be particularly valuable; a wedding ring, which is often protected under a specific wedding ring exemption, may also be included in a general group that shields jewels and watches[1697].

The value that may be exempted in certain items of property varies greatly. We have already mentioned how some states do not grant a specific homestead exemption; others, such as Texas for example, are very debtor-friendly and attempt to protect the whole value of the property. Providing limits in dollar amounts often causes assets to be "partially exempted". A statute may, for example, allow a maximum protection of $25.000 in a house worth $100.000. In this case, the remaining $75.000 would be available to repay the creditors. If an item is partially exempted in a liquidation and, therefore, some value is left in it for the creditors, the trustee may decide to sell it so that the debtor may retain the dollar amount granted by law while the rest would be available for distribution. At the same time, in a reorganization the item may be part of a plan; it may be useful to accomplish the goals of such plan and therefore it would not be sold; the debtor would be asked to pay, instead, for the difference. That part of value that by law ought to be distributed among the creditors will still be made available.

[1692] See for example Alabama and Indiana.
[1693] See for example: Arizona, Colorado, Connecticut, Georgia, and Kentucky.
[1694] See for example: Alaska, Maine, and Massachusetts.
[1695] Or both, such as Arizona.
[1696] In Pennsylvania, for example, it would be protected by the "tools of trade" exemption, while in Louisiana or Delaware it would be personal property.
[1697] Colorado; Iowa; Missouri.

In other instances, it is not the value of the item to be relevant but the quantity. Some statutes, in fact, attempt to ensure that a certain amount of vital goods is left to the debtor. Hence food, water, or gas, are sometimes exempted based estimated quantities necessary for a predetermined lapse of time. The estimation of quantity, of course, varies greatly among settings.

Some states such as Arizona or Idaho will allow the debtor to exempt food or water for a number of months (six in the first case; twelve in the second). The quantity, and consequentially the value of exempted property, will vary greatly therefore depending on what is the reasonable consumption of such goods in a particular community. Other statutes such as Colorado's or New Hampshire's give a dollar figure (up to $600 in the first case; up to $400 in the latter). Others, such as Connecticut, exempt these goods as long as "necessary"[1698]; while Texas exempts "provisions for consumption".[1699]

In general, statutes allow a certain degree of freedom to debtors in selecting, categorizing, and valuing assets.[1700] By being involved in the process, they attempt to make the best choices based on their case and, at times, they may engage in questionable behaviors that can be sanctioned. Debtors bringing assets off-shore in an attempt to save them from distribution, for example, engage in a prohibited behavior.[1701] If a transaction is regularly disclosed, though, and does not show disparity in the values sold and acquired but just a change in the type of assets (to the advantage of the debtor), that transaction may be upheld despite the consequences of distribution[1702] (this topic will be discussed further in the section on "conversions of property").

Exemptions, therefore, can lead to troublesome consequences. The most relevant aspects to monitor upon drafting a system are:

- forum shopping;
- the valuation of exempt property; and
- "exemption planning".

We will now discuss some of the most relevant aspects of these three factors.

[A] Forum shopping

The most relevant concern regarding the lack of uniformity among local and federal exemption frameworks is forum shopping.

Modern American debtors are drawn positively towards filing compared to other systems in which the burdensome consequences of bankruptcy act as powerful deterrents. Upon commencing a case many consider carefully which setting would grant a more ample relief (or more benefits). The exemption system is a very relevant variable in such strategic reasoning [1703]and it greatly impacts the outcome of a case. Debtors will, therefore, be tempted to move and file in the most "friendly" forum available.

Requirements imposed in the Code attempt to limit such behavior.

The Bankruptcy Code establishes that the set of state exemptions available (for election or imposed in the case of opt-out states) to the debtor will be the one in effect in the state where the debtor has been domiciled[1704] for the 730 days immediately before filing, or, if the debtor's domicile has not been located in the same state during such period, the place in which the domicile was located for the 180 days

[1698] 52-352 b (a).

[1699] Tex. Property Code Sec. 42.002 Personal Property (2).

[1700] See the example of the Bible. If an item is already expressly exempted under a specific section more similar property is allowed to be exempted, in this case books under another favorable section.

[1701] There is no need to prove that the transaction actually harmed the creditors as long as the overall circumstances show an intent to at the least hinder or delay creditors.

[1702] **In re Agnew** (BC D KS 2006) 355 BR 276, 285-286.

[1703] Although it does not appear to impact the number of filings in general. See **Sullivan Teresa A., Warren Elizabeth, Westbrook Jay L**., "*As we forgive our debtors – Bankruptcy and consumer credit in America*", BeardBooks publisher, Washington D.C., (1999), at 241-242.

[1704] Domicile: "The place at which a person has been physically present and that the person regards as a home; a person's true, fixed, principal and permanent home, to which that person intends to return and remain even though currently elsewhere". See **Garner Brian A**., "*Black's Law Dictionary*", ISBN 978-0314151995, (2004), 8th edition.

immediately preceding the day of filing or the longer portion of such 180 day period.[1705] If a debtor is ineligible for a state's exemption he may, by default, avail himself of the Federal ones.[1706]

Forum shopping holds a less significant impact in involuntary cases mostly due to the small number of such filings and to the fact that the creditors will usually not have many options with regard to venue. Moreover, the estate is not made immediately available and the debtor remains in possession during the gap period before the entering of an ordering for relief.[1707]

[B] Strategic thinking: the process of valuation of exempt property

Issues arise in another area often connected to forum shopping: the process of valuating property. Such problem is, obviously, connected with the way exemption rules are crafted. Depending on how states protect specific items, debtors will shape their strategies; they may move to other territories that may award higher protections or attempt to maximize the value it can protect under the rules of its state, as we will discuss in this section and the next one.

As we have mentioned in the previous pages, assets may be grouped into more generic categories and protected based on their, or up to a certain, value, or protected based on their quantity.

Upon filing, debtors sign a list of assets of their property and indicate their values. Courts usually accept it unless there is persuasive evidence of the contrary. This may leave room for mistakes and interpretation. In genera,l debtors should list fair market value at the time of petition[1708] (many courts also use “liquidation value” as a parameter).

Upon valuing or subdividing assets among categories, though, there may be relevant surprises.

Can golden kitchenware, for example, be considered of little, irrelevant value?

Would a couple of puppies of a rare species be simple “pets”?

A debtor would be allowed to keep her old personal correspondence, but what about a letter franked with an “inverted Jenny” stamp, worth a true fortune to collectors?

The evolution of the policies that allow exemptions make it clear that the system is not structured to allow debtors to obtain unfair benefits. Frauds, in general, are punished within the bankruptcy Code. It may be difficult at times, though, to distinguish between honest and dishonest behaviors.

As a general rule it is worth mentioning that the estate has a right to the surplus value that may be found in all those cases in which an item of exempt property has a declared, fair market value (hence it is regularly disclosed and valuated) that exceeds the available exemptions. See a car, for example, that is valued at $50.000 and exempted under a state statute for $10,000. Even by applying other exemptions (e.g. the wildcard one) the debtor would be unable to exempt the full fair market value and the estate would be entitled to retain the difference and dispose of it in the interest of the creditors. Filing an objection will not be necessary unless the very same car is declared to be $5.000 in value so as to fit in the available motor vehicle exemption applied in the state.[1709]

New requirements imposed on debtors’ attorneys attempt to make petitioners more responsible and estimates fairer. Section 707 (b) (4) (C) requires that the attorney assisting the debtor makes “reasonable investigation” and verifies documents are “well grounded in fact”. Hence, attorneys are given a new role of higher responsibility in verifying the client’s papers before taking him in front of bankruptcy court. Defining how much value is protected by an exemption, though, may be reason for discussion and outcomes will vary depending on the applying rules.

[C] Strategic thinking: “exemption planning”

One specific behavior which is common among debtors raises issues of interpretation: the “conversion” of property before the commencement of the case.

[1705] § 522 (a) (3) (A).
[1706] § 522 (b) (3).
[1707] § 303 (f).
[1708] § 522 (a) (2).
[1709] **Schwab v. Reilly (**2010) 560 US 770, 791-793, 130 S.Ct. 2652, 2667-2668.

Instead of moving to a state that enacts a statute that protects more items (or more value) owned by the debtor, debtors may, in fact, decide to transform assets that are not shielded into others which will be exempted. But is it a fair strategy?

If a statute allows a full homestead exemption, is it honest for a debtor to take 10 days more in filing just to sell a valuable coin or stamp collection and repay part, or all, of his mortgage with the proceeds?

Although it may be surprising to experts that come from heavily stigmatizing systems, this particular behavior is often considered congruent with the policies protected by the Code. In the United States, the pre-petition conversion of assets is generally speaking allowed and not considered fraudulent per se by most courts.[1710] The following approaches are used to justify conversions:

- Exemption statutes are empowered to pursue a very specific policy – protecting debtors and ensuring that they hold enough property to reach a fresh start, preventing them from becoming a burden on society.[1711] The law sets no barriers on the conversion of assets, hence such behavior should be deemed fair.
- Rules are not crafted to give some unfair, unknown advantage to debtors. Creditors are well aware of the statutes and of exemption policies within the area of their contracting; hence they cannot assume that debtors will behave to their disadvantage. If a creditor finds a need for more protection, she should think of it beforehand, considering also the last case scenario bankruptcy represents with all of its consequences.[1712]

Nevertheless, as stated by several cases, "when a pig becomes a hog, it is slaughtered".[1713] Exceptions apply; not all of such transactions are protected and transfers made with actual[1714] intent to "hinder, delay, defraud" creditors[1715] will not be protected and may cause even heavy consequences such as denial of discharge.[1716]

12.3 Final remarks

12.3.1 Federal limits on state exemptions

A few federal limits are imposed upon the most generous state exemptions.

Section 522 (n)[1717] limits exemptions in retirement accounts to a maximum of $1 million, unless the interest of justice requires raising such limit.

In 2005, BAPCPA added limits to homestead exemptions and in particular to pre-bankruptcy transfers of real estate property (including other kinds of property usually connected to this exemption, such as burial plots). Section 522 (o)[1718], in fact, trumps the exemption in those cases in which the debtor acts with

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[1710] **In re Beverly** (9th Cir. 2008) 551 F3d 1092.

[1711] **In re Rice** (BC ED CA 1989) 109 BR 405, 408.

[1712] **In re Roosevelt** (9th Cir. BAP 1994) 176 BR 200, 208.

[1713] See for example **In the Matter of Denis Edward Bowyer, Debtor.ncnb Texas National Bank**, **Formerly First Republicbankaustin, Appellant, v. Denis Edward Bowyer, Appellee**, 916 F.2d 1056 (5th Cir. 1990).

[1714] **In re Lacounte**, supra, 342 BR at 814-815.

[1715] § 727 (a) (2).

[1716] § 522 (o).

[1717] § 522 (n): "For assets in individual retirement accounts described in section 408 or 408A of the Internal Revenue Code of 1986, other than a simplified employee pension under section 408(k) of such Code or a simple retirement account under section 408(p) of such Code, the aggregate value of such assets exempted under this section, without regard to amounts attributable to rollover contributions under section 402(c), 402(e)(6), 403(a)(4), 403(a)(5), and 403(b)(8) of the Internal Revenue Code of 1986, and earnings thereon, shall not exceed $1,000,000 in a case filed by a debtor who is an individual, except that such amount may be increased if the interests of justice so require."

[1718] § 522 (o): "For purposes of subsection (b)(3)(A), and notwithstanding subsection (a), the value of an interest in (1)real or personal property that the debtor or a dependent of the debtor uses as a residence; (2)a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence; (3)a burial plot for the debtor or a dependent of the debtor; or (4)real or personal property that the debtor or a dependent of the debtor claims as a homestead; shall be reduced to the extent that such value is attributable to any portion of any property that the debtor disposed of in the 10-year period ending on the date of the filing of the petition with the intent to hinder, delay, or defraud a creditor and that the debtor could not exempt, or that portion that the debtor could not exempt, under subsection (b), if on such date the debtor had held the property so disposed of."

the intent to hinder, delay, or defraud creditors by converting personal property in real estate acquired any time within ten years before the filing. Moreover, § 522 (p)[1719] sets another time limit: 1215 days before the filing of the case; during this time the debtor is not allowed to acquire real estate or a burial plot for a value of more than $146.450.

A practical exception to § 522 (p) protects those debtors that have moved during this time period and therefore had to purchase a residence or a burial plot in the new location.

12.3.2 Effect of a debtor's misconduct on exemptions

Section 522 (q) imposes limitations on the amount of exemptions for debtors that engaged some kind of misconduct. Debtors are limited to an aggregate of $155.675 in exempt real estate if they have been convicted of a felony which demonstrates that their bankruptcy petition was filed as an abuse of the code[1720] or if the debtor owes debt arising from state or federal securities fraud, RICO violation, or "any criminal act, intentional tort, or willful and reckless misconduct that caused serious physical injury or death to another individual in the preceding 5 years".[1721]

12.3.3 Debts that are not shielded

As mentioned in Chapter II, exempted property is not protected against all debts.

Relevant exceptions apply to protect certain specific claims on which society does not allow "bargains"[1722]. Section 522 (c) explicitly mentions, among others:

- debts secured by valid liens;
- nondischargeable taxes[1723];
- nondischargeable alimony, maintenance or support obligations.[1724]

[1719] § 522 (p) (1)"Except as provided in paragraph (2) of this subsection and sections 544 and 548, as a result of electing under subsection (b)(3)(A) to exempt property under State or local law, a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $125,000 in value in— (A)real or personal property that the debtor or a dependent of the debtor uses as a residence; (B)a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence; (C)a burial plot for the debtor or a dependent of the debtor; or (D)real or personal property that the debtor or dependent of the debtor claims as a homestead. (2)(A)The limitation under paragraph (1) shall not apply to an exemption claimed under subsection (b)(3)(A) by a family farmer for the principal residence of such farmer. (B)For purposes of paragraph (1), any amount of such interest does not include any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215-day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State."

[1720] § 522 (q) (1) (A).

[1721] § 522 (q) (B) (iv).

[1722] § 522 (c): "(c)Unless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose, or that is determined under section 502 of this title as if such debt had arisen, before the commencement of the case, except:

(1) a debt of a kind specified in paragraph (1) or (5) of section 523(a) (in which case, notwithstanding any provision of applicable nonbankruptcy law to the contrary, such property shall be liable for a debt of a kind specified in such paragraph);

(2)a debt secured by a lien that is (A) (i) not avoided under subsection (f) or (g) of this section or under section 544, 545, 547, 548, 549, or 724(a) of this title; and (ii) not void under section 506(d) of this title; or (B) a tax lien, notice of which is properly filed;

(3) a debt of a kind specified in section 523(a)(4) or 523(a)(6) of this title owed by an institution-affiliated party of an insured depository institution to a Federal depository institutions regulatory agency acting in its capacity as conservator, receiver, or liquidating agent for such institution; or

(4) a debt in connection with fraud in the obtaining or providing of any scholarship, grant, loan, tuition, discount, award, or other financial assistance for purposes of financing an education at an institution of higher education (as that term is defined in section 101 of the Higher Education Act of 1965 (20 U.S.C. 1001)."

[1724] **In re Davis**, 105 F. 3d 1017 (5th Cir.1997).

12.4 Exemption Tables[1725]

12.4.1 State homestead exemptions

TABLE 1	HOMESTEAD EXEMPTIONS IN STATE STATUTES
STATE and Provision	**DESCRIPTION**
ALABAMA Ala.Code 1975 § 6-10-2	The homestead of every resident of this state, with the improvements and appurtenances, not exceeding in value fifteen thousand dollars ($15,000) and in area 160 acres, shall be, to the extent of any interest he or she may have therein, whether a fee or less estate or whether held in common or in severalty, exempt from levy and sale under execution or other process for the collection of debts during his or her life and occupancy and, if he or she leaves surviving him or her a spouse and a minor child, or children, or either, during the life of the surviving spouse and minority of the child, or children, but the area of the homestead shall not be enlarged by reason of any encumbrance thereon or of the character of the estate or interest owned therein by him or her. When a husband and wife jointly own a homestead each is entitled to claim separately the exemption provided herein, to the same extent and value as an unmarried individual. For purposes of this section and Sections 6-10-38 and 6-10-40, a mobile home or similar dwelling if the principal place of residence of the individual claiming the exemption shall be deemed to be a homestead.
ALASKA AS § 09.38.010.	(a) An individual is entitled to an exemption as a homestead of the individual's interest in property in this state used as the principal residence of the individual or the dependents of the individual, but the value of the homestead exemption may not exceed $54,000. (b) If property owned by the entirety or in common is used by one or more individual owners or their dependents as their principal residence, each owner is entitled to a homestead exemption of that owner's interest in the property as provided in (a) of this section. The aggregate value of multiple homestead exemptions allowable with respect to a single living unit may not exceed $54,000. If there are multiple owners of property exempt as a homestead, the value of the exemption of each individual owner may not exceed the individual owner's pro rata portion of $54,000. (c) If property that includes a homestead is sold under an execution, the sale becomes effective upon confirmation by order of the court. The court shall enter the order of confirmation unless, within 60 days after the sale, the individual repurchases the property under this section or the court extends the time for confirmation upon the filing of a timely motion by a party in interest. The individual may repurchase property, including that individual's homestead, at a sale on execution before confirmation by paying into court the costs of the sale plus the lesser of either (1) the difference between the highest bid and the amount of the exemption in the property, or (2) the amount of the creditor's claim. If the individual does not exercise the repurchase right under this subsection, the clerk of the court shall first remit an amount determined to be exempt to the individual from the proceeds of sale and the balance less the cost of the sale to the creditor. For the purpose of collecting an amount remaining unpaid on a judgment after repurchase of property by an individual under this subsection, the creditor or the creditor's assignee may not make another levy on the property repurchased. (d) Upon entry of the order of confirmation under (c) of this section and expiration of the time period for repurchase, the clerk may execute a deed to the property and when delivered it shall be sufficient to convey all title of the individual in the premises sold to the purchaser at the sale.
ARIZONA A.R.S. § 33-1101	Any person the age of eighteen or over, married or single, who resides within the state may hold as a homestead exempt from attachment, execution and forced sale, not exceeding one **hundred fifty thousand dollars in value**, any one of the following: 1. The person's interest in real property in one compact body upon which exists a dwelling house in which the person resides. 2. The person's interest in one condominium or cooperative in which the person resides.

[1725] the States that have opted out are in **BOLD AND CAPITAL** letters.

	3. A mobile home in which the person resides. 4. A mobile home in which the person resides plus the land upon which that mobile home is located.
Arkansas A.C.A. § 16-66-210	(a) This section shall be known and may be cited as the "Homestead Exemption Act of 1981". (b) The homestead of any resident of this state who is married or the head of a family shall not be subject to the lien of any judgment, or decree of any court, or to sale under execution or other process thereon, except such as may be rendered for the purchase money or for specific liens, laborers' or mechanics' liens for improving the homestead, or for taxes, or against executors, administrators, guardians, receivers, attorneys for moneys collected by them, and other trustees of an express trust for moneys due from them, in their fiduciary capacity. (c)(1) The homestead outside any city, town, or village, owned and occupied as a residence, shall consist of no more than one hundred sixty (160) acres of land, with the improvements thereon, to be selected by the owner. The homestead shall not exceed in value the sum of two thousand five hundred dollars ($2,500), but, in no event shall the homestead be reduced to less than eighty (80) acres, without regard to value. (2) The homestead in any city, town, or village, owned and occupied as a residence, shall consist of not more than one (1) acre of land, with the improvements thereon, to be selected by the owner. The homestead shall not exceed the sum of two thousand five hundred dollars ($2,500) in value, but in no event shall the homestead be reduced to less than one-quarter (¼) of an acre of land, without regard to value. (3) Any homestead outside any city, town, or village, owned and occupied as a residence, which is annexed to or made part of an incorporated city or town within the State of Arkansas, shall retain its exemption under subdivision (c)(1) of this section as long as the land on which it is located remains rural in nature and has a significant agricultural use. (d) The homestead provided for in this section shall inure to the benefit of the minor children, under the exemptions provided in this section, after the demise of the parents.
Arkansas	(3) Rural homesteads not exceeding one hundred sixty (160) acres of land with improvements thereon, up to two thousand five hundred dollars ($2,500) in value but in no event less than eighty (80) acres without regard to value--Arkansas Constitution, Article 9, § 4; (4) The urban homestead not exceeding one (1) acre of land with improvements thereon, but not to exceed two thousand five hundred dollars ($2,500) in value, but in no event to be less than one-quarter (¼) of an acre of land without regard to value--Arkansas Constitution, Article 9, § 5;
Arkansas	(1) The unmarried debtor's aggregate interest, not exceeding eight hundred dollars ($800) in value, and the married debtor's aggregate interest, not exceeding one thousand two hundred fifty dollars ($1,250) in value, in real or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor;
CALIFORNIA 1 Cal.C.C.P. § 704.730	(a) The amount of the homestead exemption is one of the following: (1) Seventy-five thousand dollars ($75,000) unless the judgment debtor or spouse of the judgment debtor who resides in the homestead is a person described in paragraph (2) or (3). (2) One hundred thousand dollars ($100,000) if the judgment debtor or spouse of the judgment debtor who resides in the homestead is at the time of the attempted sale of the homestead a member of a family unit, and there is at least one member of the family unit who owns no interest in the homestead or whose only interest in the homestead is a community property interest with the judgment debtor. (3) One hundred seventy-five thousand dollars ($175,000) if the judgment debtor or spouse of the judgment debtor who resides in the homestead is at the time of the attempted sale of the homestead any one of the following: (A) A person 65 years of age or older. (B) A person physically or mentally disabled who as a result of that disability is unable to engage in substantial gainful employment. There is a rebuttable presumption affecting the

	burden of proof that a person receiving disability insurance benefit payments under Title II or supplemental security income payments under Title XVI of the federal Social Security Act satisfies the requirements of this paragraph as to his or her inability to engage in substantial gainful employment. (C) A person 55 years of age or older with a gross annual income of not more than twenty-five thousand dollars ($25,000) or, if the judgment debtor is married, a gross annual income, including the gross annual income of the judgment debtor's spouse, of not more than thirty-five thousand dollars ($35,000) and the sale is an involuntary sale. (b) Notwithstanding any other provision of this section, the combined homestead exemptions of spouses on the same judgment shall not exceed the amount specified in paragraph (2) or (3), whichever is applicable, of subdivision (a), regardless of whether the spouses are jointly obligated on the judgment and regardless of whether the homestead consists of community or separate property or both. Notwithstanding any other provision of this Article, if both spouses are entitled to a homestead exemption, the exemption of proceeds of the homestead shall be apportioned between the spouses on the basis of their proportionate interests in the homestead.
Cal.C.C.P. § 704.710	As used in this Article: (a) “Dwelling” means a place where a person resides and may include but is not limited to the following: (1) A house together with the outbuildings and the land upon which they are situated. (2) A mobilehome together with the outbuildings and the land upon which they are situated. (3) A boat or other waterborne vessel. (4) A condominium, as defined in Section 783 of the Civil Code. (5) A planned development, as defined in Section 11003 of the Business and Professions Code. (6) A stock cooperative, as defined in Section 11003.2 of the Business and Professions Code. (7) A community apartment project, as defined in Section 11004 of the Business and Professions Code. (b) “Family unit” means any of the following: (1) The judgment debtor and the judgment debtor's spouse if the spouses reside together in the homestead. (2) The judgment debtor and at least one of the following persons who the judgment debtor cares for or maintains in the homestead: (A) The minor child or minor grandchild of the judgment debtor or the judgment debtor's spouse or the minor child or grandchild of a deceased spouse or former spouse. (B) The minor brother or sister of the judgment debtor or judgment debtor's spouse or the minor child of a deceased brother or sister of either spouse. (C) The father, mother, grandfather, or grandmother of the judgment debtor or the judgment debtor's spouse or the father, mother, grandfather, or grandmother of a deceased spouse. (D) An unmarried relative described in this paragraph who has attained the age of majority and is unable to take care of or support himself or herself. (3) The judgment debtor's spouse and at least one of the persons listed in paragraph (2) who the judgment debtor's spouse cares for or maintains in the homestead. (c) “Homestead” means the principal dwelling (1) in which the judgment debtor or the judgment debtor's spouse resided on the date the judgment creditor's lien attached to the dwelling, and (2) in which the judgment debtor or the judgment debtor's spouse resided continuously thereafter until the date of the court determination that the dwelling is a homestead. Where exempt proceeds from the sale or damage or destruction of a homestead are used toward the acquisition of a dwelling within the six-month period provided by Section 704.720, “homestead” also means the dwelling so acquired if it is the principal dwelling in which the judgment debtor or the judgment debtor's spouse resided continuously from the date of acquisition until the date of the court determination that the dwelling is a homestead, whether or not an abstract or certified copy of a judgment was recorded to create a judgment lien before the dwelling was acquired.

	(d) "Spouse" does not include a married person following entry of a judgment decreeing legal separation of the parties, unless such married persons reside together in the same dwelling.
Cal.C.C.P. § 704.710	(a) A homestead is exempt from sale under this division to the extent provided in Section 704.800. (b) If a homestead is sold under this division or is damaged or destroyed or is acquired for public use, the proceeds of sale or of insurance or other indemnification for damage or destruction of the homestead or the proceeds received as compensation for a homestead acquired for public use are exempt in the amount of the homestead exemption provided in Section 704.730. The proceeds are exempt for a period of six months after the time the proceeds are actually received by the judgment debtor, except that, if a homestead exemption is applied to other property of the judgment debtor or the judgment debtor's spouse during that period, the proceeds thereafter are not exempt. (c) If the judgment debtor and spouse of the judgment debtor reside in separate homesteads, only the homestead of one of the spouses is exempt and only the proceeds of the exempt homestead are exempt.
CALIFORNIA 2 Ann.Cal.C.C.P. § 703.140 (B) (1)	(b) The following exemptions may be elected as provided in subdivision (a): (1) The debtor's aggregate interest, not to exceed twenty-six thousand eight hundred dollars ($26,800) in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence.
COLORADO C.R.S.A. § 38-41-201	(1) Every homestead in the state of Colorado shall be exempt from execution and attachment arising from any debt, contract, or civil obligation not exceeding in actual cash value in excess of any liens or encumbrances on the homesteaded property in existence at the time of any levy of execution thereon: (a) The sum of seventy-five thousand dollars if the homestead is occupied as a home by an owner thereof or an owner's family; or (b) The sum of one hundred five thousand dollars if the homestead is occupied as a home by an elderly or disabled owner, an elderly or disabled spouse of an owner, or an elderly or disabled dependent of an owner. (2) As used in this section, unless the context otherwise requires: (a) "Disabled owner", "disabled spouse", or "disabled dependent" means an owner, spouse, or dependent who has a physical or mental impairment that is disabling and that, because of other factors such as age, training, experience, or social setting, substantially precludes the owner, spouse, or dependent from engaging in a useful occupation, as a homemaker, a wage earner, or a self-employed person in any employment that exists in the community and for which he or she has competence. (b) "Elderly owner", "elderly spouse", or "elderly dependent" means an owner, spouse, or dependent who is sixty years of age or older.
C.R.S.A. § 38-41-201.5	The general assembly hereby finds and declares that, as the cost of conventional housing continues to escalate, mobile homes will become an ever larger percentage of the total housing supply, particularly for the elderly and the low-to-moderate income groups; that the purchase of a mobile home is a major investment; that most mobile homes are permanently or semipermanently located; that great improvements have been made in the quality and variety of such homes; and that mobile homes are dwellings which should be accorded a status equivalent to conventional homes. The general assembly recognizes, however, that mobile homes are more readily moved than conventional homes; that they are presently bought and sold as personal property and that there are advantages to both the industry and consumers to continue this practice; and that they presently have a dual nature in the area of taxation and tax collection; therefore mobile homes should be entitled to a homestead exemption.
Connecticut Conn. Gen Stat. Ann. §52-352a(e)	For the purposes of this section and sections 52-352b and 52-353, the following terms shall have the following meanings:(a) "Value" means fair market value of the exemptioner's equity or unencumbered interest in the property; (b) "Necessary" means reasonably required to meet the needs of the exemptioner and his or her dependents including any special needs by reason of health or physical infirmity; (c) "Exempt" means, unless

	otherwise specified, not subject to any form of process or court order for the purpose of debt collection; (d) "Exemptioner" means the natural person entitled to an exemption under this section or section 52-352b; (e) "Homestead" means owner-occupied real property, co-op or mobile manufactured home, as defined in subdivision (1) of section 21-64, used as a primary residence. §52-352b(t)
§52-352b(t)	The homestead of the exemptioner to the value of seventy-five thousand dollars, or, in the case of a money judgment arising out of services provided at a hospital, to the value of one hundred twenty-five thousand dollars, provided value shall be determined as the fair market value of the real property less the amount of any statutory or consensual lien which encumbers it;
DELAWARE Del. Code Ann. tit. 10, § 4914 (c)	(c) In any federal bankruptcy or state insolvency proceeding, an individual debtor and/or such individual's spouse domiciled in Delaware shall be authorized to exempt from the bankruptcy or insolvency estate, in addition to the exemptions made in subsection (b) of this section and in § 4915 of this title, the following: (1) Equity in real property or equity in a manufactured home (as defined in Chapter 70 of Title 25) which constitutes a debtor's principal residence in an aggregate amount not to exceed $75,000 in 2010, $100,000 in 2011, and $125,000 in 2012, except that the exemption for persons totally disabled from working or married persons where at least 1 of the spouses is 65 years old or older shall be $125,000 effective immediately;
District of Columbia D.C. Code Ann. § 15-501 (a)(14)	the debtor's aggregate interest in real property used as the residence of the debtor, or property that the debtor or a dependent of the debtor in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or dependent of the debtor, except nothing relative to these exemptions shall impair the following debt instruments on real property: deed of trust, mortgage, mechanic's lien, or tax lien.
FLORIDA F.S.A. § 222.01	(1) Whenever any natural person residing in this state desires to avail himself or herself of the benefit of the provisions of the constitution and laws exempting property as a homestead from forced sale under any process of law, he or she may make a statement, in writing, containing a description of the real property, mobile home, or modular home claimed to be exempt and declaring that the real property, mobile home, or modular home is the homestead of the party in whose behalf such claim is being made. Such statement shall be signed by the person making it and shall be recorded in the circuit court. (2) When a certified copy of a judgment has been filed in the public records of a county pursuant to chapter 55, a person who is entitled to the benefit of the provisions of the State Constitution exempting real property as homestead and who has a contract to sell or a commitment from a lender for a mortgage on the homestead may file a notice of homestead in the public records of the county in which the homestead property is located in substantially the following form:
F.S.A. § 222.03	If the creditor in any execution or process sought to be levied is dissatisfied with the quantity of land selected and set apart, and shall himself or herself, or by his or her agent or attorney, notify the officer levying, the officer shall at the creditor's request cause the same to be surveyed, and when the homestead is not within the corporate limits of any town or city, the person claiming said exemption shall have the right to set apart that portion of land belonging to him or her which includes the residence, or not, at the person's option, and if the first tract or parcel does not contain 160 acres, the said officer shall set apart the remainder from any other tract or tracts claimed by the debtor, but in every case taking all the land lying contiguous until the whole quantity of 160 acres is made up. The person claiming the exemption shall not be forced to take as his or her homestead any tract or portion of a tract, if any defect exists in the title, except at the person's option. The expense of such survey shall be chargeable on the execution as costs; but if it shall appear that the person claiming such exemption does not own more than 160 acres in the state, the expenses of said survey shall be paid by the person directing the same to be made.
F.S.A. § 222.05	Any person owning and occupying any dwelling house, including a mobile home used as a residence, or modular home, on land not his or her own which he or she may lawfully possess, by lease or otherwise, and claiming such house, mobile home, or modular home

	as his or her homestead, shall be entitled to the exemption of such house, mobile home, or modular home from levy and sale as aforesaid.
GEORGIA Ga. Code Ann., § 44-13-100	(a) In lieu of the exemption provided in Code Section 44-13-1, any debtor who is a natural person may exempt, pursuant to this Article, for purposes of bankruptcy, the following property: (1) The debtor's aggregate interest, not to exceed $21,500.00 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor. In the event title to property used for the exemption provided under this paragraph is in one of two spouses who is a debtor, the amount of the exemption hereunder shall be $43,000.00;
Hawaii Haw. Rev. Stat. § 651-92	(a) Real property shall be exempt from attachment or execution as follows: (1) An interest in one parcel of real property in the State of Hawaii of a fair market value not exceeding $30,000 owned by the defendant who is either the head of a family or an individual sixty-five years of age or older. (2) An interest in one parcel of real property in the State of Hawaii of a fair market value not exceeding $20,000 owned by the defendant who is a person. The fair market value of the interest exempted in paragraphs (1) or (2) shall be determined by appraisal and shall be an interest which is over and above all liens and encumbrances on the real property recorded prior to the lien under which attachment or execution is to be made. Not more than one exemption shall be claimed on any one parcel of real property even though more than one person residing on such real property may otherwise be entitled to an exemption. Any claim of exemption under this section made before May 27, 1976, shall be deemed to be amended on May 27, 1976, by increasing the exemption to the amount permitted by this section on May 27, 1976, to the extent that such increase does not impair or defeat the right of any creditor who has executed upon the real property prior to May 27, 1976. (b) No exemption authorized under this section shall apply to process arising from: (1) A lien as provided by section 507-42; (2) A lien or security interest created by a mortgage, security agreement, or other security instrument; (3) A tax lien in the name of the federal or state government; (4) An improvement district lien of any county of the State; or (5) A lien or encumbrance recorded against the real property prior to the acquisition of interest in and commencement of residence on such real property.
IDAHO I.C. § 55-1001	For purposes of this chapter: (1) “Dwelling house” and “mobile home” include manufactured housing. (2) “Homestead” means and consists of the dwelling house or the mobile home in which the owner resides or intends to reside, with appurtenant buildings, and the land on which the same are situated and by which the same are surrounded, or improved; or unimproved land owned with the intention of placing a house or mobile home thereon and residing thereon. A mobile home may be exempted under this chapter whether or not it is permanently affixed to the underlying land and whether or not the mobile home is placed upon a lot owned by the mobile home owner. Property included in the homestead must be actually intended or used as a principal home for the owner. (3) “Net value” means market value less all liens and encumbrances. (4) “Owner” includes, but is not limited to, a purchaser under a deed of trust, mortgage, or contract, or a person who takes the subject property under a life estate
I.C. § 55-1003	A homestead may consist of lands, as described in section 55-1001, Idaho Code, regardless of area, but the homestead exemption amount shall not exceed the lesser of (i) the total net value of the lands, mobile home, and improvements as described in section 55-1001, Idaho Code; or (ii) the sum of one hundred thousand dollars ($100,000).
I.C. § 55-1004	(1) Property described in section 55-1001, Idaho Code, constitutes a homestead and is automatically protected by the exemption described in section 55-1003, Idaho Code, from and after the time the property is occupied as a principal residence by the owner or, if the homestead is unimproved or improved land that is not yet occupied as a homestead, from

	and after the declaration or declarations required in this section are filed for record or, if the homestead is a mobile home not yet occupied as a homestead and located on land not owned by the owner of the mobile home, from and after delivery of a declaration as described in section 55-1006, Idaho Code. (2) An owner who selects a homestead from unimproved or improved land that is not yet occupied as a homestead must execute a declaration of homestead and file the same for record in the office of the recorder of the county in which the land is located. However, if the owner also owns another parcel of property on which the owner presently resides or in which the owner claims a homestead, the owner must also execute a declaration of abandonment of homestead on that other property and file the same for record with the recorder of the county in which the land is located. (3) The declaration of homestead must contain: (a) A statement that the person making it is residing on the premises or intends to reside thereon and claims the premises as a homestead; (b) A legal description of the premises; and (c) An estimate of the premises actual cash value. (4) The declaration of abandonment must contain: (a) A statement that a premises occupied as a residence or claimed as a homestead no longer constitutes the owner's homestead; (b) A legal description of the premises; and (c) A statement of the date of abandonment. (5) The declaration of homestead and declaration of abandonment of homestead must be acknowledged in the same manner as a grant of real property is acknowledged.
ILLINOIS 735 ILCS 5/12-901	§ 12-901. Amount. Every individual is entitled to an estate of homestead to the extent in value of $15,000 of his or her interest in a farm or lot of land and buildings thereon, a condominium, or personal property, owned or rightly possessed by lease or otherwise and occupied by him or her as a residence, or in a cooperative that owns property that the individual uses as a residence. That homestead and all right in and title to that homestead is exempt from attachment, judgment, levy, or judgment sale for the payment of his or her debts or other purposes and from the laws of conveyance, descent, and legacy, except as provided in this Code or in Section 20-6 of the Probate Act of 1975.[1] This Section is not applicable between joint tenants or tenants in common but it is applicable as to any creditors of those persons. If 2 or more individuals own property that is exempt as a homestead, the value of the exemption of each individual may not exceed his or her proportionate share of $30,000 based upon percentage of ownership.
735 ILCS 5/12-906	§ 12-906. Proceeds of sale. When a homestead is conveyed by the owner thereof, such conveyance shall not subject the premises to any lien or incumbrance to which it would not be subject in the possession of such owner; and the proceeds thereof, to the extent of the amount of $15,000, shall be exempt from judgment or other process, for one year after the receipt thereof, by the person entitled to the exemption, and if reinvested in a homestead the same shall be entitled to the same exemption as the original homestead.
INDIANA IC 34-55-10-2 (c) (1)	(c) The following property of a debtor domiciled in Indiana is exempt: (1) Real estate or personal property constituting the personal or family residence of the debtor or a dependent of the debtor, or estates or rights in that real estate or personal property, of not more than fifteen thousand dollars ($15,000). The exemption under this subdivision is individually available to joint debtors concerning property held by them as tenants by the entireties.
IOWA I.C.A. § 499A.18	Each individual apartment constitutes a homestead and is exempt from execution, provided the member otherwise qualifies within the laws of the state of Iowa for such exemption.
I.C.A. § 561.2	If within a city plat, it must not exceed one-half acre in extent, otherwise it must not contain in the aggregate more than forty acres, but if, in either case, its value is less than five hundred dollars, it may be enlarged until it reaches that amount.
I.C.A. § 561.16	The homestead of every person is exempt from judicial sale where there is no special declaration of statute to the contrary. Persons who reside together as a single household unit are entitled to claim in the aggregate only one homestead to be exempt from judicial sale. A single person may claim only one homestead to be exempt from judicial sale. For

	purposes of this section, "household unit" means all persons of whatever ages, whether or not related, who habitually reside together in the same household as a group.
KANSAS K.S.A. 60-2303	Except as provided in K.S.A. 12-524a, and amendments thereto, a homestead to the extent of 160 acres of farming land, or of one acre within the limits of an incorporated town or city, or a manufactured home or mobile home, occupied as a residence by the owner or by the family of the owner, or by both the owner and family thereof, together with all the improvements on the same, shall be exempted from forced sale under any process of law, and shall not be alienated without the joint consent of husband and wife, when that relation exists; but no property shall be exempt from sale for taxes, or for the payment of obligations contracted for the purchase of such premises, or for the erection of improvements thereon. The provisions of this section shall not apply to any process of law obtained by virtue of a lien given by the consent of both husband and wife, when that relation exists.
KENTUCKY KRS § 427.060	In addition to any exemption of personal property, an individual debtor's aggregate interest, not to exceed five thousand dollars ($5,000) in value, in real or personal property that such debtor or a dependent of such debtor uses as a permanent residence in this state, or in a burial plot for such debtor or a dependent of such debtor is exempt from sale under execution, attachment or judgment, except to foreclose a mortgage given by the owner of a homestead or for purchase money due thereon. This exemption shall not apply if the debt or liability existed prior to the purchase of the property or the erection of the improvements thereon.
KRS § 427.090	If the defendant in the execution, attachment or other action owns property levied on or sought to be subjected to the payment of any debt or liability, which, in the opinion of the appraisers, is of greater value than five thousand dollars ($5,000) and not divisible without great diminution in value, the property shall be sold and five thousand dollars ($5,000) of the money arising from the sale paid to the defendant to enable him to purchase another homestead. The property shall not be sold for less than five thousand dollars ($5,000).
LOUISIANA La. Rev. Stat. Ann. § 20	(1) The bona fide homestead, consisting of a tract of land or two or more tracts of land even if the land is classified and assessed at use value pursuant to Article VII, Section 18(C) of this constitution, with a residence on one tract and a field with or without timber on it, pasture, or garden on the other tract or tracts, not exceeding one hundred sixty acres, buildings and appurtenances, whether rural or urban, owned and occupied by any person or persons owning the property in indivision, shall be exempt from state, parish, and special ad valorem taxes to the extent of seven thousand five hundred dollars of the assessed valuation. The same homestead exemption shall also fully apply to the primary residence, including a mobile home, which serves as a bona fide home and which is owned and occupied by any person or persons owning the property in indivision, regardless of whether the homeowner owns the land upon which the home or mobile home is sited; however, this homestead exemption shall not apply to the land upon which such primary residence is sited if the homeowner does not own the land. (2) The homestead exemption shall extend and apply fully to the surviving spouse or a former spouse when the homestead is occupied by the surviving spouse or a former spouse and title to it is in the name of (a) the surviving spouse as owner of any interest or either or both of the former spouses, (b) the surviving spouse as usufructuary, or (c) a testamentary trust established for the benefit of the surviving spouse and the descendants of the deceased spouse or surviving spouse, but not to more than one homestead owned by either the husband or wife, or both. (3) The homestead exemption shall extend to property owned by a trust when the principal beneficiary or beneficiaries of the trust are the settlor or settlors of the trust and were the immediate prior owners of the homestead, and the homestead is occupied as such by a principal beneficiary. The provisions of this Subparagraph shall apply only to property which qualified for the homestead exemption immediately prior to transfer, conveyance, or donation in trust or which would have qualified for the homestead exemption if such property were not owned in trust. (4) The homestead exemption shall extend to property where the usufruct of the property has been granted to no more than two usufructuaries who were the immediate prior owners of the homestead and the homestead is occupied as such by a usufructuary. The

	provisions of this Subparagraph shall apply only to property which qualified for the homestead exemption immediately prior to the granting of such usufruct, or which would have qualified for the homestead exemption if such usufruct had not been granted. (5) The homestead exemption shall extend only to a natural person or persons and to a trust created by a natural person or persons, in which the beneficiaries of the trust are a natural person or persons provided that the provisions of this Paragraph are otherwise satisfied. (6) Except as otherwise provided for in this Paragraph, the homestead exemption shall apply to property owned in indivision, but shall be limited to the pro rata ownership interest of that person or persons occupying the homestead. (7) No homestead exemption shall be granted on bond for deed property. However, any homestead exemption granted prior to June 20, 2003 on any property occupied upon the effective date of this Paragraph* by a buyer under a bond for deed contract shall remain valid as long as the circumstances giving rise to the exemption at the time the exemption was granted remain applicable. (8) Notwithstanding any provision of this Paragraph to the contrary, in no event shall more than one homestead exemption extend or apply to any person in this state. (9) This exemption shall not extend to municipal taxes. However, the exemptions shall apply (a) in Orleans Parish, to state, general city, school, levee, and levee district taxes and (b) to any municipal taxes levied for school purposes. (10)(a) Any homestead receiving the homestead exemption that is damaged or destroyed during a disaster or emergency declared by the governor whose owner is unable to occupy the homestead on or before December thirty-first of a calendar year due to such damage or destruction shall be entitled to claim and keep the exemption by filing an annual affidavit of intent to return and reoccupy the homestead within five years from December thirty-first of the year following the disaster with the assessor within the parish or district where such homestead is situated prior to December thirty-first of the year in which the exemption is claimed. In no event shall more than one homestead exemption extend or apply to any person in this state. (b) For homesteads qualifying for the homestead exemption under the provisions of Subsubparagraph (a) of this Subparagraph, after expiration of the five-year period, the owner of a homestead shall be entitled to claim and keep the exemption for a period not to exceed two additional years by filing an annual affidavit of intent to return and reoccupy the homestead with the assessor within the parish where the homestead is located prior to December thirty-first of the year in which the exemption is claimed. A homeowner shall be eligible for this extension only if the homeowner's damage claim to repair or rebuild the damaged or destroyed homestead is filed and pending in a formal appeal process with any federal, state, or local government agency or program offering grants or assistance for repairing or rebuilding damaged or destroyed homes as a result of the disaster, or if a homeowner has a damage claim filed and pending against the insurer of the property. The assessor shall require the homeowner to provide official documentation from the government agency or program evidencing the homeowner's participation in the formal appeal process or official documentation evidencing the homeowners has a damage claim filed and pending against the insurer of the property as provided by law. (c) After expiration of the extension authorized in Subsubparagraph (b) of this Subparagraph, an assessor shall have the authority to grant on a case-by-case basis up to three additional one-year extensions of the homestead exemption as prescribed by law. (B) Residential Lessees. Notwithstanding any contrary provision in this constitution, the legislature may provide for tax relief to residential lessees in the form of credits or rebates in order to provide equitable tax relief similar to that granted to homeowners through homestead exemptions.
MAINE Me. Rev. Stat. Ann. tit. 14, § 4422 (1).	The following property is exempt from attachment and execution, except to the extent that it has been fraudulently conveyed by the debtor. 1. Residence. The exemption of a debtor's residence is subject to this subsection. A. Except as provided in paragraph B, the debtor's aggregate interest, not to exceed $47,500 in value, in real or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of

	the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor, except that if minor dependents of the debtor have their principal place of residence with the debtor, the debtor's aggregate interest may not exceed $95,000 and except that if the debtor's interest is held jointly with any other person or persons, the exemption may not exceed in value the lesser of $47,500 or the product of the debtor's fractional share times $95,000. B. The debtor's aggregate interest, not to exceed $95,000 in value, in property described in paragraph A, if the debtor or a dependent of the debtor is either a person 60 years of age or older or a person physically or mentally disabled and because of such disability is unable to engage in substantial gainful employment and whose disability has lasted or can be expected to last for at least 12 months or can be expected to result in death; except that if the debtor's interest is held jointly with any other person or persons, the exemption may not exceed in value the lesser of $95,000 or the product of the fractional share of the debtor's interest times $190,000. This paragraph does not apply to liens obtained prior to its effective date or to judgments based on torts involving other than ordinary negligence on the part of the debtor. C. That portion of the proceeds from any sale of property which is exempt under this section shall be exempt for a period of 6 months from the date of receipt of such proceeds for purposes of reinvesting in a residence within that period.
MARYLAND Md. Code Ann., [Cts. & Jud. Proc] § 11-504(f)	A. Owner-occupied residential real property, including a condominium unit or a manufactured home that has been converted to real property in accordance with § 8B-201 of the Real Property Article; or B. A cooperative housing corporation that owns property that the debtor occupies as a residence. (up to 23.675,00)
Massachussets Mass. Gen. Laws Ch. 188, §§ 1	''Automatic homestead exemption'', an exemption in the amount of $125,000 pursuant to section 4; provided, however, that: (1) with respect to a home owned as joint tenants or as tenants by the entirety, the automatic homestead exemption shall remain whole and unallocated between the owners, provided that the owners together shall not be entitled to an automatic homestead exemption in excess of $125,000; and (2) with respect to a home owned by multiple owners as tenants in common or as trust beneficiaries, the automatic homestead exemption shall be allocated among all owners in proportion to their respective ownership interests. ''Declared homestead exemption'', an exemption in the amount of $500,000 created by a written declaration, executed and recorded pursuant to section 5; provided, however, that: (1) with respect to a home owned by joint tenants or tenants by the entirety who are benefited by an estate of homestead declared pursuant to section 3, the declared homestead exemption shall remain whole and unallocated, provided that the owners together shall not be entitled to a declared homestead exemption in excess of $500,000; (2) if a home is owned by tenants in common or trust beneficiaries, the declared homestead exemption for each co-tenant and trust beneficiary who benefits by an estate of homestead declared pursuant to said section 3 shall be the product of: (i) $500,000; and (ii) the co-tenant's or trust beneficiary's percentage ownership interest; (3) except as provided in clause (4), each person who owns a home and who is benefited by an estate of homestead declared pursuant to section 2 shall be entitled to the declared homestead exemption without reduction, proration or allocation among other owners of the home; and (4) separate estates of homestead may be declared pursuant to sections 2 and 3 on the same home, and in such event: (i) if the home is owned by tenants in common or trust beneficiaries, the declared homestead exemption for each co-tenant and trust beneficiary who benefits by an estate of homestead declared pursuant to section 3 shall be calculated in the manner provided in clause (2), and the declared homestead exemption for each co-tenant and trust beneficiary who benefits by an estate of homestead declared pursuant to section 2 shall be calculated in the manner provided in clause (3); or (ii) if the home is owned by joint tenants or tenants by the entirety, the declared homestead exemption for the owners together shall be the sum of $500,000 multiplied by the number of declarations recorded pursuant to section 2, plus $250,000; provided, however, that the homestead exemption under this subclause shall remain whole and unallocated among the owners; and provided further, that no owner who declares a homestead, acting individually, shall

	be entitled to claim an exemption of more than $500,000; and (5) the calculation of the amount of homestead exemption available to an owner shall not sever a joint tenancy or tenancy by the entirety. ''Disabled person'', an individual who has a medically-determinable, permanent physical or mental impairment that would meet the disability requirements for Supplemental Security Income under 42 U.S.C. 1382c(a)(3)(A) and 42 U.S.C. 1382c(a)(3)(C) as in effect at the time of recording. ''Elderly person'', an individual 62 years of age or older. ''Family'' or ''family members'', (1) married individuals, both of whom own a home, and any minor child; (2) a married individual who owns a home, a non-titled spouse of the married individual and any minor child; or (3) an unmarried individual who owns a home and any minor child. ''Home'', the aggregate of: (1) any of the following: (i) a single-family dwelling, including accessory structures appurtenant thereto and the land on which it is located; (ii) a 2 to 4–family dwelling, including accessory structures appurtenant thereto and the land on which it is located; (iii) a manufactured home as defined in section 32Q of chapter 140; (iv) a unit in a condominium, as those terms are defined in section 1 of chapter 183A, that is used for residential purposes; or (v) a residential cooperative housing unit established pursuant to chapters 156B, 157B, 180 or otherwise; (2) the sale proceeds as provided in clause (1) of subsection (a) of section 11; and (3) the proceeds of any policy of insurance insuring the home against fire or other casualty loss as provided in clause (2) of said subsection (a) of said section 11. ''Minor child'', a person aged 21 and under, who is the natural or adopted child of an owner or owner's spouse entitled to the benefits of this chapter, notwithstanding any law to the contrary. ''Owner'', a natural person who is a sole owner, joint tenant, tenant by the entirety, tenant in common, life estate holder or holder of a beneficial interest in a trust. ''Principal residence'', the home where an owner, and the owner's family if applicable, resides or intends to reside as the primary dwelling; provided, however, that no person shall hold concurrent rights in more than 1 principal residence. ''Record'', ''recording'' or ''recorded'', the act of recording in the registry of deeds or the registry district of the land court for the county or district wherein the home lies, except that with respect to a manufactured home located on registered land, recording in the registry of deeds shall be sufficient.
Michigan M.C.L.A. 559.214	Sec. 114. The laws of this state relating to the exemption of homestead property from levy and execution shall be applicable to condominium units occupied as homesteads.
M.C.L.A. 600.6023	(h) An equity of redemption as described in section 6060.[1] (i) The homestead of a family, after the death of the owner of the homestead, from the payment of his or her debts in all cases during the minority of his or her children.
Minnesota M.S.A. § 510.01	The house owned and occupied by a debtor as the debtor's dwelling place, together with the land upon which it is situated to the amount of area and value hereinafter limited and defined, shall constitute the homestead of such debtor and the debtor's family, and be exempt from seizure or sale under legal process on account of any debt not lawfully charged thereon in writing, except such as are incurred for work or materials furnished in the construction, repair, or improvement of such homestead, or for services performed by laborers or servants and as is provided in section 550.175.
M.S.A. § 510.01	**Subdivision 1. Exemption.** The homestead may include any quantity of land not exceeding 160 acres. The exemption per homestead, whether the exemption is claimed by one or more debtors, may not exceed $390,000 or, if the homestead is used primarily for agricultural purposes, $975,000, exclusive of the limitations set forth in section 510.05. **Subd. 2. Adjustment of dollar amounts.** The dollar amounts in subdivision 1 must change periodically in the manner provided for under section 550.37, subdivision 4a. The commissioner of commerce shall include the changes in the dollar amounts as part of the announcement and publication made under those provisions.
M.S.A. § 550.37 (12)	**Manufactured home.** A manufactured home, as defined in section 168.002, subdivision 16, which is actually inhabited as a home by the debtor.
MISSISSIPPI	(d) One (1) mobile home, trailer, manufactured housing, or similar type dwelling owned

Miss. Code Ann. § 85-3-1 (d) (1)	and occupied as the primary residence by the debtor, not exceeding a value of Thirty Thousand Dollars ($30,000.00); in determining this value, existing encumbrances on the dwelling, including taxes and all other liens, shall first be deducted from the actual value of the dwelling. A debtor is not entitled to the exemption of a mobile home as personal property who claims a homestead exemption under Section 85-3-21, and the exemption shall not apply to collection of delinquent taxes under Sections 27-41-101 through 27-41-109.
Miss. Code Ann. § 85-3-21 (d) (1)	Every citizen of this state, male or female, being a householder shall be entitled to hold exempt from seizure or sale, under execution or attachment, the land and buildings owned and occupied as a residence by him, or her, but the quantity of land shall not exceed one hundred sixty (160) acres, nor the value thereof, inclusive of improvements, save as hereinafter provided, the sum of Seventy-five Thousand Dollars ($75,000.00); provided, however, that in determining this value, existing encumbrances on such land and buildings, including taxes and all other liens, shall first be deducted from the actual value of such land and buildings. But husband or wife, widower or widow, over sixty (60) years of age, who has been an exemptionist under this section, shall not be deprived of such exemption because of not residing therein.
MISSOURI M.R.S. 513.430 (6)	(6) Any mobile home used as the principal residence but not attached to real property in which the debtor has a fee interest, not to exceed five thousand dollars in value;
M.R.S. 513.475	1. The homestead of every person, consisting of a dwelling house and appurtenances, and the land used in connection therewith, not exceeding the value of fifteen thousand dollars, which is or shall be used by such person as a homestead, shall, together with the rents, issues and products thereof, be exempt from attachment and execution. The exemption allowed under this section shall not be allowed for more than one owner of any homestead if one owner claims the entire amount allowed under this subsection; but, if more than one owner of any homestead claims an exemption under this section, the exemption allowed to each of such owners shall not exceed, in the aggregate, the total exemption allowed under this subsection as to any one homestead.
MONTANA MCA 70-32-104	(1) A homestead may not exceed $250,000 in value. In a proceeding instituted to determine the value of the homestead, the assessed value of the land with included appurtenances, if any, and of the dwelling house as it appears on the last-completed assessment roll preceding the institution of the proceeding is prima facie evidence of the value of the property claimed as a homestead.
MCA 70-32-201	The homestead is exempt from execution or forced sale, except as in this chapter provided.
NEBRASKA Neb.Rev.St. § 40-101	A homestead not exceeding sixty thousand dollars in value shall consist of the dwelling house in which the claimant resides, its appurtenances, and the land on which the same is situated, not exceeding one hundred and sixty acres of land, to be selected by the owner, and not in any incorporated city or village, or, at the option of the claimant, a quantity of contiguous land not exceeding two lots within any incorporated city or village, and shall be exempt from judgment liens and from execution or forced sale, except as provided in sections 40-101 to 40-116.
NEVADA N.R.S. 21.090; (l) (m)	(l) The homestead as provided for by law, including a homestead for which allodial title has been established and not relinquished and for which a waiver executed pursuant to NRS 115.010 is not applicable. (m) The dwelling of the judgment debtor occupied as a home for himself or herself and family, where the amount of equity held by the judgment debtor in the home does not exceed $550,000 in value and the dwelling is situated upon lands not owned by the judgment debtor.
N.R.S. 115.010 (1); (2)	1. The homestead is not subject to forced sale on execution or any final process from any court, except as otherwise provided by subsections 2, 3 and 5, and NRS 115.090 and except as otherwise required by federal law. 2. The exemption provided in subsection 1 extends only to that amount of equity in the property held by the claimant which does not exceed $550,000 in value, unless allodial title has been established and not relinquished, in which case the exemption provided in subsection 1 extends to all equity in the dwelling, its appurtenances and the land on which it is located.
New Hampshire	Every person is entitled to $120,000 worth of his or her homestead, or of his or her interest

N.H. Rev. Stat. § 480:1	therein, as a homestead. The homestead right created by this chapter shall exist in manufactured housing, as defined by RSA 674:31, which is owned and occupied as a dwelling by the same person but shall not exist in the land upon which the manufactured housing is situated if that land is not also owned by the owner of the manufactured housing.
New Jersey	None
New Mexico N. M. S. A. 1978, § 42-10-9	Each person shall have exempt a homestead in a dwelling house and land occupied by the person or in a dwelling house occupied by the person although the dwelling is on land owned by another, provided that the dwelling is owned, leased or being purchased by the person claiming the exemption. Such a person has a homestead of sixty thousand dollars ($60,000) exempt from attachment, execution or foreclosure by a judgment creditor and from any proceeding of receivers or trustees in insolvency proceedings and from executors or administrators in probate. If the homestead is owned jointly by two persons, each joint owner is entitled to an exemption of sixty thousand dollars ($60,000).
NEW YORK CPLR § 5206	(a) Exemption of homestead. Property of one of the following types, not exceeding one hundred fifty thousand dollars for the counties of Kings, Queens, New York, Bronx, Richmond, Nassau, Suffolk, Rockland, Westchester and Putnam; one hundred twenty-five thousand dollars for the counties of Dutchess, Albany, Columbia, Orange, Saratoga and Ulster; and seventy-five thousand dollars for the remaining counties of the state in value above liens and encumbrances, owned and occupied as a principal residence, is exempt from application to the satisfaction of a money judgment, unless the judgment was recovered wholly for the purchase price thereof: 1. a lot of land with a dwelling thereon, 2. shares of stock in a cooperative apartment corporation, 3. units of a condominium apartment, or 4. a mobile home. But no exempt homestead shall be exempt from taxation or from sale for non-payment of taxes or assessments. (b) Homestead exemption after owner's death. The homestead exemption continues after the death of the person in whose favor the property was exempted for the benefit of the surviving spouse and surviving children until the majority of the youngest surviving child and until the death of the surviving spouse. (c) Suspension of occupation as affecting homestead. The homestead exemption ceases if the property ceases to be occupied as a residence by a person for whose benefit it may so continue, except where the suspension of occupation is for a period not exceeding one year, and occurs in consequence of injury to, or destruction of, the dwelling house upon the premises. (d) Exemption of homestead exceeding one hundred fifty thousand dollars in value for the counties of Kings, Queens, New York, Bronx, Richmond, Nassau, Suffolk, Rockland, Westchester and Putnam; one hundred twenty-five thousand dollars for the counties of Dutchess, Albany, Columbia, Orange, Saratoga and Ulster; and seventy-five thousand dollars for the remaining counties of the state. The exemption of a homestead is not void because the value of the property exceeds one hundred fifty thousand dollars for the counties of Kings, Queens, New York, Bronx, Richmond, Nassau, Suffolk, Rockland, Westchester and Putnam; one hundred twenty-five thousand dollars for the counties of Dutchess, Albany, Columbia, Orange, Saratoga and Ulster; and seventy-five thousand dollars for the remaining counties of the state but the lien of a judgment attaches to the surplus. (e) Sale of homestead exceeding one hundred fifty thousand dollars for the counties of Kings, Queens, New York, Bronx, Richmond, Nassau, Suffolk, Rockland, Westchester and Putnam; one hundred twenty-five thousand dollars for the counties of Dutchess, Albany, Columbia, Orange, Saratoga and Ulster; and seventy-five thousand dollars for the remaining counties of the state in value. A judgment creditor may commence a special proceeding in the county in which the homestead is located against the judgment debtor for the sale, by a sheriff or receiver, of a homestead exceeding one hundred fifty thousand dollars for the counties of Kings, Queens, New York, Bronx, Richmond, Nassau, Suffolk, Rockland, Westchester and Putnam; one hundred twenty-five thousand dollars for the

	counties of Dutchess, Albany, Columbia, Orange, Saratoga and Ulster; and seventy-five thousand dollars for the remaining counties of the state in value. The court may direct that the notice of petition be served upon any other person. The court, if it directs such a sale, shall so marshal the proceeds of the sale that the right and interest of each person in the proceeds shall correspond as nearly as may be to his right and interest in the property sold. Money, not exceeding one hundred fifty thousand dollars for the counties of Kings, Queens, New York, Bronx, Richmond, Nassau, Suffolk, Rockland, Westchester and Putnam; one hundred twenty-five thousand dollars for the counties of Dutchess, Albany, Columbia, Orange, Saratoga and Ulster; and seventy-five thousand dollars for the remaining counties of the state, paid to a judgment debtor, as representing his interest in the proceeds, is exempt for one year after the payment, unless, before the expiration of the year, he acquires an exempt homestead, in which case, the exemption ceases with respect to so much of the money as was not expended for the purchase of that property; and the exemption of the property so acquired extends to every debt against which the property sold was exempt. Where the exemption of property sold as prescribed in this subdivision has been continued after the judgment debtor's death, or where he dies after the sale and before payment to him of his portion of the proceeds of the sale, the court may direct that portion of the proceeds which represents his interest be invested for the benefit of the person or persons entitled to the benefit of the exemption, or be otherwise disposed of as justice requires. (f) Exemption of burying ground. Land, set apart as a family or private burying ground, is exempt from application to the satisfaction of a money judgment, upon the following conditions only: 1. a portion of it must have been actually used for that purpose; 2. it must not exceed in extent one-fourth of an acre; and 3. it must not contain any building or structure, except one or more vaults or other places of deposit for the dead, or mortuary monuments.
NORTH CAROLINA N.C.G.S.A. § 1C-1601 (1) (a)	(a) Exempt property. -- Each individual, resident of this State, who is a debtor is entitled to retain free of the enforcement of the claims of creditors: (1) The debtor's aggregate interest, not to exceed thirty-five thousand dollars ($35,000) in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor; however, an unmarried debtor who is 65 years of age or older is entitled to retain an aggregate interest in the property not to exceed sixty thousand dollars ($60,000) in value so long as the property was previously owned by the debtor as a tenant by the entireties or as a joint tenant with rights of survivorship and the former co-owner of the property is deceased.
NORTH DAKOTA NDCC, 28-22-02 (7); (10)	7. The homestead as created, defined, and limited by law. 10. In lieu of the homestead, and subject to the same value limitations that exist with respect to the homestead exemption, any housetrailer or mobile home occupied as a residence by the debtor or the debtor's family, except that it is not exempt from process, levy, or sale for taxes levied on it pursuant to chapter 57-55. This section does not preclude the debtor from claiming a mobile home as a dwelling house as part of the homestead. The exemption in this subsection is not available if the debtor has chosen the exemption provided for under subsection 1 of section 28-22-03.1.
NDCC, 47-18-01	The homestead of any individual, whether married or unmarried, residing in this state consists of the land upon which the claimant resides, and the dwelling house on that land in which the homestead claimant resides, with all its appurtenances, and all other improvements on the land, the total not to exceed one hundred thousand dollars in value, over and above liens or encumbrances or both. The homestead shall be exempt from judgment lien and from execution or forced sale, except as otherwise provided in this chapter. The homestead may not embrace different lots or tracts of land unless the lots or tracts of land are contiguous. For purposes of this section, “contiguous” means two or more tracts of real property which share a common point or which would share a common point but for an intervening road or right of way.
OHIO	(A) Every person who is domiciled in this state may hold property exempt from execution,

O. R.C. § 2329.66 (A) (1)	garnishment, attachment, or sale to satisfy a judgment or order, as follows: (1)(a) In the case of a judgment or order regarding money owed for health care services rendered or health care supplies provided to the person or a dependent of the person, one parcel or item of real or personal property that the person or a dependent of the person uses as a residence. Division (A)(1)(a) of this section does not preclude, affect, or invalidate the creation under this chapter of a judgment lien upon the exempted property but only delays the enforcement of the lien until the property is sold or otherwise transferred by the owner or in accordance with other applicable laws to a person or entity other than the surviving spouse or surviving minor children of the judgment debtor. Every person who is domiciled in this state may hold exempt from a judgment lien created pursuant to division (A)(1)(a) of this section the person's interest, not to exceed 136.925,00 dollars, in the exempted property. (b) In the case of all other judgments and orders, the person's interest, not to exceed one hundred twenty-five thousand dollars, in one parcel or item of real or personal property that the person or a dependent of the person uses as a residence. (c) For purposes of divisions (A)(1)(a) and (b) of this section, "parcel" means a tract of real property as identified on the records of the auditor of the county in which the real property is located.
OKLAHOMA 31 O.S. Section 1	A. Except as otherwise provided in this title and notwithstanding subsection B of this section, the following property shall be reserved to every person residing in the state, exempt from attachment or execution and every other species of forced sale for the payment of debts, except as herein provided: 1. The home of such person, provided that such home is the principal residence of such person; 2. A manufactured home, provided that such manufactured home is the principal residence of such person;
31 O.S. Section 2	A. The homestead of any person in this state, not within any city or town, shall consist of not more than one hundred sixty (160) acres of land, which may be in one or more parcels, to be selected by the owner. B. Effective November 1, 1997, the homestead of any person in this state, not within any city or town, annexed by a city or town on or after November 1, 1997, owned and occupied and used for both residential and commercial agricultural purposes shall consist of not more than one hundred sixty (160) acres of land, which may be in one or more parcels, to be selected by the owner. C. The homestead within any city or town, owned and occupied as a residence only, or used for both residential and business purposes, shall consist of not exceeding one (1) acre of land, to be selected by the owner. For purposes of this subsection, at least seventy-five percent (75%) of the total square foot area of the improvements for which a homestead exemption is claimed must be used as the principal residence in order to qualify for the exemption. If more than twenty-five percent (25%) of the total square foot area of the improvements for which a homestead exemption is claimed is used for business purposes, the homestead exemption amount shall not exceed Five Thousand Dollars ($5,000.00). D. Nothing in the laws of the United States, or any treaties with the Indian tribes in the state, shall deprive any Indian or other allottee of the benefit of the homestead and exemption laws of the state. E. Any temporary renting of the homestead shall not change the character of the same, when no other homestead has been acquired.
OREGON O.R.S. § 18.395	(1) A homestead shall be exempt from sale on execution, from the lien of every judgment and from liability in any form for the debts of the owner to the amount in value of $40,000, except as otherwise provided by law. The exemption shall be effective without the necessity of a claim thereof by the judgment debtor. When two or more members of a household are debtors whose interests in the homestead are subject to sale on execution, the lien of a judgment or liability in any form, their combined exemptions under this section shall not exceed $50,000. The homestead must be the actual abode of and occupied by the owner, or the owner's spouse, parent or child, but the exemption shall not be impaired by: (a) Temporary removal or temporary absence with the intention to reoccupy the same as a

	homestead; (b) Removal or absence from the property; or (c) The sale of the property. (2) The exemption shall extend to the proceeds derived from such sale to an amount not exceeding $40,000 or $50,000, whichever amount is applicable under subsection (1) of this section, if the proceeds are held for a period not exceeding one year and held with the intention to procure another homestead therewith.
Pennsylvania Pa.C.S. § 42.8123	NONE but wildcard exemption allows to save some value in real estate.
Rhode Island §9-26-4.1	(a) In addition to the property exempt from attachment as set forth in § 9-26-4, an estate of homestead to the extent of five hundred thousand dollars ($500,000) in the land and buildings may be acquired pursuant to this section by an owner of a home or an individual who rightfully possesses the premises by lease, as a life tenant, as a beneficiary of a revocable or irrevocable trust or otherwise, and who occupies or intends to occupy the home as his or her principal residence. The estate of homestead provided pursuant to this section shall be automatic by operation of law, and without any requirement or necessity for the filing of a declaration, a statement in a deed, or any other documentation. The estate shall be exempt from the laws of attachment, levy on execution and sale for payment of debts or legacies except in the following cases: (1) Sale for taxes, sewer liens, water liens, lighting district assessments and fire district assessments; (2) For a debt contracted prior to the acquisition of the estate of homestead; (3) For a debt contracted for the purchase of the home; (4) Upon an order issued by the family court to enforce its judgment that a spouse pay a certain amount weekly or otherwise for the support of a spouse or minor children; (5) Where a building or buildings are situated on land not owned by the owner of a homestead estate are attached, levied upon or sold for the ground rent of the lot upon which the building or buildings are situated; (6) for a debt due to, or a lien in favor of, the department of human services and the state of Rhode Island for reimbursement of medical assistance, as provided for in § 40-8-15; (7) For a debt heretofore or hereafter owing to a federally insured deposit taking institution or a person regulated or licensed under title 19. (b) For the purposes of this section, "owner of a home" includes a sole owner, lessee (but only a lessee that was the owner of a home prior to a transfer to the lessor) joint tenant, tenant by the entirety or tenant in common; provided, that only one individual may acquire an estate of homestead in the home for the benefit of his or her family; and provided further, that an estate of homestead may be acquired on only one principal residence for the benefit of a family. For the purposes of this section, "family" includes either a parent and child or children, a husband and wife and their children, if any, or a sole owner. The provisions of this section shall not apply to any debt owing to a regulated institution, a debt secured by a mortgage or other voluntary lien on a home, or a mechanics' lien on the property comprising the estate as provided for under chapter 28 of title 34. Notwithstanding any other provisions of law, it shall not be necessary to record a declaration of homestead in order to take advantage of the homestead estate exemption.
SOUTH CAROLINA Code 1976 § 15-41-30	(A) The following real and personal property of a debtor domiciled in this State is exempt from attachment, levy, and sale under any mesne or final process issued by a court or bankruptcy proceeding: (1) The debtor's aggregate interest, not to exceed fifty thousand dollars in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor, except that the aggregate value of multiple homestead exemptions allowable with respect to a single living unit may not exceed one hundred thousand dollars. If there are multiple owners of such a living unit exempt as a homestead, the value of the exemption of each individual owner may not exceed his fractional portion of one hundred thousand dollars.
SOUTH DAKOTA SDCL § 43-31-1	The homestead, including a homestead listed for sale, of every family, resident in this state, so long as it continues to possess the character of a homestead is exempt from judicial

	sale, from judgment lien, and from all mesne or final process from any court, to the extent and as provided by statute. However, a creditor or lien holder of a mobile home classified as a homestead under § 43-31-2 prior to January 1, 1973, may not be cut off and is not subject to a homestead exemption. In addition, a homestead with a value of less than one hundred seventy thousand dollars of a person seventy years of age or older, and the unremarried surviving spouse of such person, is exempt from sale for taxes for so long as it continues to possess the character of a homestead.
SDCL § 43-31-2	The homestead embraces the house used as a home by the owner of it, being either, real property or a mobile home, and if the owner has two or more houses or mobile homes thus used at different times and places, the owner shall select which he or she will retain as a homestead. The homestead may not embrace more than one dwelling house or any other buildings except such as are properly appurtenant to the homestead. A shop, store, or other building situated on real property and really used or occupied by the owner in the prosecution of the owner's own ordinary business may be deemed appurtenant to the owner's homestead. A mobile home may include any vehicle without motive power which can provide adequate, comfortable, all season quarters for the purpose of making it a residence and which vehicle is larger than two hundred forty square feet, measuring at the base of the vehicle. The mobile home must be registered in South Dakota at least six months prior to the claim of exemption.
SDCL § 43-31-3	The homestead may contain one or more lots or tracts of land with the buildings thereon and other appurtenances, subject to the limitations contained in this code, but must in no case embrace different lots and tracts unless they are contiguous, or unless they are habitually and in good faith used as part of the same homestead.
TENNESSEE T. C. A. § 26-2-301	(a) An individual, whether a head of family or not, shall be entitled to a homestead exemption upon real property which is owned by the individual and used by the individual or the individual's spouse or dependent, as a principal place of residence. The aggregate value of such homestead exemption shall not exceed five thousand dollars ($5,000); provided, individuals who jointly own and use real property as their principal place of residence shall be entitled to homestead exemptions, the aggregate value of which exemptions combined shall not exceed seven thousand five hundred dollars ($7,500), which shall be divided equally among them in the event the homestead exemptions are claimed in the same proceeding; provided, if only one (1) of the joint owners of real property used as their principal place of residence is involved in the proceeding wherein homestead exemption is claimed, then the individual's homestead exemption shall be five thousand dollars ($5,000). The homestead exemption shall not be subject to execution, attachment, or sale under legal proceedings during the life of the individual. Upon the death of an individual who is head of a family, any such exemption shall inure to the benefit of the surviving spouse and their minor children for as long as the spouse or the minor children use such property as a principal place of residence. (b) If a marital relationship exists, a homestead exemption shall not be alienated or waived without the joint consent of the spouses. (c) The homestead exemption shall not operate against public taxes nor shall it operate against debts contracted for the purchase money of such homestead or improvements thereon nor shall it operate against any debt secured by the homestead when the exemption has been waived by written contract. (d) A deed, installment deed, mortgage, deed of trust, or any other deed or instrument by any other name whatsoever conveying property in which there may be a homestead exemption, duly executed, conveys the property free of homestead exemption, but the homestead exemption may not be waived in a note, other instrument evidencing debt, or any other instrument not conveying property in which homestead exemption may be claimed. (e) Notwithstanding the provisions of subsection (a) to the contrary, an unmarried individual who is sixty-two (62) years of age or older shall be entitled to a homestead exemption not exceeding twelve thousand five hundred dollars ($12,500) upon real property that is owned by the individual and used by the individual as a principal place of

	residence; a married couple, one (1) of whom is sixty-two (62) years of age or older and the other of whom is younger than sixty-two (62) years of age, shall be entitled to a homestead exemption not exceeding twenty thousand dollars ($20,000) upon real property that is owned by one (1) or both of the members of the couple and used by the couple as their principal place of residence; and a married couple, both of whom are sixty-two (62) years of age or older, shall be entitled to a homestead exemption not exceeding twenty-five thousand dollars ($25,000) upon real property that is owned by one (1) or both of the members of the couple and used by the couple as their principal place of residence. (f) Notwithstanding subsection (a) to the contrary, an individual who has one (1) or more minor children in the individual's custody shall be entitled to a homestead exemption not exceeding twenty-five thousand dollars ($25,000) on real property that is owned by the individual and used by the individual as a principal place of residence.
Texas V.T.C.A., Property Code § 41.001	(a) A homestead and one or more lots used for a place of burial of the dead are exempt from seizure for the claims of creditors except for encumbrances properly fixed on homestead property. (b) Encumbrances may be properly fixed on homestead property for: (1) purchase money; (2) taxes on the property; (3) work and material used in constructing improvements on the property if contracted for in writing as provided by Sections 53.254(a), (b), and (c); (4) an owelty of partition imposed against the entirety of the property by a court order or by a written agreement of the parties to the partition, including a debt of one spouse in favor of the other spouse resulting from a division or an award of a family homestead in a divorce proceeding; (5) the refinance of a lien against a homestead, including a federal tax lien resulting from the tax debt of both spouses, if the homestead is a family homestead, or from the tax debt of the owner; (6) an extension of credit that meets the requirements of Section 50(a)(6), Article XVI, Texas Constitution; or (7) a reverse mortgage that meets the requirements of Sections 50(k)-(p), Article XVI, Texas Constitution. (c) The homestead claimant's proceeds of a sale of a homestead are not subject to seizure for a creditor's claim for six months after the date of sale.
UTAH U.C.A. 1953 § 78B-5-503 (1) –(3)	(1) For purposes of this section: (a) “Household” means a group of persons related by blood or marriage living together in the same dwelling as an economic unit, sharing furnishings, facilities, accommodations, and expenses. (b) “Mobile home” is as defined in Section 57-16-3. (c) “Primary personal residence” means a dwelling or mobile home, and the land surrounding it, not exceeding one acre, as is reasonably necessary for the use of the dwelling or mobile home, in which the individual and the individual's household reside. (d) “Property” means: (i) a primary personal residence; (ii) real property; or (iii) an equitable interest in real property awarded to a person in a divorce decree by a court. (2)(a) An individual is entitled to a homestead exemption consisting of property in this state in an amount not exceeding: (i) $5,000 in value if the property consists in whole or in part of property which is not the primary personal residence of the individual; or (ii) $30,000 in value if the property claimed is the primary personal residence of the individual. (b) If the property claimed as exempt is jointly owned, each joint owner is entitled to a homestead exemption; however (i) for property exempt under Subsection (2)(a)(i), the maximum exemption may not exceed $10,000 per household; or (ii) for property exempt under Subsection (2)(a)(ii), the maximum exemption may not

	exceed $60,000 per household. (c) A person may claim a homestead exemption in either or both of the following: (i) one or more parcels of real property together with appurtenances and improvements; or (ii) a mobile home in which the claimant resides. (d) A person may not claim a homestead exemption for property that the person acquired as a result of criminal activity. (3) A homestead is exempt from judicial lien and from levy, execution, or forced sale except for: (a) statutory liens for property taxes and assessments on the property; (b) security interests in the property and judicial liens for debts created for the purchase price of the property; (c) judicial liens obtained on debts created by failure to provide support or maintenance for dependent children; and (d) consensual liens obtained on debts created by mutual contract.
Vermont Vt. Stat. Ann. tit. 27 § 101	The homestead of a natural person consisting of a dwelling house, outbuildings, and the land used in connection therewith, not exceeding $125,000.00 in value, and owned and used or kept by such person as a homestead together with the rents, issues, profits, and products thereof, shall be exempt from attachment and execution except as hereinafter provided.
VIRGINIA VA Code Ann. § 34-4	Every householder shall be entitled, in addition to the property or estate exempt under §§ 23-38.81, 34-26, 34-27, 34-29, and 64.2-311, to hold exempt from creditor process arising out of a debt, real and personal property, or either, to be selected by the householder, including money and debts due the householder not exceeding $5,000 in value or, if the householder is 65 years of age or older, not exceeding $10,000 in value. In addition, upon a showing that a householder supports dependents, the householder shall be entitled to hold exempt from creditor process real and personal property, or either, selected by the householder, including money or monetary obligations or liabilities due the householder, not exceeding $500 in value for each dependent. For the purposes of this section, “dependent” means an individual who derives support primarily from the householder and who does not have assets sufficient to support himself, but in no case shall an individual be the dependent of more than one householder.
Washington RCWA 6.13.010	(1) The homestead consists of real or personal property that the owner uses as a residence. In the case of a dwelling house or mobile home, the homestead consists of the dwelling house or the mobile home in which the owner resides or intends to reside, with appurtenant buildings, and the land on which the same are situated and by which the same are surrounded, or improved or unimproved land owned with the intention of placing a house or mobile home thereon and residing thereon. A mobile home may be exempted under this chapter whether or not it is permanently affixed to the underlying land and whether or not the mobile home is placed upon a lot owned by the mobile home owner. Property included in the homestead must be actually intended or used as the principal home for the owner. (2) As used in this chapter, the term “owner” includes but is not limited to a purchaser under a deed of trust, mortgage, or real estate contract. (3) As used in this chapter, the term “net value” means market value less all liens and encumbrances senior to the judgment being executed upon and not including the judgment being executed upon.
RCWA 6.13.030	A homestead may consist of lands, as described in RCW 6.13.010, regardless of area, but the homestead exemption amount shall not exceed the lesser of (1) the total net value of the lands, manufactured homes, mobile home, improvements, and other personal property, as described in RCW 6.13.010, or (2) the sum of one hundred twenty-five thousand dollars in the case of lands, manufactured homes, mobile home, and improvements, or the sum of fifteen thousand dollars in the case of other personal property described in RCW 6.13.010, except where the homestead is subject to execution, attachment, or seizure by or under any legal process whatever to satisfy a judgment in favor of any state for failure to pay that state's income tax on benefits received while a resident of the state of Washington from a pension or other retirement plan, in which

	event there shall be no dollar limit on the value of the exemption.
WEST VIRGINIA W. Va. Code, § 38-10-4	(a) The debtor's interest, not to exceed twenty-five thousand dollars in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence or in a burial plot for the debtor or a dependent of the debtor: *Provided*, That when the debtor is a physician licensed to practice medicine in this state under Article three or Article fourteen, chapter thirty of this code, and has commenced a bankruptcy proceeding in part due to a verdict or judgment entered in a medical professional liability action, if the physician has current medical malpractice insurance in the amount of at least one million dollars for each occurrence, the debtor physician's interest that is exempt under this subsection may exceed twenty-five thousand dollars in value but may not exceed two hundred fifty thousand dollars per household.
Wisconsin W.S.A. 815.20	(1) An exempt homestead as defined in s. 990.01(14) selected by a resident owner and occupied by him or her shall be exempt from execution, from the lien of every judgment, and from liability for the debts of the owner to the amount of $75,000, except mortgages, laborers', mechanics', and purchase money liens and taxes and except as otherwise provided. The exemption shall not be impaired by temporary removal with the intention to reoccupy the premises as a homestead nor by the sale of the homestead, but shall extend to the proceeds derived from the sale to an amount not exceeding $75,000, while held, with the intention to procure another homestead with the proceeds, for 2 years. The exemption extends to land owned by husband and wife jointly or in common or as marital property, and each spouse may claim a homestead exemption of not more than $75,000. The exemption extends to the interest therein of tenants in common, having a homestead thereon with the consent of the cotenants, and to any estate less than a fee. (2) Any owner of an exempt homestead against whom a judgment has been rendered and entered in the judgment and lien docket, and any heir, devisee, or grantee of the owner, or any mortgagee of the homestead, may proceed under s. 806.04 for declaratory relief if the homestead is less than * * * $75,000 in value and the owner of the judgment shall fail, for 10 days after demand, to execute a recordable release of the homestead from the judgment owner's judgment lien
WYOMING W.S.1977 § 1-20-101	Every resident of the state is entitled to a homestead not exceeding twenty thousand dollars ($20,000.00) in value, exempt from execution and attachment arising from any debt, contract or civil obligation entered into or incurred.
Wyo. S.1977 § 1-20-102	(a) The homestead is only exempt as provided in W.S. 1-20-101 while occupied as such by the owner or the person entitled thereto, or his or her family. (b) When two (2) or more persons jointly own and occupy the same residence, each shall be entitled to the homestead exemption.
Wyo. S.1977 § 1-20-104	The homestead may consist of a house on a lot or lots or other lands of any number of acres, or a house trailer or other movable home on a lot or lots, whether or not the house trailer or other movable home is equipped with wheels or resting upon immovable support.

12.4.2 State motor vehicle exemptions

TABLE 3	SPECIFIC[1726] MOTOR VEHICLE EXEMPTION
STATE	**DESCRIPTION**
ALABAMA	None (included in wildcard).
ALASKA AS § 09.38.020 (e)	An individual is entitled to an exemption of one motor vehicle to the extent of a value not exceeding $ 4.050,00 if the full value of the motor vehicle does not exceed $27,000.
ARIZONA A.R.S. § 33-1125 (8)	Equity in one motor vehicle not in excess of six thousand dollars. If the debtor or debtor's dependent is a person with a physical disability, the equity in the motor vehicle shall not exceed

[1726] Some states do not allow for a specific exemption in motor vehicles; debtors can usually apply their wildcard exemptions in that case.

	twelve thousand dollars.
Arkansas Ark. Code. 16-66-218	Arkansas allows exemption of Motor vehicle to $1,200.
CALIFORNIA 1 704.010. (a)	Any combination of the following is exempt in the amount of two thousand three hundred dollars ($2,300): (1) The aggregate equity in motor vehicles. (2) The proceeds of an execution sale of a motor vehicle. (3) The proceeds of insurance or other indemnification for the loss, damage, or destruction of a motor vehicle. (b) Proceeds exempt under subdivision (a) are exempt for a period of 90 days after the time the proceeds are actually received by the judgment debtor. (c) For the purpose of determining the equity, the fair market value of a motor vehicle shall be determined by reference to used car price guides customarily used by California automobile dealers unless the motor vehicle is not listed in such price guides. (d) If the judgment debtor has only one motor vehicle and it is sold at an execution sale, the proceeds of the execution sale are exempt in the amount of two thousand three hundred dollars ($2,300) without making a claim. The levying officer shall consult and may rely upon the records of the Department of Motor Vehicles in determining whether the judgment debtor has only one motor vehicle. In the case covered by this subdivision, the exemption provided by subdivision (a) is not available.
CALIFORNIA 2 Cal.C.C.P. § 703.140 (b) (2)	The debtor's interest, not to exceed five thousand three hundred and fifty dollars ($ 5.350) in value, in one or more motor vehicles.
COLORADO **C.R.S § 13-54-102 (1) (j)**	Up to two motor vehicles or bicycles kept and used by any debtor in the aggregate value of seven thousand five hundred dollars; or Up to two motor vehicles or bicycles kept and used by any elderly or disabled debtor or by any debtor with an elderly or disabled spouse or dependent, in the aggregate value of twelve thousand five hundred dollars.
Connecticut Conn. Gen Stat. Ann. §52-352b(j)	One motor vehicle to the value of three thousand five hundred dollars, provided value shall be determined as the fair market value of the motor vehicle less the amount of all liens and security interests which encumber it.
DELAWARE Del. Code Ann. tit. 10, § 4914 (c) (2)	In any federal bankruptcy or state insolvency proceeding, an individual debtor and/or such individual's spouse domiciled in Delaware shall be authorized to exempt from the bankruptcy or insolvency estate, in addition to the exemptions made in subsection (b) of this section and in § 4915 of this title, the following: (2)A vehicle and/or tools of the trade necessary for purposes of employment in an amount not to exceed $15,000 each.
District of Columbia D.C. Code Ann. 15-501 (a) (1)	Motor vehicle to $2,575.
FLORIDA F.S.A. § 222.25 (1)	The following property is exempt from attachment, garnishment, or other legal process: A debtor's interest, not to exceed $1,000 in value, in a single motor vehicle as defined in s. 320.01.
GEORGIA Ga. Code Ann., § 44-13-100 (a) (3)	The debtor's interest, not to exceed the total of $5,000.00 in value, in all motor vehicles.
Hawaii Haw. Rev. Stat. § 651-121 (2)	One motor vehicle up to a value of $2,575 over and above all liens and encumbrances on the motor vehicle; provided that the value of the motor vehicle shall be measured by established wholesale used car prices customarily found in guides used by Hawaii motor vehicle dealers; or, if not listed in such guides, fair wholesale market value, with necessary adjustment for condition.
IDAHO	An individual is entitled to exemption, not exceeding two thousand five hundred dollars ($2,500) in

I.C. § 11-605 (3)	aggregate value, of implements, professional books, business equipment and tools of the trade; and to an exemption of one (1) motor vehicle to the extent of a value not exceeding seven thousand dollars ($7,000).
ILLINOIS 735 ILCS 5/12-1001 (c)	The debtor's interest, not to exceed $2,400 in value, in any one motor vehicle.
INDIANA	None.
IOWA IC 34-55-10-2 (b) (2)	The debtor's interest in one motor vehicle, not to exceed in value seven thousand dollars.
KANSAS K.S.A. 60-2304 (c)	Every person residing in this state shall have exempt from seizure and sale upon any attachment, execution or other process issued from any court in this state, the following Articles of personal property: Such person's interest, not to exceed $20,000 in value, in one means of conveyance regularly used for the transportation of the person or for transportation to and from the person's regular place of work, except that the value limitation specified in this subsection shall not apply when the means of conveyance is a vehicle designed or equipped, or both, for handicapped persons, as defined in K.S.A. 8-1,124 and amendments thereto. §60-2304(c).
KENTUCKY KRS § 427.010(1)	(1) The following personal property of an individual debtor resident in this state is exempt from execution, attachment, garnishment, distress or fee-bill: All household furnishings, jewelry, personal clothing and ornaments not to exceed three thousand dollars ($3,000) in value; tools, equipment and livestock, including poultry, of a person engaged in farming, not exceeding three thousand dollars ($3,000) in value; one (1) motor vehicle and its necessary accessories, including one (1) spare tire, not exceeding in the aggregate two thousand five hundred dollars ($2,500) in value; professionally prescribed health aids for the debtor, or a dependent of the debtor.
LOUISIANA La. Rev. Stat. Ann. 13:3881 (A) (2) 7 -8	(7) Seven thousand five hundred dollars in equity value for one motor vehicle per household used by the debtor and his family household for any purpose. The equity value of the motor vehicle shall be based on the NADA retail value for the particular year, make, and model. (8) Seven thousand five hundred dollars in equity value for one motor vehicle per household which vehicle is substantially modified, equipped, or fitted for the purposes of adapting its use to the physical disability of the debtor or his family and is used by the debtor or his family for the transporting of such disabled person for any use.
MAINE Me. Rev. Stat. Ann. tit. 14, § 4422 (2)	The debtor's interest, not to exceed $5,000 in value, in one motor vehicle.
MARYLAND	None.
Massachusetts Mass. Ann. Laws. ch. 235, § 34 (16)	An automobile necessary for the debtor's personal transportation or to secure or maintain employment, not exceeding $7,500 of wholesale resale value; provided, however, that the equitable value of a vehicle owned or substantially used by debtor who is either a handicapped person or a person 60 years of age or older shall be exempt up to $15,000 in wholesale resale value;
Michigan M. C. L. A. 600.5451(1)(g).	The interest, not to exceed $2,775.00 in value, in 1 motor vehicle.600.5451(1)(g).
Minnesota M. S. A. 550.37 subd. 12(a)	One motor vehicle to the extent of a value not exceeding $4,600; or one motor vehicle to the extent of a value not exceeding $46,000 that has been modified, at a cost of not less than $3,450, to accommodate the physical disability making a disabled person eligible for a certificate authorized by section 169.345.
MISSISSIPPI	None (but personal property exemptions allow 10.000,00 USD in categories which include vehicles)
MISSOURI M.R.S 513.430 (1) 5	Any motor vehicles, not to exceed three thousand dollars in value in the aggregate.
MONTANA Mont. Code Ann. §25-13-609 (2)	The judgment debtor's interest, not to exceed $2,500 in value, in one motor vehicle.
NEBRASKA Neb. Rev. Stat. 25-1556 (4)	No property hereinafter mentioned shall be liable to attachment, execution, or sale on any final process issued from any court in this state, against any person being a resident of this state (4) the debtor's interest, not to exceed an aggregate fair market value of two thousand four hundred

	dollars, in implements, tools, or professional books or supplies held for use in the principal trade or business of such debtor or his or her family, which may include one motor vehicle used by the debtor in connection with his or her principal trade or business or to commute to and from his or her principal place of trade or business (as part of tools of trade exemption).
NEVADA Nev. Rev. Stat. Ann. §21.090(1)(f), §21.090(1)(p).	Except as otherwise provided in paragraph (p), one vehicle if the judgment debtor's equity does not exceed $15,000 or the creditor is paid an amount equal to any excess above that equity.
New Hampshire N.H. Rev. Stat. §511:2 (XVI)	One automobile to the value of $4,000.
New Jersey	None.
New Mexico N. M. S. A. § 42-10-1	One motor vehicle in the amount of four thousand dollars ($4,000)
NEW YORK CPLR § 5205 (a) (8)	One motor vehicle not exceeding 4.425 dollars in value above liens and encumbrances of the debtor; if such vehicle has been equipped for use by a disabled debtor, then 11.025 dollars in value above liens and encumbrances of the debtor; provided, however, that this exemption for one motor vehicle shall not apply if the debt enforced is for child support, spousal support, maintenance, alimony or equitable distribution, or if the state of New York or any of its agencies or any municipal corporation is the judgment creditor.
NORTH CAROLINA N.C.G.S.A. § 1C-1601 (a) (3)	The debtor's interest, not to exceed three thousand five hundred dollars ($3,500) in value, in one motor vehicle.
N.C.G.S.A. § 1C-1601 (d)	Recent purchases. - The exemptions provided in subdivisions (2), (3), (4), and (5) of subsection (a) of this section are inapplicable with respect to tangible personal property purchased by the debtor less than 90 days preceding the initiation of judgment collection proceedings or the filing of a petition for bankruptcy, unless the purchase of the property is directly traceable to the liquidation or conversion of property that may be exempt and no additional property was transferred into or used to acquire the replacement property.
NORTH DAKOTA NDCC, 28-22-03. 1	A motor vehicle exemption in one vehicle not to exceed two thousand nine hundred fifty dollars in value over security interests and liens upon that vehicle, or a motor vehicle exemption in one vehicle not to exceed thirty-two thousand dollars for a motor vehicle that has been modified at a cost of not less than one thousand five hundred dollars to accommodate an individual with a permanent physical disability who is the owner of that motor vehicle.
OHIO O. R.C. § 2329.66 (A) (2)	The person's interest, not to exceed 3.775,00 dollars, in one motor vehicle.
OKLAHOMA 31 Okla. Stat. Ann. 1 (A)(13)	Such person's interest, not to exceed Seven Thousand Five Hundred Dollars ($7,500.00) in value, in one motor vehicle.
OREGON O.R.S. § 18.345 (1) (d)	A vehicle to the value of $3,000. As used in this paragraph vehicle includes an automobile, truck, trailer, truck and trailer or other motor vehicle.
Pennsylvania	NONE
Rhode Island R.I. Gen Laws §9-26-4(13)	Any and all motor vehicles owned by the debtor not to exceed an aggregate total of twelve thousand dollars ($12,000).
SOUTH CAROLINA Code 1976 § 15-41-30 (a) (2)	The debtor's interest, not to exceed five thousand dollars in value, in one motor vehicle.
SOUTH DAKOTA	None.
TENNESSEE	None.

Texas Tex. Prop. Code Ann. 41.002(a)(9).	a two-wheeled, three-wheeled, or four-wheeled motor vehicle for each member of a family or single adult who holds a driver's license or who does not hold a driver's license but who relies on another person to operate the vehicle for the benefit of the nonlicensed person.
UTAH Utah Code Ann. 78B-5-506 (3)	(2) An individual is entitled to an exemption, not exceeding $5,000 in aggregate value, of implements, professional books, or tools of the individual's trade, including motor vehicles to which no other exemption has been applied, and that are actually used by the individual in the individual's principal business, trade, or profession. (3) (a) As used in this Subsection (3), "motor vehicle" does not include any motor vehicle designed for or used primarily for recreational purposes, such as: (i) an off-highway vehicle as defined in Section 41-22-2, except a motorcycle the individual regularly uses for daily transportation; or (ii) a recreational vehicle as defined in Section 13-14-102, except a van the individual regularly uses for daily transportation. (b) An individual is entitled to an exemption, not exceeding $3,000 in value, of one motor vehicle. (4) This section does not affect property exempt under Section 78B-5-505.
Vermont Vt. Stat. Ann. tit. 12, chapter 111 subchapter 2 § 2740 (1)	The goods or chattels of a debtor may be taken and sold on execution, except the following Articles, which shall be exempt from attachment and execution, unless turned out to the officer to be taken on the attachment or execution, by the debtor: (1) the debtor's interest, not to exceed $2,500.00 in aggregate value, in a motor vehicle or motor vehicles.
VIRGINIA VA Code Ann. § 36-26 (8)	Motor vehicles, not held as exempt under subdivision 7, owned by the householder, not to exceed a total of $6,000 in value, except that a perfected security interest on a motor vehicle shall have priority over the claim of exemption under this subdivision.
Washington R.C.W. § 6.15.010 (1)(c)(B)(iii)	For an individual, a motor vehicle used for personal transportation, not to exceed three thousand two hundred fifty dollars or for a community two motor vehicles used for personal transportation, not to exceed six thousand five hundred dollars in aggregate value.
WEST VIRGINIA W. Va. Code, § 38-10-4 (b)	The debtor's interest, not to exceed two thousand four hundred dollars in value, in one motor vehicle.
WISCONSIN Wis. Stat. Ann. 815.18 (3) (g)	*Motor vehicles.* Motor vehicles not to exceed $4,000 in aggregate value. Any unused amount of the aggregate value from par. (d) may be added to this exemption to increase the aggregate exempt value of motor vehicles under this paragraph.
WYOMING Wyo Stat.§1-20-106(a)(iv)	The value in a motor vehicle not exceeding five thousand dollars ($5,000.00).§1-20-106(a)(iv).

12.4.3 State: wildcard exemptions

TABLE 2	**WILDCARD EXEMPTION**
STATE **local provision**	**DESCRIPTION**
ALABAMA Ala.Code 1975 § 6-10-6	The personal property of such resident, except for wages, salaries, or other compensation, to the extent of the resident's interest therein, to the amount of seven thousand five hundred dollars (**$7,500**) in value, to be selected by him or her, and, in addition thereto, all necessary and proper wearing apparel for himself or herself and family, all family portraits or pictures and all books used in the family shall also be exempt from levy and sale under execution or other process for the collection of debts. No wages, salaries, or other compensation shall be exempt except as provided in Section 5-19-15 or Section 6-10-7.
ALASKA	None.
ARIZONA	None.
Arkansas	The personal property of any resident of this State, who is not married or the head of a family, in

Ark. Const. Art. 9, § 1	specific Articles to be selected by such resident, not exceeding in value the sum of two hundred dollars **($ 200)**, in addition to his or her wearing apparel, shall be exempt from seizure on attachment, or sale on execution or other process from any court, issued for the collection of any debt by contract: provided, that no property shall be exempt from execution for debts contracted for the purchase money therefore while in the hands of the vendee.
Ark. Const. Art. 9, § 2	The personal property of any resident of this State, who is married or the head of a family, in specific Articles to be selected by such resident, not exceeding in value the sum of five hundred dollars **($ 500)**, in addition to his or her wearing apparel, and that of his or her family, shall be exempt from seizure on attachment, or sale on execution or other process from any court, on debt by contract.
CALIFORNIA 1	None.
CALIFORNIA 2 Cal.C.C.P. § 703.140 (B) (5) and (1)	The debtor's aggregate interest, not to exceed in value one thousand four hundred twenty-five dollars (**$1,425**) plus any unused amount of the exemption provided under paragraph (1 – homestead exemption -), in any property.
COLORADO	None.
Connecticut Conn. Gen Stat. Ann. §52-352b(r)	Any interest of the exemptioner in any property not to exceed in value one thousand dollars **($ 1,000)**.
DELAWARE Del. Code 10, § 4903.	Every person residing in this State, and being the head of a family, shall have exempt from execution or attachment process, in addition to the exemptions in § 4902 of this title, other personal property not exceeding **$500**, the Articles to be selected by the debtor. The exemptions in this section shall not apply to goods or chattels of a merchantable character bought to be sold and trafficked in by the person in the prosecution of the person's regular business or occupation. No person shall have exempt from execution or attachment process any personal property, excepting that which is expressly exempted by § 4902 of this title when such exemption would prevent the collection according to law of any debt or claim that may be due or growing due for labor or services (other than professional services) rendered by any clerk, mechanic, laborer, or other employee of any person or persons against whom such execution or attachment process may be issued.
District of Columbia § 15-501 (a) (3)	the debtor's aggregate interest in any property, not to exceed $850 in value, plus up to $8,075 of any unused amount of the exemption provided under paragraph (14) of this subsection.
FLORIDA	None.
GEORGIA Ga. Code Ann., § 44-13-100 (a) (6)	The debtor's aggregate interest, not to exceed **$1,200.00** in value plus any unused amount of the exemption, not to exceed **$10,000.00**, provided under paragraph (1) of this subsection, in any property.
Hawaii	None.
IDAHO I.C. § 55-1001 (11-605 (10))	An individual's aggregate interest in any tangible personal property, not to exceed the value of eight hundred dollars (**$800**).
ILLINOIS 735 ILCS 5/12-1001 (b)	The debtor's equity interest, not to exceed **$ 4.000,00** in value, in any property.
INDIANA IC 34-55-10-2 (c) (2)/(3)	$10.250 non-residential property.
IOWA I.C.A. § 627.6 (14)	The debtor's interest, not to exceed one thousand dollars **($ 1,000)** in the aggregate, in any cash on hand, bank deposits, credit union share drafts, or other deposits, wherever situated, or in any other personal property whether otherwise exempt or not under this chapter.
KANSAS	None.
KENTUCKY KRS § 427.160	Solely for the purpose of applying the provisions of 11 U.S.C. sec. 522(b)(3)(A) in a federal bankruptcy proceeding, in addition to other exemptions provided in this chapter and only to the extent otherwise allowed by applicable federal law, every debtor shall have a general exemption not to exceed one thousand dollars (**$1,000**) in value to be applied toward any property, real or

	personal, tangible or intangible in his estate when he or she has filed for bankruptcy under the provisions of The Bankruptcy Code of 1978, 92 Stat. 2549 (1978), Public Law 95-598, as amended.
LOUISIANA	None.
MAINE Me. Rev. Stat. Ann. tit. 14, § 4422 (15)	The debtor's aggregate interest, not to exceed in value **$400**, in any property, whether or not otherwise exempt under this section.
Me. Rev. Stat. Ann. tit. 14, § 4422 (16)	The debtor's interest, equal to any unused amount of the exemption provided under subsection 1 but not exceeding **$6,000**, in any property exempt under subsections 3 and 5 and subsection 14, paragraph D. - unused homestead exemption-.
MARYLAND Md. Code § 11-504(b)(5)	Cash or property of any kind equivalent in value to **$ 6,000** is exempt, if within 30 days from the date of the attachment or the levy by the sheriff, the debtor elects to exempt cash or selected items of property in an amount not to exceed a cumulative value of **$ 6,000**.
Md. Code § 11-504(f)(1)(i)(1)	In addition to the exemptions provided in subsection (b) of this section, and in other statutes of this State, in any proceeding under Title 11 of the United States Code, entitled "Bankruptcy", any individual debtor domiciled in this State may exempt the debtor's aggregate interest in personal property, up to **$ 5,000.**
Massachusetts Mass. Ann. Laws. ch. 235, § 34(17)	The debtor's aggregate interest in any personal property, not to exceed **$1,000** in value, plus up to **$5,000** of any unused dollar amount of the aggregate exemptions provided under clauses Second, Fifth and Sixteenth.
Michigan	None.
Minnesota	None
MISSISSIPPI Miss. Code Ann. §85-3-1 (h)	In addition to all other exemptions listed in this section, there shall be an additional exemption of property having a value of Fifty Thousand Dollars (**$ 50,000.00**) of whatever type, whether real, personal or mixed, tangible or intangible, including deposits of money, available to any Mississippi resident who is seventy (70) years of age or older.
MISSOURI M.R.S. 513.430 (3)	Any other property of any kind, not to exceed in value six hundred dollars **($ 600)**, in the aggregate.
M.R.S. 513.440	Each head of a family may select and hold, exempt from execution, any other property, real, personal or mixed, or debts and wages, not exceeding in value the amount of one thousand two hundred fifty dollars **($ 1,250)** plus three hundred fifty dollars **($ 350)**, for each of such person's unmarried dependent children under the age of twenty-one years or dependent as defined by the Internal Revenue Code of 1986, as amended, determined to be disabled by the Social Security Administration, except ten percent of any debt, income, salary or wages due such head of a family.
MONTANA	None.
NEBRASKA Neb. Rev. St. §25-1552.	Each natural person residing in this state shall have exempt from forced sale on execution the sum of two thousand five hundred dollars **($ 2,500)** in personal property, except wages. The provisions of this section do not apply to the exemption of wages, that subject being fully provided for by section 25-1558. In proceedings involving a writ of execution, the exemption from execution under this section shall be claimed in the manner provided by section 25-1516. The debtor desiring to claim an exemption from execution under this section shall, at the time the request for hearing is filed, file a list of the whole of the property owned by the debtor and an indication of the items of property which he or she claims to be exempt from execution pursuant to this section and section 25-1556, along with a value for each item listed. The debtor or his or her authorized agent may select from the list an amount of property not exceeding the value exempt from execution under this section according to the debtor's valuation or the court's valuation if the debtor's valuation is challenged by a creditor.
NEVADA N.R.S. §21.090(z)	Any personal property not otherwise exempt from execution pursuant to this subsection belonging to the judgment debtor, including, without limitation, the judgment debtor's equity in any property, money, stocks, bonds or other funds on deposit with a financial institution, not to exceed **$1,000** in total value, to be selected by the judgment debtor.
New Hampshire	The debtor's interest in any property, not to exceed **$1,000** in value, plus up to **$7,000** of any unused amount of the exemptions provided under paragraphs III, VI, VIII, IX, XVI, and XVII of this

N.H. Rev. Stat. §511:2 (XVIII)	section. (food, fuel, furniture, motor vehicle, tools of trade).
New Jersey N.J. Stat. Ann. 2A 17-19	Goods and chattels, shares of stock or interests in any corporation and personal property of every kind, not exceeding in value, exclusive of wearing apparel, $1,000.00, and all wearing apparel, the property of a debtor shall be reserved, both before and after his death, for his use or that of his family or his estate, and shall not be liable to be seized or taken by virtue of any execution or civil process whatever, issued out of any court of this State. Nothing herein contained shall be deemed or held to protect from sale under execution or other process any goods, chattels or property, for the purchase whereof the debt or demand for which the judgment on which such execution or process was issued, shall have been contracted, or to apply to process issued for the collection of taxes or assessments.
New Mexico N. M. S. A. § 42-10-1	Personal property in the amount of five hundred dollars **($500)**.
N. M. S. A. § 42-10-10	Any resident of this state who does not own a homestead shall in addition to other exemptions hold exempt real or personal property in the amount of five thousand dollars **($5,000)** in lieu of the homestead exemption.
NEW YORK CPLR § 5205 (9)	if no homestead exemption is claimed, then one thousand dollars **($ 1,000)** in personal property, bank account or cash.
NORTH CAROLINA N.C.G.S.A. § 1C-1601 (a) (2)	The debtor's aggregate interest in any property, not to exceed five thousand dollars **($5,000)** in value of any unused exemption amount to which the debtor is entitled under subdivision (1) of this subsection.
N.C. Const. Art. X, § 1	The personal property of any resident of this State, to a value fixed by the General Assembly but not less than **$500**, to be selected by the resident, is exempted from sale under execution or other final process of any court, issued for the collection of any debt.
NORTH DAKOTA NDCC, 28-22-03	In addition to the absolute exemptions mentioned in section 28-22-02, except in subsection 8 thereof, the head of a family, personally or by his agent, may select from his other personal property, any goods, chattels, merchandise, money, and other personal property not exceeding in value the sum of five thousand dollars **($ 5,000)** which also is exempt from all attachment or mesne process, levy and sale upon execution, and any other final process issued from any court.
NDCC, 28-22-05	In addition to the absolute exemptions mentioned in section 28-22-02, except in subsection 8 thereof, a single person, in person or by his agent, may select from his other personal property, goods, chattels, merchandise, money, or other personal property not exceeding in value the sum of two thousand five hundred dollars **($2,500),** which is exempt.
NDCC, 28-22-03.1 (1)	In lieu of the homestead exemption, up to ten thousand dollars **($10,000).** This exemption is not available if the resident exemption claimant, the spouse of the resident exemption claimant, or other head of the family of the resident exemption claimant has chosen the homestead exemption provided for under subsection 7 of section 28-22-02.
OHIO O.R.C. § 2329.66 (A) (18)	The person's aggregate interest in any property, not to exceed 1250 dollars except that division (A)(18) of this section applies only in bankruptcy proceedings.
OKLAHOMA	None.
OREGON O.R.S. § 18.345 (1) (p)	The debtors interest, not to exceed **$400** in value, in any personal property. However, this exemption may not be used to increase the amount of any other exemption.
Pennsylvania P.A. Cons. Stat. 42-8123	In addition to any other property specifically exempted by this subchapter, property of the judgment debtor (including bank notes, money, securities, real property, judgments or other indebtedness due the judgment debtor) to the value of **$300** shall be exempt from attachment or execution on a judgment. Within such time as may be prescribed by general rules the judgment debtor may claim the exemption in kind and may designate the specific items of property to which the exemption provided by this section shall be applicable unless the designated property is not capable of appropriate division, or the judgment debtor may claim the exemption in cash out of the proceeds of the sale. **(b) Exception.--**Subsection (a) shall not apply to any judgment:(1) For support.(2) Debtor who is not an individual.(3) Obtained for board for four weeks or less.(4) For $100 or less obtained for wages for manual labor.(5) Obtained in foreclosing a mortgage secured upon real property whether the judgment is by an action in

	mortgage foreclosure or an action on a note, bond or other evidence of indebtedness accompanying a mortgage. The exception to the general monetary exemption provided for in this paragraph shall be limited to the real property secured by the mortgage. The exception shall not apply to any deficiency judgment.**(c) Executions issued by minor judiciary.--**As to executions issued by the minor judiciary the amount of the exemption specified in subsection (a) shall be reduced by the value of any real or personal property of the judgment debtor which is generally subject to attachment or execution but which by law is not subject to attachments or executions issued by the minor judiciary.
Rhode Island R.I. Gen Laws §9-26-4(16)	In addition to the exemptions herein, a debtor in bankruptcy may exempt an additional six thousand five hundred dollars **($6,500**) in any assets.
SOUTH CAROLINA Code 1976 § 15-41-30 (a) (7)	The debtor's aggregate interest in any property, not to exceed five thousand dollars **($5,000)** in value of an unused exemption amount to which the debtor is entitled pursuant to subsection (A), items (1) through (6).
SOUTH DAKOTA SDCL § 43-45-4	In addition to the property provided for in §§ 43-45-2 and 43-45-3, the debtor, if the head of a family, may, personally, or by agent or attorney, select from all other of the debtor's personal property, not absolutely exempt, goods, chattels, merchandise, money, or other personal property not to exceed in the aggregate seven thousand dollars **($ 7.000)** in value; and, if not the head of a family, property as aforesaid of the value of five thousand dollars, which is also exempt, and which shall be chosen and appraised as provided by law.
TENNESSEE T. C. A. § 26-2-103	(a) Personal property to the aggregate value of ten thousand dollars ($10,000) debtor's equity interest shall be exempt from execution, seizure or attachment in the hands or possession of any person who is a bona fide citizen permanently residing in Tennessee, and such person shall be entitled to this exemption without regard to the debtor's vocation or pursuit or to the ownership of the debtor's abode. Such person may select for exemption the items of the owned and possessed personal property, including money and funds on deposit with a bank or other financial institution, up to the aggregate value of ten thousand dollars ($10,000) debtor's equity interest. (b) An item shall not be eligible, in whole or in part, for the personal property exemption provided by this part, if the item has been purchased with or maintained by fraudulently obtained funds or if ownership of the item has been maintained using fraudulently obtained funds. A court shall be required to find by a preponderance of the evidence that an item was purchased with or maintained by funds obtained by defrauding another person or that ownership of an item was maintained by funds obtained by defrauding another person in order to disqualify the item from eligibility for the personal property exemption.
Texas	None.
UTAH	None.
Vermont Vt. Stat. Ann. tit. 12, chapter 111 subchapter 2 § 2740 (7)	the debtor's aggregate interest in any property, not to exceed $400.00 in value, plus up to **$7,000.00** of any unused amount of the exemptions provided under subdivisions (1), (2), (4), (5) and (6) of this section; - motor vehicle, tools of trade, jewelry, household furniture, appliances, clothing, & crops -.
VIRGINIA VA Code Ann. § 34-4.1	Every veteran residing in this Commonwealth having a service connected disability of forty percent or more, as rated by the U.S. Department of Veterans Affairs, shall be entitled, in addition to the property or estate which he is entitled to hold exempt from creditor process under §§ 34-4, 34-26, 34-27, 34-29, and 64.2-311, to hold exempt from creditor process his real and personal property, or either, to be selected by him by the writings required by §§ 34-6 and 34-14, including money and debts due him, not exceeding **$10,000** in value.
VA Code Ann. § 34-13	If the householder does not set apart any real estate as before provided, or if what he does or has so set apart is not of the total value which he is entitled to hold exempt, he may, in addition to the property or estate which he is entitled to hold exempt under §§ 34-26, 34-27, 34-29, and 64.2-311, in the first case select and set apart by the writing required by § 34-14 to be held by him as exempt under §§ 34-4 and 34-4.1, so much of his personal estate as shall not exceed the total value which he is entitled to hold exempt and, in the latter case, personal estate, the value of which, when added to the value of the real estate set apart, does not exceed such total value.

Washington R.C.W. § 6.15.010 (1)(c)(ii)	To each individual or, as to community property of spouses maintaining a single household as against a creditor of the community, to the community: […] Other personal property, except personal earnings as provided under RCW 6.15.050(1), not to exceed three thousand dollars in value, of which not more than one thousand five hundred dollars **($500)** in value may consist of cash, and of which not more than: (I) For debts owed to state agencies, two hundred dollars **($200)** in value may consist of bank accounts, savings and loan accounts, stocks, bonds, or other securities. The maximum exemption under (c)(ii)(A) of this subsection may not exceed two hundred dollars, regardless of the number of existing separate bank accounts, savings and loan accounts, stocks, bonds, or other securities.(II) For all other debts, five hundred dollars in value may consist of bank accounts, savings and loan accounts, stocks, bonds, or other securities. The maximum exemption under (c)(ii)(B) of this subsection may not exceed five hundred dollars, regardless of the number of existing separate bank accounts, savings and loan accounts, stocks, bonds, or other securities.(B) After January 1, 2018: For all debts, five hundred dollars in value may consist of bank accounts, savings and loan accounts, stocks, bonds, or other securities. The maximum exemption under this subsection (1)(c)(ii)(B) may not exceed five hundred dollars, regardless of the number of existing separate bank accounts, savings and loan accounts, stocks, bonds, or other securities;(iii) For an individual, a motor vehicle used for personal transportation, not to exceed three thousand two hundred fifty dollars or for a community two motor vehicles used for personal transportation, not to exceed six thousand five hundred dollars in aggregate value;(iv) Any past due, current, or future child support paid or owed to the debtor, which can be traced;(v) All professionally prescribed health aids for the debtor or a dependent of the debtor; and(vi) To any individual, the right to or proceeds of a payment not to exceed twenty thousand dollars on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent; or the right to or proceeds of a payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor. The exemption under this subsection (1)(c)(vi) does not apply to the right of the state of Washington, or any agent or assignee of the state, as a lienholder or subrogee under RCW 43.20B.060.
WEST VIRGINIA W. Va. Code, § 38-10-4 (e)	The debtor's interest, not to exceed in value eight hundred dollars **($ 800)** plus any unused amount of the exemption provided under subsection (a) of this section in any property
Wisconsin	None.
WYOMING	None.

12.4.4 A selection of state personal property exemptions

KEY to personal property exemptions tables	
For printing reasons the table has been split into three sections. The third includes tools of trade or, in general, assets connected to the debtor's professional or business activities; the first and second mostly personal property. The three blocks are originally part of a single spreadsheet and, if, placed together, show left to right the different groups of exemptions and the value exempted under each category.	
State	Sate that DID NOT opt out
STATE	**STATE THAT OPTED OUT**
(12) + M	the quantity necessary over the number (for example 12) of MONTHS determined in the law is exempted
***;";^**	the amount is available for different categories of items which are part of different groups presenting the same symbol
400/8000	the first number is the maximum amount per item; the second the total value that is available to be exempted
X	the exemption is available in some way but cannot easily be placed in the table
P.I.	dollar amount allowed "Per Item"

STATE EXEMPTIONS PERSONAL PROPERTY TABLE 1	heirlooms	food/water	Fuel	clothing/ storage containers	household goods/ furnishing /appliances	type writer/ computer/tv/ radio	building materials	health aids	musical instruments	engagement/ wedding ring	jewelry/ watches	books/ school books/ library	pictures/ portraits	Bible	Church pew	burial plot /crypts/grave stones/ coffins	pets/animals	weapons (rifles; pistols; guns…)
ALABAMA				X								X	x		x	x		
ALASKA	$4500*			$4500*	$4500*		x	x	$4500*		$1350	$4500*				x	$1.350	
ARIZONA		6 M	6 M	$500		$1.000*		x	$400	$2.000	$150	$250		$1.000*		$1.000*	$800	$1.000*
Arkansas				X						x						x		
CALIFORNIA 1	$8.000*	x	X		x		$3.200				$8.000*					x		
CALIFORNIA 2				$675* P.I.	$675* P.I.			x	$675* P.I.		$1.600	$675* P.I.				x	$675* P.I.	
COLORADO		$600^	$600^	$2.000	$3.000			x			$2.500	$2.000*	$2.000*			x		
Connecticut		x		X	x			x				X				x		
DELAWARE				X					x		x	X	x	x	x	x		
District of Columbia		3 M		$425/ $8.625*	$425/ $8.625*			x	$425/ $8.625*			$400^	$400^			x	$425/ $8.625*	
FLORIDA								x										
GEORGIA				$300/ $5.000*	$300/ $5.000*			x	$300/ $5.000*		$500	$300/ $5.000*				x	$300/ $5.000*	
Hawaii					x						$1.000	X				x		
IDAHO	$750/ $7.500*	12 M		$750/ $7.500*	$750/ $7.500*		x	x	$750/ $7.500*		$1.000	$750/ $7.500*	$750/ $7.500*			x	$750/ $7.500*	$750
ILLINOIS				X				x				x		x				
INDIANA								x										
IOWA				$7.000^	$7.000^			x	$7.000^		$2.000	$1.000*	$1.000*	$1.000*		x		x
KANSAS		12 M	12M	12 M	x						$1.000					x		
KENTUCKY				$3.000*	$3.000*			x			$3.000*					$5.000		
LOUISIANA					x				x	$5.000			x			x	x	x
MAINE		6 M		$200 P.I.*	$200 P.I.*			x	$200 P.I.*		$750					x	$200 P.I.*	
MARYLAND				1000*	1000*			x				$1.000*				x	$1.000*	
Massachusetts		$600			$15.000	$300					$1.225	$500*		$500*	x	x	x	
Michigan		6 M	6 M	X	$600/ $3.775*	$650		x				$600/ $3.775*	x		$650	x	$650	
Minnesota		x		X	10350*	10350*				$2.817,5	$10.350*	x		x	x	x		
MISSISSIPPI				$200/ $10.000*	$200/ $10.000*	$200/ $10.000*		$200/ $10.000*		$200/ $10.000*		$200/ $10.000*					$200/ $10.000*	$200/ $10.000*
MISSOURI				$3.000*	$3.000*			x	$3.000*	$1.500	$500	$3.000*				$100	$3.000*	
MONTANA				$600/ $4.500*	$600/ $4.500*			x			$600/ $4.500*	$600/ $4.500*				x	$600/ $4.500*	$600/ $4.500*

NEBRASKA				X	$1.500*	$1.500*		x	$1.500*			$1.500*				x		
NEVADA				$12.000*	$12.000*			x	$5.000^		$5.000^	$5.000^				x		1 GUN
New Hampshire		$400*	$400*	X	x	x					$500				x	x	x	
New Jersey				X	1000											x		
New Mexico				X	x		x	x			$2.500	x						
New York				$1.100*/ $11.025	$1.100*/ $11.025	$1.100*/ $11.025		x		$1.100^/ $11.025	$1.100^/ $11.025	$550°/ $11.025		$550° / $11.025	x	x	x	
NORTH CAROLINA								x								$18.500		
NORTH DAKOTA		12 M		X								x	x	x	x	x		
OHIO					$600/ $12.625*			x	$600/ $12.625*		$600/ $12.625*	$600/ $12.625*				x	$600/ $12.625*	$600/ $12.625*
OKLAHOMA		12 M		$4.000	x			x		$3.000		x	x			x		$2.000
OREGON		2 M	2 M	$1.800^	$3.000°	$3.000°	x	x	$600*		$1.800^	$600*	$600*			x	$1.000	$1.000
Pennsylvania				X								x		x				
Rhode Island				X	$9.600						$2.000	$300*		$300*		x		
SOUTH CAROLINA				$4.600*	$4.600*			x	$4.600*		$1.175					$58.255	$4.600*	
SOUTH DAKOTA		12 M	12 M	X				x				$200*	x	$200*	x	x		
TENNESSEE				X				x				x	x	x		x		
Texas	x	x		X	x						x			x		x		2 firearms
UTAH		12 M		X	x			x	1000*			1000*				x	$1.000*	$250
Vermont				$2.500*	$2.500*	x		x	$2.500*	x	$500	$2.500*					$2.500*	
VIRGINIA	$5.000			$1.000	$5.000			x		x			$5.000*	x		x	x	$3.000
Washington		x	X	X	$750/ $6.500	$3.500*		x			$3.500*	$3500*				x		
WEST VIRGINIA				$400/ $8.000*				x	$400/ $8.000*		$1.000	$400/ $8.000*				x	$400/ $8.000*	
Wisconsin				$12.000*	$12.000*				$12.000*			$12.000*		$12.000*		x	$12.000*	$12.000*
WYOMING		$4.000*		$2.000^	$4.000*					$2.000^		x	x	x		x		

STATE EXEMPTIONS PERSONAL PROPERTY Tools of trade TABLE 2	tools of trade (implements, professional books[1727])	fishing boat/nets/ privileges	farm animals	agricultural/ farming machinery	mining equipment
ALABAMA	**X**				
ALASKA	**$ 3.780**	x			
ARIZONA	**X**		**$2.500°**	**$2.500°**	
Arkansas	**X**				
CALIFORNIA 1	**X**				
CALIFORNIA 2	**X**				
COLORADO	**X**		**$50.000"**	**$50.000"**	
Connecticut	**X**		x		
DELAWARE	**X**				
District of Columbia	**X**				
FLORIDA					
GEORGIA	**$1.500**		**$300/5$.000***		
Hawaii	**X**	x			
IDAHO	**X**				
ILLINOIS	**$1.500**				
INDIANA	**X**				
IOWA	**X**			**$10.000**	
KANSAS	**$7.500**				
KENTUCKY	**X**		**$3.000**		
LOUISIANA					
MAINE	**X**	x		x	
MARYLAND	**X**				
Massachusetts	**X**	**$1.500**		**$5.000**	
Michigan	**$2.525**				
Minnesota	**X**			**$3.000**	
MISSISSIPPI	**$200/$10.000***				
MISSOURI	**$3.000**				
MONTANA	**$3.000**				
NEBRASKA	**$2.400**				
NEVADA	**X**			**$4.500**	**$4.500**
New Hampshire	**X**			x	

[1727] In Alabama, arms and uniforms or Army.

New Jersey					
New Mexico	**$1.500**				
New York	**X**			**x**	
NORTH CAROLINA	**$2.000**				
NORTH DAKOTA	**$1.500**				
OHIO	**$2.400**				
OKLAHOMA	**$10.000**				
OREGON	**$5.000**				
Pennsylvania	**X**				
Rhode Island	**X**				
SOUTH CAROLINA	**$1.750**				
SOUTH DAKOTA					
TENNESSEE	**$1.900**				
Texas	**X**	**x**		**x**	
UTAH	**$5.000**				
Vermont	**$5.000**				
VIRGINIA	**X**			**x**	
Washington	**X**			**$10.000**	
WEST VIRGINIA	**$1.500**				
Wisconsin	**$15.000**				
WYOMING	**$8.000**				

13. Discharge

Discharge is the Holy Grail that awaits the honest debtor at the end of the bankruptcy quest.

It is the main factor in pushing a debtor to file for relief.[1728] Moreover, as we have already discussed in the historical overview of American statutes, this is the feature that made the difference among state and federal statutes.

Federal statutes were advocated as necessary, in fact, as they allowed relief to operate cross-border without causing issues of recognition.

Obtaining discharge upon the conclusion of a bankruptcy proceeding allows the debtor to forget about several obligations (debts, not liens[1729]) that could not be satisfied through the distribution of the available assets in the estate. Such privilege a is made available to "worthy" debtors only; those that have complied with the rules and the policies of the Code without taking undue advantage of the bankruptcy system. Frauds lose of this valuable benefit.

Different Chapters of Title 11 make discharge available in different forms; the requirements to achieve it also vary greatly. Hence, a petitioner who may be allowed to file under more than one Chapter will be more inclined to do it under the one that will make discharge more easily available or that, in general, will award greater relief. Not all that glitters is gold, though. Excessive strategic thinking may cause harm and harsh consequences.

Section 707 (b), through its test, limits filing in all those cases in which individuals, tempted by the easy discharge offered in Chapter 7 liquidations, refrain from going through a fairer reorganization of their finances, hence damaging creditors.

Moreover, several rules, some of which were recently enacted, attempt to prevent abuses and punish those who take advantage of bankruptcy protections. The ending result can be harsh. A dishonest debtor can find himself out of bankruptcy, dispossessed of non-exempt assets, which would have been liquidated by the trustee and sold for the benefit of the creditors, without any protections against those who still hold a claim. The protections of the stay in section § 524 would not, in fact, be available and creditors would be allowed to continue their attempts to recover.

Some limits are imposed on discharges. Not all debts can be erased, even when an honest debtor obtains relief. Specific policies have been enacted through the Code in order to protects some claims which are supported by relevant public policies.

As a last remark, it is interesting to point out that discharge is personal; it does not protect co-obligated debtors.

13.1 Different discharge frameworks depending on the Chapter

The different Chapters of the Code contain different discharge frameworks. Requirements to obtain it vary and so do the outcomes. It is interesting to have a quick overview of the main differences existing among the four main Chapters of the Bankruptcy Code (7, 11, 12, 13), while keeping in mind that under each, discharge may be awarded in full or denied or successively revoked in case of misconduct.

13.1.1 Chapter 7

Discharge in Chapter 7 is made available to individuals only and not to corporations or partnerships[1730], a good incentive for entities to pursue a Chapter 11 reorganization whenever possible.

Not all individuals may be discharged at the end of the case, though. § 727 (a) (2) states the following, further reasons to deny discharge[1731]:

[1728] See the FAQs published by the District Court of Hawaii on Credit Counseling and Debtor Education requirements which at page 3 state eloquently that "The discharge is why you filed for bankruptcy", at: http://www.hib.uscourts.gov/forms/packages/CreditCounselingDebtorEd.pdf

[1729] **Johnson v. Home State Bank**, 501 U.S. (1991).

[1730] § 727 (a) (1) "The Court shall grant the debtor a discharge, unless a) the debtor is not an individual".

[1731] See FRBP § 7001 on the need for a party in interest to file a motion for dismissal of discharge : "An adversary proceeding is governed by the rules of this Part VII. The following are adversary proceedings:

(1) a proceeding to recover money or property, other than a proceeding to compel the debtor to deliver property to the trustee, or a proceeding under §554(b) or §725 of the Code, Rule 2017, or Rule 6002;

i) **The debtor acted maliciously with intent to "hinder, delay, or defraud the creditors"[1732]**: we already discussed the history and modern application of the "hinder, delay, or defraud" prong in UFTA and the Code. In this section, the Code mentions specifically the acts of intentionally removing, destroying, mutilating, concealing, or transferring property of the debtor within one year before the date of filing, or property of the estate post-filing. Of course, if the debtor's actions begin before one year but maliciously continue over time they are still punishable.

The destruction, mutilation, or concealment of property obviously goes in the "not to do" list. We have also already discussed the consequences of fraudulent conversions of assets from non-exempted ones to exempted ones. Since the debtor is allowed to have a chance to a fresh start but not a "head start", such behavior is also prohibited if it is in violation of the rules of the Code or made with the intent to hinder, delay, or defraud creditors.

ii) **The debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers** [1733]: not maintaining current and correct records is a traditional misbehavior in bankruptcy. It burdens the administrators that find themselves in a difficult position trying to recreate the history of the debtor's transactions and affects the creditors negatively;

iii) **Fraudulent behavior[1734]:** the debtor knowingly and fraudulently made false oaths or accounts; withheld documents, books or records; tried to obtain an unfair advantage; or presented or used a false claim – all elements that constitute her intention to avail herself of the protections granted through bankruptcy while damaging the creditors;

iv) **failure to justify satisfactorily the loss or deficiency of assets[1735];**

v) **refusal to comply with court orders or to cooperate[1736];**

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(2) a proceeding to determine the validity, priority, or extent of a lien or other interest in property, other than a proceeding under Rule 4003(d);

(3) a proceeding to obtain approval under §363(h) for the sale of both the interest of the estate and of a co-owner in property;

(4) a proceeding to object to or revoke a discharge, other than an objection to discharge under §§727(a)(8),1 (a)(9), or 1328(f);

(5) a proceeding to revoke an order of confirmation of a Chapter 11, Chapter 12, or Chapter 13 plan;

(6) a proceeding to determine the dischargeability of a debt;

(7) a proceeding to obtain an injunction or other equitable relief, except when a Chapter 9, Chapter 11, Chapter 12, or Chapter 13 plan provides for the relief;

(8) a proceeding to subordinate any allowed claim or interest, except when a Chapter 9, Chapter 11, Chapter 12, or Chapter 13 plan provides for subordination;

(9) a proceeding to obtain a declaratory judgment relating to any of the foregoing; or

(10) a proceeding to determine a claim or cause of action removed under 28 U.S.C. §1452."

[1732] §727 (a) (2) (A) and (B): "the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed (A) property of the debtor, within one year before the date of the filing of the petition; or (B) property of the estate, after the date of the filing of the petition".

[1733] § 727 (a) (3): "the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case".

[1734] § 727 (a) (4): "the debtor knowingly and fraudulently, in or in connection with the case

(A) made a false oath or account;

(B) presented or used a false claim;

(C) gave, offered, received, or attempted to obtain money, property, or advantage, or a promise of money, property, or advantage, for acting or forbearing to act; or

(D) withheld from an officer of the estate entitled to possession under this title, any recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs".

[1735] § 727 (a) (5) "the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities.

vi) **any of the actions above committed in connection with a case concerning an insider**[1737]**;**

vii) **the debtor has been granted a previous discharge in Chapter 7 or 11 within a specified time**[1738]**:** BAPCPA additions to the Code extended the bar to eight years between the filing of the first petition and the filing of the second one;

viii) **the debtor has been granted a previous discharge in a reorganization Chapter 12 or 13**[1739]**:** within six years (two less than in the previous instance, hence encouraging filing under Chapter 13). Exceptions apply in the case that a minimum quota of payments determining the "success" of the reorganization was reached. No issue arises if 100% of the unsecured claims were paid (good faith is implied in the positive result of the reorganization). If the debtor reaches the quota of at least 70% payment for unsecured payments, the debtor will not suffer the consequences of the bar if the plan was proposed and executed in good faith and with the debtor's best effort;

ix) **the debtor waives discharge and the court approves**[1740]: debtors are allowed to waive discharge, which means they would remain liable for all outstanding pre-petition debts. It is a different situation than the one found in section § 524 (c)[1741], which allows a debtor to reaffirm a single debt

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[1736] § 727 (a) (6) "the debtor has refused, in the case

(A) to obey any lawful order of the court, other than an order to respond to a material question or to testify;

(B) on the ground of privilege against self-incrimination, to respond to a material question approved by the court or to testify, after the debtor has been granted immunity with respect to the matter concerning which such privilege was invoked; or

(C) on a ground other than the properly invoked privilege against self-incrimination, to respond to a material question approved by the court or to testify.

[1737] § 727 (a) (7) "the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider".

[1738] § 727 (a) (8): "the debtor has been granted a discharge under this section, under section 1141 of this title, or under section 14, 371, or 476 of the Bankruptcy Act, in a case commenced within 8 years before the date of the filing of the petition".

[1739] § 727 (a) (9): "the debtor has been granted a discharge under section 1228 or 1328 of this title, or under section 660 or 661 of the Bankruptcy Act, in a case commenced within six years before the date of the filing of the petition, unless payments under the plan in such case totaled at least

(A) 100 percent of the allowed unsecured claims in such case; or

(B) (i) 70 percent of such claims; and (ii) the plan was proposed by the debtor in good faith, and was the debtor's best effort".

[1740] § 727 (a) (10): "the court approves a written waiver of discharge executed by the debtor after the order for relief under this Chapter".

[1741] "An agreement between a holder of a claim and the debtor, the consideration for which, in whole or in part, is based on a debt that is dischargeable in a case under this title is enforceable only to any extent enforceable under applicable nonbankruptcy law, whether or not discharge of such debt is waived, only if

(1) such agreement was made before the granting of the discharge under section 727, 1141, 1228, or 1328 of this title;

(2) the debtor received the disclosures described in subsection (k) at or before the time at which the debtor signed the agreement;

(3) such agreement has been filed with the court and, if applicable, accompanied by a declaration or an affidavit of the attorney that represented the debtor during the course of negotiating an agreement under this subsection, which states that— **(A)** such agreement represents a fully informed and voluntary agreement by the debtor; **(B)** such agreement does not impose an undue hardship on the debtor or a dependent of the debtor; and **(C)** the attorney fully advised the debtor of the legal effect and consequences of— **(i)** an agreement of the kind specified in this subsection; and **(ii)** any default under such an agreement;

(4) the debtor has not rescinded such agreement at any time prior to discharge or within sixty days after such agreement is filed with the court, whichever occurs later, by giving notice of rescission to the holder of such claim;

(5) the provisions of subsection (d) of this section have been complied with; and

(6) **(A)** in a case concerning an individual who was not represented by an attorney during the course of negotiating an agreement under this subsection, the court approves such agreement as— **(i)** not imposing an undue hardship on the debtor or a dependent of the debtor; and (ii) in the best interest of the debtor. (B) Subparagraph (A) shall not apply to the extent that such debt is a consumer debt secured by real property."

(effectively waiving the discharge of that single debt) while imposing a number of safeguards to ensure the debtor is not coerced into the agreement (agreement is in writing and filed with the court; the debtor is informed "clearly and conspicuously in writing"[1742]; the debtor has a right to rescind the agreement within 60 days, etc...);

x) **the debtor fails to comply with the instruction financial management counseling course requirements[1743]:** we have already discussed the topic of credit counseling.[1744] This last course is less extensive than the first and may be waived in some circumstances. The courses are not free;

xi) **a case under § 522 (q)[1745], regarding criminal convictions, is pending; or the court finds elements of § 522 (q)**[1746]: Discharge under Chapter 7 may be revoked by the court with notice and an opportunity for a hearing[1747] in the following instances upon finding: that it had been awarded due to fraud; that the debtor acquired or became entitled to property of the estate without reporting such acquisition or that he committed any acts specified in sections (a) (6); or for failure of making available the necessary books accounts or financial records.[1748]

1742 § 544 (k) (2).

1743 § 727 (a) (11): "After filing the petition, the debtor failed to complete an instructional course concerning personal financial management described in section 111, except that this paragraph shall not apply with respect to a debtor who is a person described in section 109(h)(4) or who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved instructional courses are not adequate to service the additional individuals who would otherwise be required to complete such instructional courses under this section (The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in this paragraph shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually thereafter.)"

[1744] See in this Chapter section 11.5.

[1745] "(1) As a result of electing under subsection (b)(3)(A) to exempt property under State or local law, a debtor may not exempt any amount of an interest in property described in subparagraphs (A), (B), (C), and (D) of subsection (p)(1) which exceeds in the aggregate $160,375 if— (A) the court determines, after notice and a hearing, that the debtor has been convicted of a felony (as defined in section 3156 of title 18), which under the circumstances, demonstrates that the filing of the case was an abuse of the provisions of this title; or (B) the debtor owes a debt arising from (i) any violation of the Federal securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934), any State securities laws, or any regulation or order issued under Federal securities laws or State securities laws; (ii) fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 or under section 6 of the Securities Act of 1933; (iii) any civil remedy under section 1964 of title 18; or (iv) any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding 5 years. (2) Paragraph (1) shall not apply to the extent the amount of an interest in property described in subparagraphs (A), (B), (C), and (D) of subsection (p)(1) is reasonably necessary for the support of the debtor and any dependent of the debtor."

[1746] § 717 (a) (12): "the court after notice and a hearing held not more than 10 days before the date of the entry of the order granting the discharge finds that there is reasonable cause to believe tha
(A) section 522(q)(1) may be applicable to the debtor; and
(B) there is pending any proceeding in which the debtor may be found guilty of a felony of the kind described in section 522(q)(1)(A) or liable for a debt of the kind described in section 522(q)(1)(B)."

[1747] § 727 (e) (1).

[1748] § 727 (d): "On request of the trustee, a creditor, or the United States trustee, and after notice and a hearing, the court shall revoke a discharge granted under subsection (a) of this section if **(1)** such discharge was obtained through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge; **(2)** the debtor acquired property that is property of the estate, or became entitled to acquire property that would be property of the estate, and knowingly and fraudulently failed to report the acquisition of or entitlement to such property, or to deliver or surrender such property to the trustee; **(3)** the debtor committed an act specified in subsection (a)(6) of this section; or **(4)** the debtor has failed to explain satisfactorily **(A)** a material misstatement in an audit referred to in section 586(f) of title 28; or (**B)** a failure to make available for inspection all necessary accounts, papers, documents, financial records, files, and all other papers, things, or property belonging to the debtor that are requested for an audit referred to in section 586(f) of title 28."

13.1.2 Chapter 11

Chapter 11 offers bankrupts an opportunity to reorganize their finances. All debtors eligible under this Chapter may be awarded discharge without exclusions.

Although the plan takes time to accomplish, discharge is nearly always awarded upon confirmation of the plan[1749] (exceptions apply for the few individuals that file under Chapter 11 instead ofunder Chapter 13, as they have to finish successfully making the payments included in the plan before being discharged). This being said, it is consequential that discharge is denied if the plan is not confirmed, although, in general, discharge in Chapter 11 should be denied upon finding the same elements discussed for Chapter 7.[1750]

Chapter 11 allows for discharge to be waived and it does not mention specific time bars to preventing re-filers from obtaining it. In a Chapter 11, discharge may be revoked in case of frauds but exclusively within 180 days of the order of confirmation of the plan.[1751]

13.1.3 Chapter 12

In a Chapter 12 case, family farmers and fishermen will be discharged if they comply with the plan filed (in good faith) with the court.[1752] Restrictions apply but are limited mostly to the commission of acts sanctioned under 522 (q).[1753] In Chapter 12, discharge may be revoked exclusively on grounds of fraud within one year from when it was granted.[1754]

13.1.4 Chapter 13

In a Chapter 13 casem a consumer debtor attempts to reorganize filing a plan that will allow him to repay a higher percentage of debts over a term of three to five years. Such a plan is confirmed if it is filed in good faith[1755] and, upon completion, it allows a debtor to discharge a great variety of debts (more than in a Chapter 7 liquidation). Exceptions apply under section 1328 (b,) which makes discharge available in case of "hardship" which caused the failure of the plan or made complying with it impracticable.

A debtor under this Chapter, though, will be ineligible for discharge if he received a discharge in an earlier Chapter 7, 11, or 12 filed within four years before the order for relief in the subsequent Chapter 13. Doing so prevents abuses and multiple filings in an attempt to gain more relief.

In a Chapter 13, discharge may be revoked on the same terms and grounds of Chapter 12.[1756]

13.2 Non-dischargeable debts

Even if a debtor behaves honestly and complies with the rules, he will not be able to discharge all of his unpaid obligations. The following categories are examples of the vast number of non-dischargeable debts[1757] that have been protected, based on numerous policies, over time by Congress:

- **TAXES**[1758]: if exceptions must apply, it is evident how this would be one of them. Taxes (the ones included in § 507) are in particular a priority to be non-dischargeable (but not exclusively

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[1749] § 1141 (d).
[1750] § 1141 (d) (3).
[1751] § 1144.
[1752] § 1225 (a) (3).
[1753] § 1228 (f).
[1754] § 1228 (d).
[1755] § 1325 (a).
[1756] § 1328 (e).
[1757] Section 523 lists 19 points which includes major topics such as "taxes"; "debts not discharged in previous cases"; "embezzlement or larceny" together with "condominium fees" and "student loans".
[1758] § 503 (a) (1): "(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt.
(1) for a tax or a customs duty (A) of the kind and for the periods specified in section 507(a)(3) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed; (B) with respect to which a return, or equivalent report or notice, if required (i) was not filed or given; or (ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or (C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax".

since the group is very broad). If such claims are not paid despite their ranking, it will be up to the debtor to do it post-bankruptcy;

- **FRAUDULENTLY INCURRED DEBTS**[1759]**:** the Code does not allow the discharge of fraudulently incurred debts. It is reasonable to do so, considering the relevance of honesty in bankruptcy law. All debts incurred though actual frauds, false oaths, and misrepresentations are non-dischargeable under section 523[1760];
- **FAILURE TO SCHEDULE DEBTS**[1761]: filing documents honestly and correctly is critical in the system. One reason for this is the fact that creditors receive notice of the case upon filing a voluntary petition. Notice is based on the debts scheduled by the petitioner. Omitting to list creditors, therefore, would be detrimental to the whole process and an abusive attempt to have higher chances to reach relief which would have to be denied;
- **EMBEZZLEMENT, LARCENY, OR OTHER FIDUCIARY FRAUDS**[1762]: the reasoning is the same applied to fraudulently incurred debts; the Code does not allow discharges when frauds, in general, have occurred;
- **ALIMONY MAINTENANCE SUPPORT**[1763]: the reason for making maintenance non-dischargeable is the same one that allows these particular claims to gain a priority status. It is important to make sure that a debtor continues to act responsibly with regard to these particular obligations. Chapter 13 though allows for a limitation of the general policy and for discharge of property settlements;
- **DEBTOR'S WILLFUL OR MALICIOUS INJURY OF ANOTHER OR ANOTHER'S PROPERTY**[1764]**:** the same principles that prevents frauds from being discharged, making it impossible to use the bankruptcy system as a tool to get rid of debts related to a maliciously inflicted injury;
- **FINES, PENALTIES AND COURT COSTS**[1765]**:** this group is connected to the first category protecting taxes and governmental credits in general;

[1759] § 523 (a) (2) "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; (B) use of a statement in writing (i) that is materially false; (ii) respecting the debtor's or an insider's financial condition; (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and (iv) that the debtor caused to be made or published with intent to deceive; or (C) (i) for purposes of subparagraph (A) (I) consumer debts owed to a single creditor and aggregating more than $500 for luxury goods or services incurred by an individual debtor on or within 90 days before the order for relief under this title are presumed to be nondischargeable; and (II) cash advances aggregating more than $750 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 70 days before the order for relief under this title, are presumed to be nondischargeable; and (ii) for purposes of this subparagraph (I) the terms "consumer", "credit", and "open end credit plan" have the same meanings as in section 103 of the Truth in Lending Act; and (II) the term "luxury goods or services" does not include goods or services reasonably necessary for the support or maintenance of the debtor or a dependent of the debtor".

[1760] Upon filing of a complaint by a party in interest see 523(c)(1), FRBP 7001.

[1761] § 523 (a) (3): "neither listed nor scheduled under section 521(a)(1) of this title, with the name, if known to the debtor, of the creditor to whom such debt is owed, in time to permit (A) if such debt is not of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing; or (B) if such debt is of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request".

[1762] § 523 (a) (4): "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny".

[1763] § 523 (a) (5): "for a domestic support obligation", See also § 523 (a) (15): "to a spouse, former spouse, or child of the debtor and not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, or a determination made in accordance with State or territorial law by a governmental unit".

[1764] § 523 (a) (6): "for willful and malicious injury by the debtor to another entity or to the property of another entity".

[1765] § 523 (a) (7): "to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty (A) relating to a tax of a

- **STUDENT LOANS**[1766]**:** as mentioned in Chapter II, this is a relevant point within the American Bankruptcy Code, while it would be less relevant in other international settings. Today, the Code discharges both public and private loans as long as "undue hardship" is proven;
- **LIABILITY FOR DAMAGES FROM DEBTOR'S DRUNK OR DRUGGED DRIVING**[1767]**:** "driving" applies to cars or operation of other vehicles such as vessels. This category concerns a relevant topic; it prevents rewarding those found guilty of causing death or personal injuries with their reckless or malicious conduct;
- **DEBTS EXCLUDED FROM A PRIOR DISCHARGE**[1768];
- **POST-PETITION CONDOMINIUM FEES**[1769].

Several of the above mentioned sections do not apply to Chapter 13 cases in which most debts are discharged with the exceptions of alimony, maintenance, spousal or child support; student loans; liability for drugged or drunk driving; and restitution of criminal fines.

14 Bankruptcy crimes

Our discussion could not be complete without an overview of the methods used by the U.S. Bankruptcy framework to ensure fairness and honesty within the system . This is indeed one of the most interesting elements in the evolution of insolvency bankruptcy laws. American bankruptcy evolved from its heavily punitive roots, connected to the harsh European models, into a system in which specific bankruptcy crimes still exist. They are not anymore, though, a part of the Bankruptcy Code and the whole field of criminal of bankruptcy law involves a very minor number of cases.

The Bankruptcy Code went from governing a purely criminal field of law characterized by criminal "acts of bankruptcy" in which all debtors were criminals, to a formula that gives little relevance to this component. This is not to say though that American bankrupts are more honest, but that the system has made different choices compared to several others in the globalized market.[1770]

> "Denial of discharge is one form of discipline, and prison is another. While our consumer bankruptcy laws may fairly be characterized as generous to troubled debtors, it is important that the debtors be fair to the system. The threat of jail is useful in keeping the system in balance, and many other countries' bankruptcy systems are far more punitive

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kind not specified in paragraph (1) of this subsection; or (B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition".

[1766] §523 (a) (8): "unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for
(A) (i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or (ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or (B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual".

[1767] § 523 (a) (9): "for death or personal injury caused by the debtor's operation of a motor vehicle, vessel, or aircraft if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance".

[1768] § 523 (a) (10): "that was or could have been listed or scheduled by the debtor in a prior case concerning the debtor under this title or under the Bankruptcy Act in which the debtor waived discharge, or was denied a discharge under section 727(a)(2), (3), (4), (5), (6), or (7) of this title, or under section 14c(1), (2), (3), (4), (6), or (7) of such Act".

[1769] § 523 (a) (16): "for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a unit that has condominium ownership, in a share of a cooperative corporation, or a lot in a homeowners association, for as long as the debtor or the trustee has a legal, equitable, or possessory ownership interest in such unit, such corporation, or such lot, but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case".

[1770] **Warren Elizabeth, Westbrook Jay, Westbrook Jay M., Porter Katherine, Pottow John**, "*The law of debtors and creditors – text, cases and problems*", Seventh Edition, Wolters Kluwer Law & Business, New York, ISBN 9781454822387, (2014), 181.

> on debtors. Unfortunately, not many U.S. attorneys are prepared to invest resources in this kind of prosecution."

In our historical overview we have discussed some of the relevant steps made in this process. We have observed, for example, how imprisonment for debts has been abandoned both due to budgetary reasons and because of its negative impact on societies.

> "Imprisonment for debt, an institution inherited from the mother country, had become one of the great plagues of the time. Insolvent debtors, victims of the consequences of the war and, in particular, of the monetary disorders, filled the prisons to capacity. Legislation, different in each state, was inadequate to cope with the situation."[1771]

The system moved toward punishing dishonest or non-cooperative debtors only by denying discharge and other benefits of the bankruptcy system.

We will briefly discuss the evolution of imprisonment for debts and of modern bankruptcy crimes.

14.1 Imprisonment for debts and other early crimes[1772]

In Chapter IV, we discussed the origins of imprisonment for debt in medieval Italy and England, where thousands of people would be thrown in jail each year.[1773] We have also discussed the gruesome and perverse effects of imprisonment in America in colonial times. Early federal statutes followed the same path, criminalizing the field until 1867, when "An Act for the Abolition of Imprisonment for Debt, for the punishment of fraudulent debtors, and for other purposes" ultimately reduced criminal burdens for bankrupts.

Imprisonment for debt, though, remained possible,[1774] although with a more limited impact on the lives of bankrupts[1775]. It was finally abolished in 1970.[1776] Debtors were not the only ones at risk. Ever since the very first Acts, heavy punishments could be imposed on insolvency administrators, court officials, and third parties. Some crimes, such as perjury or the concealment of property by a dishonest trustee, were punished harshly with two to ten years of jail time.

The Act of 1869 is the ancestor of modern bankruptcy criminal rules.[1777]

While voluntary relief was made available to more debtors, extensive sections regarding bankruptcy crimes were crafted. The Act punished:

- the concealment of property;
- frauds and dishonesty;
- the spending or alienation of the estate's property which deprived the trustee of the necessary liquidity to pay claims.

Aside from monetary sanctions, behaviors such as bribery were punishable with up to three years of jail time, while forging a Judge's signatures or official seals could get up to five years.

The bankruptcy Act of 1898 designed specific sections to punish criminal behaviors of creditors or officials taking part to the proceeding. Embezzlement was sanctioned, and so were all the actions committed in contrast with the goals or interests of the proceeding or of the estate. Filing fake proofs of claim also constituted a crime.

[1771] **Nadelmann Kurt H**., "*On the origin of the Bankruptcy Clause*", The American Journal of Legal History, Vol. 1, No. 3, 215-228, (1957), at 224.

[1772] **Ware J. Stephen**, "*A 20th Century Debate About Imprisonment for Debt*", 54 Am. J. Legal Hist. 351 (2014).

[1773] UK Debtor's Act 1869 at http://www.legislation.gov.uk/ukpga/Vict/32-33/62/enacted

[1774] "[…]from 1887 to 1891, "over 30,000 persons went to prison, and of these, over 19,000 stayed in prison the maximum six weeks." In 1904, 11,096 people were committed to prison for nonpayment of debt." See **Ware J. Stephen**, "*A 20th Century Debate About Imprisonment for Debt*", 54 Am. J. Legal Hist. 351 (2014), at 356-7.

[1775] Many debtors continued to be imprisoned despite the apparently narrow grounds for which the 1869 Act retained imprisonment as a creditors' remedy.

[1776] **Ware J. Stephen**, "*A 20th Century Debate About Imprisonment for Debt*", 54 Am. J. Legal Hist. 351 (2014), at 352-3.

[1777] **Peyton Gaumer Craig**, "*Bankruptcy Fraud: Crime and Punishment*", 43 S.D. L. Rev. 527 (1998), at 531-2.

An amendment in 1926 added § 157 (7) against corporate officers and crimes in connection with the destruction or making false entries in documents.

Today, federal criminal bankruptcy law sections continue to be enforced and punish a variety of behaviors that may be committed by the debtor and other parties. Despite the ample reach of criminal provisions in bankruptcy, though, very few cases are commenced every year.

14.2 The US criminal bankruptcy system and the reduced impact of stigma

The Bankruptcy Code gives great relevance to honesty. It attempts to keep the system healthy, preventing dishonest and non-cooperative debtors from enjoying the available benefits, and to inculcate responsible behaviors[1778] while limiting stigma.

In the modern U.S. model, bankruptcy crimes have not been abolished and jail can still be imposed upon those interested parties that cheat and commit frauds. Crimes are mandatorily referred to the U.S. Trustee by the insolvency administrators involved in a case, or to the United States Attorney by judges or the FBI.[1779] Despite the ample reach of the criminal sections and the number of petitioners that may tempted to cheat the system, very few cases are referred each year and just a fraction are prosecuted.[1780] On the other hand, though, data shows that when the case is prosecuted, the rate of convictions is extraordinarily high (more than 80%).

The framework, therefore, seems to take two interconnected paths. It uses criminal sanctions to punish the most critical situations, hence deterring professional offenders, while the loss of the privileges offered by the bankruptcy framework is used as a tool to punish lower degrees of "malice" or gross mistakes.[1781]

14.3 Modern bankruptcy crimes

Since the Bankruptcy Code does not include a specific criminal section, several other federal (and state) criminal sections interact with the bankruptcy framework in this area.[1782]

As we are about to discuss, the relevant federal criminal sections are mostly placed in Chapter 9 of Title 18 of the US Code. Other sections that impact this area of bankruptcy law are:

- 18 U.S.C. §§ 1341, 1343 and 1344 (mail, wire, and bank fraud); 18 U.S.C. § 1001 (false statements); 18 U.S.C. § 1519 (Sarbanes-Oxley violations involving destruction/alteration/falsification of documents);
- 18 U.S.C. § 1621 (perjury);
- 18 U.S.C. §§ 1956 and 1957 (money laundering);
- 42 U.S.C. § 408 (use of a false Social Security number); and 26 U.S.C. § 7201, *et seq.* (tax fraud).[1783]

The most relevant bankruptcy crimes are listed in sections 151 to 157 of U.S.C. Title 18. Such sections represent a congressional attempt to cover all the possible methods by which a debtor or any other person

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[1778] **Flynn Ed and Bowles Charles**, "*Bankruptcy Crime and Punishment*", 34-JAN Am. Bankr. Inst. J. 24 (2015), at 63.

[1779] § 18 USC 158.

[1780] About 150 referrals each year and 10 prosecutions mostly under section 152. See statistics in different articles cited: **Flynn Ed and Bowles Charles**, "*Bankruptcy Crime and Punishment*", 34-JAN Am. Bankr. Inst. J. 24 (2015), at 25-26 and 63-64.

[1781] A third definition of “malice” given by the Black’s law Dictionary which is typical of non-legal contexts is “ill will” or “wickedness of heart”. Bankruptcy tends to inspire a variety of ill behaviors.

[1782] For different statutes interacting see **Gebbia Karen M**., "*Debt and Crime: Inevitable Bedfellows in the Intersection of Fraud, Bankruptcy and Asset Forfeiture*", Symposium: A Cross-Disciplinary Dialogue: White Collar Fraud, Asset Forfeiture, and Bankruptcy, Introductory Article, 42 Golden Gate U. L. Rev. 525 (2012). See also the interaction with 18 USC 1956 and 1957, **Peyton Gaumer Craig**, "*Money Laundering, Asset Forfeiture and Bankruptcy Fraud*", 20-MAY Am. Bankr. Inst. J. 6 (2001).

[1783] **Flynn Ed and Bowles Charles**, "*Bankruptcy Crime and Punishment*", 34-JAN Am. Bankr. Inst. J. 24 (2015), at 24; **Peyton Gaumer Craig**, "*When Two Worlds Collide*", 21 Am. Bankr. Inst. J. 10 (2002) discussing the interaction between bankruptcy and federal civil and criminal asset forfeiture remedies.

may attempt to defeat the beneficial purposes of the Code and attempt to lower the degree of trust in the system[1784].

All bankruptcy specific crimes exist in direct connection with a regularly commenced proceeding.[1785]

Section 151, "Definitions", specifies that the term "debtor" used in the following sections refers to petitioners in Title 11. But, as we have already mentioned, other parties in interest may commit bankruptcy crimes. Section 153, for example, is concerned with embezzlement in a bankruptcy setting, a crime which is typically committed by third parties in charge of administering property (of the estate) to which they have been entrusted, in an attempt to prevent misbehaviors on behalf of administrators.

The following specific criminal bankruptcy sections are included in U.S.C. TITLE 18, Part I, Chapter 9:

§ 152. Concealment of Assets, False Oaths and Claims; Bribery;

§ 153. Embezzlement Against Estate;

§ 154. Adverse Conduct of Officers[1786];

§ 155. Fee Agreements in Cases Under Title 11 and Receiverships[1787]

§ 156. Knowing Disregard of Bankruptcy Law or Rule[1788];

§ 157. Bankruptcy Fraud;

§ 158. Designation of United States attorneys and agents of the Federal Bureau of Investigation to address abusive reaffirmations of debt and materially fraudulent statements in bankruptcy schedules.

Most cases occur under Section 152.[1789] [1790] It has been amended and modified a number of times, most recently in 1994.[1791] It contains a general prohibition not to conceal assets and presents a list of specific offences in an attempt to describe all possible criminal acts.[1792]

[1784] **Sousa Michael D.**, "*The Crime of Concealing Assets in Bankruptcy: An Overview and an Illustration*", 26-MAR Am. Bankr. Inst. J. 20 (2007), at 20 citing 883 F.2d 1362, 1369 (7th Cir. 1989) (citation omitted), *cert. denied*, 494 U.S. 1007 (1990).

[1785] **Peyton Gaumer Craig**, "*The Hazard of Concealing Assets in Bankruptcy*", 22-MAY Am. Bankr. Inst. J. 8 (2003), at 43; McCollough Ralph C. II, "Bankruptcy Fraud: Crime Without Punishment", 96 Com. L.J. 257 (1991), at 268-9.

[1786] 18 U. S. Code § 154: "Adverse conduct of officers

A person who, being a custodian, trustee, marshal, or other officer of the court

(1) knowingly purchases, directly or indirectly, any property of the estate of which the person is such an officer in a case under title 11;

(2) knowingly refuses to permit a reasonable opportunity for the inspection by parties in interest of the documents and accounts relating to the affairs of estates in the person's charge by parties when directed by the court to do so; or

(3) knowingly refuses to permit a reasonable opportunity for the inspection by the United States Trustee of the documents and accounts relating to the affairs of an estate in the person's charge, shall be fined under this title and shall forfeit the person's office, which shall thereupon become vacant."

[1787] 18 U.S. Code § 155: "Fee agreements in cases under Tile 11 and receiverships:

Whoever, being a party in interest, whether as a debtor, creditor, receiver, trustee or representative of any of them, or attorney for any such party in interest, in any receivership or case under title 11 in any United States court or under its supervision, knowingly and fraudulently enters into any agreement, express or implied, with another such party in interest or attorney for another such party in interest, for the purpose of fixing the fees or other compensation to be paid to any party in interest or to any attorney for any party in interest for services rendered in connection therewith, from the assets of the estate, shall be fined under this title or imprisoned not more than one year, or both."

[1788] 18 U.S. Code § 155: "Fee agreements in cases under Tile 11 and receiverships:

Whoever, being a party in interest, whether as a debtor, creditor, receiver, trustee or representative of any of them, or attorney for any such party in interest, in any receivership or case under title 11 in any United States court or under its supervision, knowingly and fraudulently enters into any agreement, express or implied, with another such party in interest or attorney for another such party in interest, for the purpose of fixing the fees or other compensation to be paid to any party in interest or to any attorney for any party in interest for services rendered in connection therewith, from the assets of the estate, shall be fined under this title or imprisoned not more than one year, or both."

[1789] 18 U.S. Code § 152:

"Concealment of assets; false oaths and claims; bribery

A person who (1) knowingly and fraudulently conceals from a custodian, trustee, marshal, or other officer of the court charged with the control or custody of property, or, in connection with a case under title 11, from creditors or the United States Trustee, any property belonging to the estate of a debtor; (2) knowingly and fraudulently makes a false oath or account in or in relation to any case under title 11; (3) knowingly and fraudulently makes a false declaration,

As such, it is a broad section that includes a variety of sanctioned behaviors such as the act of concealing property from administrators of the proceeding before filing or while the case is pending, by physically hiding it or by giving false or omitting information.[1793] It also punishes those who may file false claims, or destroy or mutilate documents and records, a typical behavior in bankruptcy intended to hide the causes, and magnitude, of a financial default, not to mention the responsibilities behind it.

Section 152, therefore, aims to punish a variety of participants to the case in all Chapters of Title 11. The debtor, third parties, insolvency administrators, or creditors may all incur wrongful behaviors. The *fil rouge* among the different criminal acts listed is "intent". Guilty acts must be proven to have been committed "knowingly and fraudulently". If this requirement is met, an offender may not only be fined but also be imprisoned for up to five years. Despite its wide reach, § 152 it is often invoked and seldom enforced.[1794]

This section should be read in connection with § 157, "Bankruptcy Fraud"[1795], which was enacted in 1990 and acts as a catch-all provision for all those instances that may elude § 152. It specifically criminalizes the fraudulent filing of an involuntary petition under § 303.[1796]

Section 153[1797] punishes embezzlement[1798] as the fraudulent taking of personal property with which one has been entrusted. It is therefore typically committed by appointed administrators which may be punished also under sections 154 and 155.

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certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28, in or in relation to any case under title 11; (4) knowingly and fraudulently presents any false claim for proof against the estate of a debtor, or uses any such claim in any case under title 11, in a personal capacity or as or through an agent, proxy, or attorney; (5) knowingly and fraudulently receives any material amount of property from a debtor after the filing of a case under title 11, with intent to defeat the provisions of title 11; (6) knowingly and fraudulently gives, offers, receives, or attempts to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof for acting or forbearing to act in any case under title 11; (7) in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under title 11 by or against the person or any other person or corporation, or with intent to defeat the provisions of title 11, knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation; (8) after the filing of a case under title 11 or in contemplation thereof, knowingly and fraudulently conceals, destroys, mutilates, falsifies, or makes a false entry in any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor; or (9) after the filing of a case under title 11, knowingly and fraudulently withholds from a custodian, trustee, marshal, or other officer of the court or a United States Trustee entitled to its possession, any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor, shall be fined under this title, imprisoned not more than 5 years, or both."

[1790] **Gwertz Nevin M**., "*Act or Asset? Multiplicitous Indictments Under the Bankruptcy Fraud Statute*", 18 USC § 152", 76 U. Chi. L. Rev. 909 (2009); **Ogier Tamara** and **Williams Jack F**., "*Bankruptcy Crimes and Bankruptcy Practice*", 6 Am. Bankr. Inst. L. Rev. 317 (1998); **Peyton Gaumer Craig**, "*The Never-Ending Story?*", 20-NOV Am. Bankr. Inst. J. 8 (2001), discussing statute of limitation issues.

[1791] **Peyton Gaumer Craig**, "*The Hazard of Concealing Assets in Bankruptcy*", 22-MAY Am. Bankr. Inst. J. 8 (2003), at 43.

[1792] **McCollough Ralph C. II**, "*Bankruptcy Fraud: Crime Without Punishment*", 96 Com. L.J. 257 (1991), at 258-261.

[1793] Title 11 § 152 (1). See on the topic **Peyton Gaumer Craig**, "*The Hazard of Concealing Assets in Bankruptcy*", 22-MAY Am. Bankr. Inst. J. 8 (2003), at 43-46; Sousa Michael D., "*The Crime of Concealing Assets in Bankruptcy: An Overview and an Illustration*", 26-MAR Am. Bankr. Inst. J. 20, (2007).

[1794] **McCollough Ralph C. II**, "*Bankruptcy Fraud: Crime Without Punishment*", 96 Com. L.J. 257 (1991), at 258.

[1795] 18 U.S. Code § 153:

"Bankruptcy Fraud: A person who, having devised or intending to devise a scheme or artifice to defraud and for the purpose of executing or concealing such a scheme or artifice or attempting to do so (1)files a petition under title 11, including a fraudulent involuntary petition under section 303 of such title; (2)files a document in a proceeding under title 11; or (3)makes a false or fraudulent representation, claim, or promise concerning or in relation to a proceeding under title 11, at any time before or after the filing of the petition, or in relation to a proceeding falsely asserted to be pending under such title, shall be fined under this title, imprisoned not more than 5 years, or both."

[1796] **Peyton Gaumer Craig**, "*Bankruptcy Fraud: Crime and Punishment*", 43 S.D. L. Rev. 527 (1998), at 536; **Tighe Maureen A.,** "*A Guide to Making a Criminal Bankruptcy Fraud Referral*", 6 Am. Bankr. Inst. L. Rev. 409 (1998), at 431-3.

[1797] 18 U.S. Code § 153: "Embezzlement against the estate

Section 156[1799] is an interesting recent addition. The crime was added in 1994 and punishes a non-attorney petition preparer for disregarding the rules.[1800] This particular section follows a "trend" in recent years, also in the BAPCPA, to impose greater liabilities on those that aid debtors in filing and during the proceeding.

15. Protections against discrimination

The American Bankruptcy Code does much to reduce the impact of stigma and the negative repercussions of bankruptcy proceedings. We have discussed how the system is tuned, under several relevant aspects, to support the honest, cooperative debtor effectively. The ultimate goal is to ensure that honest debtors that have been through bankruptcy successfully can make full use of their fresh start; if they could not, the whole system would be damaged.

Section 525 is particularly interesting since it aims to make available specific post-discharge protections against "discrimination", one of the key factors in making bankrupts second-class citizens. It, in fact, prevents several common forms of abuse and discrimination that take place in heavily punitive societies and that, ultimately, prevent debtors from getting back on their feet.

In such settings, honest former debtors may face difficulties in finding or keeping jobs. They also may be prevented from obtaining, or renewing, important licenses.[1801] Bankrupts, due to their past, can also be discriminated against in obtaining loans even if they were successfully awarded a full discharge.

Section 525 attempts to award protections in all such vital aspects of the life of an individual:

> **"(a)**Except as provided in the Perishable Agricultural Commodities Act, 1930, the Packers and Stockyards Act, 1921, and section 1 of the Act entitled "An Act making appropriations for the Department of Agriculture for the fiscal year ending June 30, 1944, and for other purposes," approved July 12, 1943, a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, discriminate with respect to such a grant against, deny employment to, terminate the employment of, or discriminate with respect to employment against, a person that is or has been a debtor under this title or a bankrupt or a debtor under the Bankruptcy Act, or another person with whom such bankrupt or debtor has been associated, solely because such bankrupt or debtor is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of the case under this title, or during the case but before the debtor is

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(a)Offense. A person described in subsection (b) who knowingly and fraudulently appropriates to the person's own use, embezzles, spends, or transfers any property or secretes or destroys any document belonging to the estate of a debtor shall be fined under this title, imprisoned not more than 5 years, or both.
(b)Person to Whom Section Applies. A person described in this subsection is one who has access to property or documents belonging to an estate by virtue of the person's participation in the administration of the estate as a trustee, custodian, marshal, attorney, or other officer of the court or as an agent, employee, or other person engaged by such an officer to perform a service with respect to the estate."

[1798] **Tighe Maureen A.**, "*A Guide to Making a Criminal Bankruptcy Fraud Referral*", 6 Am. Bankr. Inst. L. Rev. 409 (1998), at 430.

[1799] 18 U.S. Code § 156: "Knowing disregard of bankruptcy law or rule:
"(a)Definitions. In this section (1)the term "bankruptcy petition preparer" means a person, other than the debtor's attorney or an employee of such an attorney, who prepares for compensation a document for filing; and (2) the term "document for filing" means a petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a case under title 11. (b)Offense. If a bankruptcy case or related proceeding is dismissed because of a knowing attempt by a bankruptcy petition preparer in any manner to disregard the requirements of title 11, United States Code, or the Federal Rules of Bankruptcy Procedure, the bankruptcy petition preparer shall be fined under this title, imprisoned not more than 1 year, or both."

[1800] See **Peyton Gaumer Craig**, "*Bankruptcy Fraud: Crime and Punishment*", 43 S.D. L. Rev. 527 (1998), at 536.

[1801] See **FCC V. Nextwave Personal Communications inc**. 537 U.S. 293 (2003). The Supreme Court held that a governmental unit may not revoke a license solely due to the debtor's failure to make timely payments.

granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.
(b) No private employer may terminate the employment of, or discriminate with respect to employment against, an individual who is or has been a debtor under this title, a debtor or bankrupt under the Bankruptcy Act, or an individual associated with such debtor or bankrupt, solely because such debtor or bankrupt—
(1)is or has been a debtor under this title or a debtor or bankrupt under the Bankruptcy Act;
(2)has been insolvent before the commencement of a case under this title or during the case but before the grant or denial of a discharge; or
(3)has not paid a debt that is dischargeable in a case under this title or that was discharged under the Bankruptcy Act.
(c)(1)A governmental unit that operates a student grant or loan program and a person engaged in a business that includes the making of loans guaranteed or insured under a student loan program may not deny a student grant, loan, loan guarantee, or loan insurance to a person that is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, or another person with whom the debtor or bankrupt has been associated, because the debtor or bankrupt is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of a case under this title or during the pendency of the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.
(2) In this section, "student loan program" means any program operated under title IV of the Higher Education Act of 1965 or a similar program operated under State or local law."

As such, this section is a relevant example of the steps that can be taken to bring improvements and de-stigmatize a model. Ensuring that honest debtors have a shot at a meaningful second chance to be productive members of society is one of the cornerstones of modern insolvency frameworks. Education systems, efficient and supportive insolvency laws, and protections such as the ones included in the section we have just mentioned are a necessary "survival package" that can make the difference in modern economies.

All these principles may serve as inspiration to bring concrete improvements to the process of refounding European insolvency frameworks.

16. Analysis of relevant elements of Chapter V

In this Chapter, we covered a great amount of material filled with important information.

The American system is unique and complex. It has become, with time, a model for several other players competing within the globalized market, due to its capacity to actively and effectively support the efforts of the US economy. As discussed in Chapter I, several aspects of this framework have inspired the European strategies for the new millennium and the process of refoundation.

Europe has attempted to close the gap with the American economy by adopting similar approaches. In the field of bankruptcy law, the reforms have taken two main paths: a) the development of a new philosophy based on restructuring and on supporting debtors – in contrast with the previous one filled with stigma; b) the adoption, through several legal transplants, of rules and principles that could support the new philosophy. The results obtained through this process over two decades, though, are far from matching the original expectations and the current needs of the Union.

Several obstacles have been met in successfully deploying the American tools that were borrowed. Not all European societies have been able to adapt to them. The incapacity to merge the European mentality with foreign rules became a relevant cause of the impasse which has halted the development of the process of refoundation.

In this chapter, we have gained relevant information to better understand this complex phase in the evolution of our laws. We have gained a better understanding of these foreign tools and of the scenario in which they were conceived, in which they have evolved, and in which they are deployed. In particular, we analyzed:

- How American bankruptcy laws have evolved – showing that this process has not been free from difficulties and proving that early US models were not kind to debtors at all. They were also filled with punitive factors. The process that led to critical modifications and to the adoption of the modern model (which applies almost opposite principles compared to its ancestors) went hand in hand with changes in the American society.
- The "timing" of this process – reforms did not happen overnight; they took centuries, and the process is still ongoing. The latest adjustments are recent (2005) and they were put into place to allow the rules to be more effective and efficient within the modern scenario;
- The difficulties faced in structuring an efficient and effective system of bankruptcy courts – bankruptcy is a matter of balance in countless areas. The evolution of the American court system offers important information on the compromises that need to be studied upon developing a new model.
- The ambitious process through which bankruptcy was opened to a wider group of debtors, including natural persons – this is an area that should be studied in depth at the European level. The reasons for the enactment of frameworks to deal with non-business debtors are deeply connected with the ones that have started the process of refoundation. They are rooted in the evolution of our economies. Understanding the evolution of the American framework and learning from it can support the swift deployment of European models and prevent mistakes.

We will now briefly elaborate on some of the most relevant aspects of the American framework based the information acquired in previous chapters.

16.1 The evolutionary process of the American system has been complex and filled with compromises

In the first part of this chapter, we discussed the evolution of the American bankruptcy system. These sections of our analysis are relevant and provide interesting food for thought. It appears, in fact, that in modern days we tend to give the effectiveness and efficiency of the American formula for granted without considering the steps that have been taken to create the modern structure of the Code.

When we transplant its rules and approaches into our models, therefore, we risk seeing them rejected by our societies as we are not often aware of the process that led to their enactment. The evolution of the American economy and of the American bankruptcy system must serve as a guide in the implementation of the new approaches embodied in the process of refounding European insolvency frameworks. It must be kept in mind that:

- Federal statutes were not implemented at early stages of the development of American bankruptcy laws to impose a system from the top-down. They gained relevance only at a later time to improve the administration of "cross-border" cases, we could say, at the national level.
- The system struggled to balance Federal and State influence within each draft of a new bankruptcy statute and even today the impact of local laws is relevant.
- American models have also been heavily punitive. Change occurred with time and was based not just on the needs of the US economy but also on social reforms.

All these factors constitute a useful lesson on which to build the future. when copy and pasting rules and approaches, it must be kept in mind that the history of American bankruptcy laws is as complex and as filled with stigma and compromises as ours.

But there is more. A particularly interesting piece of information can be drawn from the structure of early state systems.

English laws were uniformly applied within the colonies. With the loss of the Crown's influence, though, territories immediately took different paths. It is important to remember, in fact, that not all states enacted bankruptcy laws, and only some designed well-structured statutes that even included discharge rules.

In Chapter IV, we also discussed the multitude of different formulas adopted within the borders of countless Italian city-states. In the previous sections we had a chance reference the most relevant differences existing netween exemption statutes at local level, while in the first three chapters we acquired relevant information on European frameworks. It appears, therefore, that bankruptcy regulations tend to

have a very local dimension and to move away from high degrees of uniformity despite social, political, or geographical, proximity.

This is something that European legislators should keep well in mind. If such great difficulties are met in harmonizing systems in a single country that is born from a "clean slate"[1802], the task can only be exponentially greater in a complex context such as the one of the Union.

16.2 The evolution of the American system required time and evolved alongside the American society and economy

Time is an essential factor to bringing change in insolvency laws. The fragile but vital balance that constitutes effective and efficient models does not change overnight. Countless examples can be made on this point based on our discussion. We have just observed, for example, how it took almost a century from the enactment of the Bankruptcy Clause to obtain a well-structured federal insolvency system. During this period of time, in fact, state regulations appeared to be sufficient, in absence of major economic crises, to support and protect the markets of the American States. Similarly, it took hundreds of years for bankruptcy law to lose its purely criminal connotations.

We also observed in Chapter IV how it took centuries for the definition of insolvency to evolve till its current versions and to ensure basic protections to honest bankrupts.

The American bankruptcy system originated from a "clean slate"[1803] in a "new world". It was shaped and reshaped over the decades and it took over two hundred years to become the innovative model which the EU is inspired by today. Europe is attempting to replicate this process; it aims to bind the Member States to a new, harmonious formula while travelling at the speed of light.

As discussed in Chapter I, the Union planned for major reforms in the field of bankruptcy laws to occur over the first ten-year plans of the new millennium. Having discussed in greater detail the American experience, this appears, now, impossible, and it would be unrealistic even if the reforms were imposed from the top through the massive use of Regulations.

Such a process, in fact, would not automatically ensure the success of the new laws or that society would accept them. Improving the modern European economy and legal scenario truly is a great challenge. The Union is evidently attempting to make progress at great speed; but within a young, fragile, and complex coalition, this approach may not work.

16.3 The value of insolvency within the American bankruptcy model and its importance for the refoundation of European systems

Within the American system, insolvency has lost most of its relevance as an access criteria. This is another consequence of the evolutionary process that has occurred within the American framework over the past two centuries. The modern structure of the Bankruptcy Code incentivizes voluntary cases and early filing, offering several potential benefits to honest bankrupts.

Insolvency, therefore, finds itself to be in a residual position.

This point is relevant. It shows that a complex, modern bankruptcy system does not need to rely on insolvency as the key access criteria (as has happened for centuries), and it shows the feasibility of achieving the balance that the Union has tried to replicate through its recent reforms. Hence, much of the discussion on providing an acceptable international definition of "insolvency" to be applied within the international scenario appears to have become relatively irrelevant and actions could be undertaken to provide useful, harmonized criteria. The goal to standardize all access criteria remains relevant.

As discussed in Chapter III, as long as the local models of nations competing within the globalized economy do not adopt uniform approaches, cross-border regulations will have to be careful in dealing with the opening of secondary cases; while the adoption of a common definition of insolvency and other relevant access criteria would increase the levels of predictability and transparency within markets.

[1802] **Martin Nathalie**, "*The role of history and culture in developing bankruptcy and insolvency systems: the perils of legal transplantation*", 28 B.C. Int'l & Comp. L. Rev. 1, (2005).
[1803] *Id.*

16.4 Stigma within the American system

As discussed in Chapter I, the stigma of failure is perceived as one of the great barriers delaying not just the process of refounding European insolvency systems but the development of the whole master plan of the Union. It negatively impacts levels of entrepreneurship within a system. In the modern American system there almost is no room for the stigma; bankruptcy supports eligible debtors as long as they are honest in complying with the rules.

This is one of the critical elements that makes of the U.S. Bankruptcy Code an inspiring model in modern days.

American rules have certainly not been always free of heavy burdens for bankrupts, though. As amply discussed in the first part of this chapter, in the beginning there was little difference between European and American bankruptcy laws. Even when the new continent was freed from British influence, states adopted harsh bankruptcy systems.

Change occurred slowly over time and was matched with significant modifications within the American society and economy. The process of adjustment remained ongoing and did not operate in favor of debtors only. The goal was to attain a constructive equilibrium. The BAPCPA, for example, attempted to limit what was felt by the community to be "excessive relief", imposing several limits on the benefits present within the system.[1804]

Although the framework remained extremely supportive, rules were enacted to limit abuses and to maintain a careful balance between interests at stake based on the needs of the society of the time. The American bankruptcy system, therefore, did not just grow "friendlier" over the centuries; it attempted to strike a careful balance between the needs of all parties in favor of society and of the economy.

The EU on the other hand, in its attempt to swiftly reverse a highly punitive scenario, appears to have lost the balance between the different interests at stake and therefore caused an impasse.

In Chapter VI we will discuss this topic further, analyzing the transformation suffered by modern Italian systems based on the process of refounding European insolvency frameworks. We will observe how a solid but heavily punitive system has changed, in just a decade, in an attempt to grant generous relief, ample access to reorganization, and wide moratoriums and stays. Sudden changes, though, led to systemic weaknesses, uncertainty, lack of transparency, and abuses; as a consequence, legislatures were forced to enact several reforms in an attempt to calibrate and stabilize the new system.

This confirms what we have discussed in Chapter II: for reforms to be effective and efficient in local systems, they must match the society they are enacted within. The Bankruptcy Code is successful today because it was not just the law that changed radically through different phase, but the whole American society. This is a relevant point to keep in mind, for it may be an underlying reason of the failures we have witnessed in the process of refounding European insolvency frameworks.

16.5 Rehabilitating natural persons

As observed in Chapter II, insolvency frameworks to address the excessive levels of debts of natural persons are often inspired by American laws on the topic. In this chapter, we discussed several relevant aspects that shape such models:

- mandatory education;
- bankruptcy fees;
- availability of relief in the form of exemptions and discharge for honest debtors;
- systems to prevent fraud.

A (possibly) cheap and available insolvency system to support consumers (or in general non-business debtors) is becoming a necessary part of modern, competitive, effective, and efficient insolvency scenarios.

The American system does a great job in providing honest debtors with support and relief. It also deters abusive behaviors by preventing debtors from accessing liquidations too easily and binding them to filing, showing honesty and cooperation. Our discussion of exemption statutes, though, shows the complexity of balancing relevant rules.

[1804] https://www.grassley.senate.gov/news/news-releases/opening-statement-sen-chuck-grassley-bankruptcy-reform-hearing

Providing indebted individuals with a meaningful fresh start is not easy at all. In Chapter II, we discussed how best practices dictate that debtors should be uplifted after a financial default, in the interest of their communities. Every possible step should be taken to ensure that traumatic experiences will not doom honest bankrupts and that they will find within their society the necessary support to create a better future. In this scenario, mandatory education requirements become an absolutely necessary part of the process for discharge. Fresh starts cannot do the trick alone.

Debtors must learn from their mistakes to be able to move forward and to improve their lives (hence providing benefits to the whole community). To learn, though, they must be taught. But the Bankruptcy Code does more; it also protects individuals from stigma after discharge has been awarded.

We could therefore say that the process for the rehabilitation of an honest debtor is subdivided into the following phases:

1- Analysis of the behavior of the debtor – she will be supported by the system and the community only if she is honest and cooperative;
2- Payment of part of the debts – through a plan or a liquidation;
3- Discharge – freedom from most unpaid debts;
4- Fresh start – the opportunity to “get back in the game” thanks to: a) exemptions which allow the debtor to retain some property; b) the protections of § 525; and c) education programs.

16.6 The structure of American bankruptcy courts

A major element that we discussed in previous chapters is the importance of bankruptcy courts within any local or cross-border framework. The enactment of an effective and efficient bankruptcy system cannot disregard the high quality of its specialized court system, a topic which is discussed in depth by the World Bank’s principles. This is one area in which the United States have struggled.

The cost of the bankruptcy process is a main source of headaches. Disentangling conflicts is a great task and the cause of heavy burdens.

The implementation of complex reforms such as the one designated within the process of refoundation requires great coordination among the internal apparatuses of all of the Member States. Coordinating them all leads to major barriers due to the differences among laws, languages, approaches, powers, the structure of frameworks, etc.

The Union should start developing studies on this complex topic, for one day, maybe soon, the difficulties met in the American context could affect (if they aren't doing so already) the European scenario as well.

16.7 Modern bankruptcy crimes

A topic that is deeply linked to stigma is the enactment of specific criminal bankruptcy rules – a true bankruptcy tradition. Historically, the American insolvency framework considered bankruptcy to be a crime per se, just as it happened (and it still may happen[1805]) in Europe.

Much changed in a couple of centuries. American bankruptcy crimes were reduced in number and importance and moved to other Titles of the United States Code. What is more interesting, though, is that apparently the Code has managed find an effective balance to decrease stigma while keeping the numbers of criminal cases to a minimum.

Statistics show, in fact, that only a few criminal proceedings are opened today. This is a relevant piece of information; it proves that it is possible to build a system of trust which is not based purely on fear and punishment. Such ba alance would favor the development of economic strategies deployed by the EU.

In the next chapter, we will discuss the Italian system and gain more information on this topic. We will focus in particular on the modification of Italian laws (which could be observed by joining Chapter IV to the discussion from medieval times). We will observe that bringing relevant modifications to reduce stigma and the significance of bankruptcy crimes has proven to be a true challenge. Despite the influence of modern studies and best practices, the Italian mentality is reluctant to accept new principles and change.

[1805] See Chapter VI.

Such difficulties must be kept well in mind in structuring reforms, as they can be (and have been) met in other areas and in several frameworks. As discussed in the previous chapters, bringing the models of the Member States to greater levels of uniformity is a true challenge as they tend to reject those transplants that go against principles endorsed by their societies.

17 Conclusion

In this chapter, we discussed the evolution of American insolvency framework from its roots up to the current Bankruptcy Code. This process has allowed us to analyze how bankruptcy in the new Continent has changed over the decades; how it went from its stigmatizing roots, which were indeed equal to European ones, until to become a much-copied model filled with innovations.

In our historical introduction, we examined the deep correlation between the evolution of rules and approaches in the field of insolvency law and American economy and society. Just as suggested in Chapter II, in fact, the two have made progress together.[1806] In the next chapter, we will move back to Europe.

In Chapter VI, we will discuss the reforms that occurred within a specific model to better understand the consequences of the process of refounding European insolvency frameworks and the consequent impasse. The next pages will be a case study. We will discuss about 150 years of modifications within modern Italian laws to see the difference between the "natural" evolution of a framework and the effects of the process endorsed by the Union and caused by the globalized market.

[1806] **Martin Nathalie**, "*The role of history and culture in developing bankruptcy and insolvency systems: the perils of legal transplantation*", 28 B.C. Int'l & Comp. L. Rev. 1, (2005).

CHAPTER VI.
THE PROCESS OF REFOUNDATION APPLIED WITHIN THE MODERN ITALIAN INSOLVENCY SCENARIO: A CASE STUDY

1. Introduction

In the previous chapter we analyzed the evolution of insolvency laws in the United States and the current structure of the American bankruptcy framework. We will now follow a similar approach in discussing the evolution and current structure of Italian laws. During this part of our journey, we will focus on the rules embodied in the Commerce Code of 1882, the bankruptcy law of 1942, and the countless reforms that have been taking place since 2005.

The analysis of Italian statutes will serve as a case study; we are not interested in focusing on Italian bankruptcy law per se. This is not, in the end, an Italian bankruptcy law manual and we do not want to risk expanding the analysis to complex topics that would distract us from our targets.

We intend to compare the processes for the modification of existing models and rules, comparing the trend followed in the past 140 years (if we consider this chapter in connection with Chapter IV we can discuss of a much longer timeline) to recent times (following the deployment of the process of refoundation). This approach will allow us to obtain relevant information on the barriers which we discussed in the first chapter.

We will limit our analysis to carefully selected elements and focus on the goal of understanding more about the process of refounding European insolvency frameworks and on the impasse. From this perspective the Italian system is an ideal choice to improve our comparative study and inspec further relevant elements before reaching our conclusions. It will allow us to:

- continue our discussion from Chapter IV – by joining the two chapters we will, for example, be able to see how stigma changed from its roots to modern times;
- examine the impact of the process of refoundation in bringing radical changes to frameworks in an attempt to achieve greater uniformity.

Upon analyzing the frameworks of 1942 and the modern reforms that happened since 2005 we will often refer to the World Bank's Principles to evaluate the levels of effectiveness and efficiency of different laws based on international parameters. It will be interesting to understand the:

- degreeof effectiveness and efficiency of Italian laws before the beginning of the process of refoundation;
- results/improvements obtained through the process of refoundation.

2. The origins of modern Italian bankruptcy laws

In Chapter IV we discussed the evolution of a multitude of insolvency systems that constellated the territory of the Italian Peninsula over the past centuries. Such models were exported abroad in commercial settlements under the control of Italian city-states and in foreign countries.[1807] All such frameworks had a strong local identity, serving the needs and interests of the different societies they were enacted within. They, nevertheless, often shared a common matrix, a structure that has characterized most Italian models up to modern times.

[1807] See Chapter IV.

The balance within bankruptcy formulas changed among administrations based on local priorities, but remained mostly in favor of the adoption of strict public proceedings to protect the rights of the creditors. Debtors were heavily stigmatized (with Venice being the most notable exception). In the nineteenth century, after three wars of independence, the Italian Peninsula returned to being a unified territory. The Kingdom of Sardinia joined under a single flag the following states:

- the Kingdom of Lombardy Venetia;
- the Grand Duchy of Tuscany;
- the Duchy of Modena;
- the Duchy of Parma;
- most parts of the Papal States;
- the Kingdoms of Naples and Sicily.

The countless medieval city-states, with their local approaches to bankruptcy, which were already merged into ampler states, ultimately formed a single society with one insolvency regulation.

Aside from obtaining geographic uniformity, a major task that would keep governments busy for decades became the one of creating social cohesion between the different communities. As a politician and patriot of the time stated on this topic:

> "Now that we have made Italy, we have to make the Italians."[1808]

Following our discussion in Chapter I, we could say that we made a European Union, but it will still take time and effort to make European citizens.

In the early years of the Kingdom of Italy virtually all aspects of society were under revision. Insolvency regulations were, of course an important part of the process of the creation of the new Nation and of its economy.

At that time, the newly born kingdom did not avail itself of a separate Bankruptcy Code. A well-regulated and comprehensive insolvency model was included in the already-enacted Code of Commerce whose third book, entitled "Of Bankruptcy", counted more than two hundred articles on this topic. The necessary sections to connect rules on the topic of bankruptcies to other parts of the local legal framework were found in other statutes, mainly in the Italian Civil Code, to which the Code of Commerce referred directly in several articles.

We will begin our overview of the evolutionary process followed by early Italian bankruptcy laws from these first rules included in the Code of 1882. As we will observe, in fact, they will be a good connector between medieval statutes and modern ones.[1809]

As already mentioned, this chapter will be shorter than the American one. Our goal is not be to analyze as many rules, approaches, or principles in depth. That would be impossible (and probably not very useful).

Our goal is to gain an understanding of how laws changed in the past 150 years in an emblematic European (bankruptcy) scenario. We will discuss specific rules to see how stigma remained present until modern times and how the model struggled to adapt to the process of refounding European insolvency frameworks and to the needs of the globalized market. We will also examine the consequences of excessive legal transplants.

3. The Italian insolvency framework of 1882

The Italian insolvency system included in the Code of Commerce of 1882 was animated by goals which presented a clear connection with the ones of the medieval models we discussed in Chapter IV[1810].

[1808] The restatement of a thought written by Massimo d' Azeglio who stated that the different people of Italy were not yet ready to be unified under a single flag. See http://www.treccani.it/enciclopedia/massimo-d-azeglio/ and http://www.treccani.it/enciclopedia/la-letteratura-dell-italia-unita_%28L%27Unificazione%29/

[1809] **Fabiani Massimo**, "*Diritto Fallimentare – Un profilo organico*", Zanichelli Editore, Bologna, (2011), at 23.

[1810] In making statements of this kind we are always referring to the vast majority of Italian systems, the punitive and horrific ones; Venice remained an enlightened exception in as much that the model of 1882 did not include any reorganization option.

The first royal framework aimed to provide an efficient, official, and public tool for protecting the interests of society and creditors against the threats caused by the insolvency of business debtors. The model was heavily stigmatizing and included burdensome civil and criminal punishments to discourage misbehaviors. Liquidations were the preferred (and in the beginning, the only) solution to insolvency issues. Reorganizations were not allowed until the beginning of the twentieth century.

Title 1, Book 3 of the Italian Code of Commerce of 1882 opened the discussion on the topic of insolvencies with Article 683, which stated that a business debtor (an entrepreneur, to use the more modern European terminology as synonym of businessman, merchant, trader or dealer[1811]) who stopped repaying his debts would be declared bankrupt.[1812]

The book, therefore, through an extraordinarily laconic article, addressed at its very beginning three of the most relevant elements that have been part of our previous discussions:

- to be declared "bankrupt" the debtor had to be a merchant, a dealer or a business related debtor in general.[1813] It was immediately stated therefore that bankruptcy remained a purely business related matter;
- insolvency, defined as the "cessation of payments", was the key access criteria and the most relevant element for the opening of involuntary proceedings (which were, as we will see, the vast majority);
- the presence of stigma through the use of the term "bankrupt", which constituted a clear nexus with the preceding regulations (the breaking of the bench) and was used to identify a harsh, punitive model.

By definition, under Article 683, the eligible debtor became bankrupt upon the occurrence of the element of the "cessation of payments". In such case, in fact, the debtor was obligated to submit himself to the competent Commerce Court within three days, handing over all information and documents regarding its accounting and its remaining assets, together of course with an updated list of all creditors and their domiciles.[1814] If he refrained from doing so, he would incur heavy criminal punishments. Debtors had, therefore, to be extremely cautious in the administration of their business activities and, in theory, had to be swift in taking action upon incurring difficulties.

Whether this could be considered a form of "voluntary" filing for statistical purposes may be the subject of discussion. In the end, debtors did not have much of a choice or a chance to express their free will. Voluntary cases were admissible[1815], although not incentivized by the structured of the system. While not taking prompt action to commence a case was a crime, it is also true that the consequences of bankruptcy were extremely harsh. Debtors, therefore, were incentivized to take the risk of delaying filing, hoping that unexpected income could cure their financial difficulties before an involuntary petition would be filed.

Since debtors, despite the requirement to act promptly, may have been reluctant to comply with the rules (or to commence a case voluntarily in general) the framework allowed ample recourse to involuntary filings. Under the model of 1882, an involuntary case could be commenced by petition of a creditor[1816], as long as it could be proven that the debtor was insolvent (that he had stopped making payments). The case could be commenced involuntarily also by the competent Commerce Court[1817][1818]; but it could not be commenced by the debtor's descendants, children, and spouse[1819].

[1811] See Articles 3 and 8 of the Commerce Code of 1882 which define the "acts of commerce" and the term "*commercianti*" or "dealers", providing some identification of the categories of debtors that would then be included in the insolvency framework.

[1812] "Il commerciante che cessa di fare i suoi pagamenti per obbligazioni commerciali è in stato di fallimento". See **Bonfatti Sido, Censoni Paolo F**., "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 15.

[1813] As we will discuss later in this paragraph, corporations, of course, were also eligible under Title VII. Article 690, moreover, addressed the issue of the bankrupt that had retired from its business activity.

[1814] Article 686.

[1815] Article 684 - 686.

[1816] See also Article 687, which clearly mentions that one or more creditors could file the involuntary petition.

[1817] See Article 688 by which the competent Commerce Court must declare the merchant bankrupt when it was of public knowledge that he stopped making payments.

On the topic of proving insolvency, Article 705 stated that:

> "The refusal to make some payments in good faith is not equivalent to the debtor's incapacity to pay; the continuation of payments (on the other hand) through ruinous or fraudulent manners is not proof of the debtor's capacity to pay."

Article 829, moreover, stated that, if the debtor could prove that the omission or cessation of payments was caused by extraordinary causes and that the patrimony was worth more than his debts, then he could be granted a moratorium to accomplish all of the acts necessary to cover his outstanding obligations. Hence the system did provide ways to spare debtors from the often irreparable consequences and effects of the stigma of bankruptcy, if could pay. Such reasonable protection could be considered almost necessary.

Once the case was commenced, the proceeding moved swiftly and the punitive factors afflicting bankrupts would soon come into effect.

The case would fall automatically under the supervision of the competent Commerce Court (the one in charge for the area in which the debtor had its business establishments) and the direction of a Delegated Judge who would exercise ample powers to solicit any act necessary to push proceedings forward and swiftly reach its conclusion.[1820] The case would also be automatically placed under the supervision of a King's Prosecutor who would verify whether crimes (in the next pages we will discuss some of the most relevant crimes applying specifically to bankruptcy cases) had been committed[1821], eventually ordering the immediate "capture" of the bankrupt and of other culprits.[1822]

The creation of the estate[1823] would leave the debtor dispossessed of all of his assets (with very minor exceptions). An administrator would be put in charge of administering the property of the proceeding which would be promptly and officially sealed by a public official.[1824]

Under Articles 734-735, just a few items (mostly of no economic value) would be exempted or protected. Article 735 listed: the debtor's furniture, clothing, and furnishings that would be necessary to the bankrupt or to his family, unless the Bankruptcy Judge in charge decided otherwise. A peculiar protection, which shows clear signs of the connection standing between the insolvency framework of 1882 and its predecessors, was placed in Article 780 (and subsequent ones), regulating the rights of the wife of a bankrupt. Itawarded a special protection on all those assets that could be proven to be part of her dowry (including real estate[1825]).

Following the liquidation of the debtor's assets, the distribution process would take place, prioritizing the repayment of expenses that had to be faced for the proceeding and the rights of secured creditors. Unsecured creditors that did not enjoy a priority ranking would receive the remaining liquidity under the *pari passu* principle.

A bankruptcy case commenced voluntarily or involuntarily under the Code of 1882 could be closed though:

a) distribution of all the available assets (if any at all) – the standard conclusion of a liquidation proceeding;
b) payment of all debts including expenses and interests – an extremely rare occurrence that meant that the debtor was able to obtain finance somehow.

A further option allowed liquidations to be closed through an agreement between the debtor and creditors, a "*concordato fallimentare*" (a proceeding we discussed also in Chapter IV). In order to do so the

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[1818] Article 684.
[1819] Article 687.
[1820] Article 685.
[1821] Article 694 the file had to be sent to the King's prosecutor's office within 24 hours from the commencement of the case.
[1822] Article 695.
[1823] See Article 699.
[1824] See Article 692.
[1825] See Article 780.

debtor had to obtain the approval of the majority of creditors. Incentives supporting such *concordati* were not as generous as the ones discussed in modern systems today. The debtor[1826] would regain his right to travel but he would not, for example, be able to halt any criminal investigation for bankruptcy crimes for which he could still be found guilty. Moreover, restrictions on his ability to trade would continue to be imposed and the stigma suffered from the publication of his name in specific registers could be difficult to contain.

Reorganization proceedings would not become available until a later time. A framework including a form of *concordato preventivo* was enacted in 1903[1827] to offer the honest but unfortunate debtor a means to avoid the inexorable destruction of its business, which was still vital, causing damage to the public economy.[1828]

3.1 Stigma within the framework of 1882

The stigma permeating the insolvency framework of 1882 derived from the copious civil limitations and criminal punishments imposed on bankrupts, who ultimately became second class citizens.

Civil consequences of bankruptcies impacted several basic freedoms. The debtor would be unable to move freely within (and, of course, outside of) the country[1829] and often forced into house arrest (which could, nevertheless, be considered progress compared to automatic imprisonment). He would also be prevented from trading and his name would be listed in the public register of bankrupts which would be affixed in court and in local stock exchanges[1830] (from which he would be banned).

Title VIII was an ample section concerned with bankruptcy crimes. The stigmatizing framework predisposed by the Code of 1882 punished the misbehaviors of bankrupts and of several other parties involved in the bankruptcy process.

The term “bankruptcy” (*bancarotta*) identified a crime itself. The crime of *bancarotta* could be “simple” or “fraudulent”.[1831] Article 855 stated that violations could be committed even before the commencement of the case in all those instances in which the debtor:

- “escaped”;
- closed down the business;
- hid or stole assets fraudulently causing harm to the creditors[1832].

The “simple” form of bankruptcy punished the debtor who had been incautious, imprudent, and reckless in managing the business. He could be imprisoned for a period of time ranging from six months to two years. Typical actions that constituted this crime were the dissipation of the patrimony of the debtor by:

- spending excessive amounts of money to maintain himself or his family and other dependent individuals;
- making investments which could be considered as based purely on luck or as characterized by manifest imprudence;
- implementing a strategy to delay the commencement of the case through loans or other “ruinous” means to obtain finance;
- making preferential payments to certain creditors after the commencement of the case (more precisely after the moment of cessation of payments);

Other relevant factors were:

[1826] Under Article 698, for example, with the closure of the proceeding the debtor would regain his right to leave his residence and travel. Article 816 stated that if the case was closed with the full payment of all debts and interests (hard to imagine possible) the name of the debtor would be cancelled from all public shaming registers; such privilege though would not be awarded to those that were convicted for “fraudulent bankruptcy”.

[1827] Law May, 24th 1903 , n. 197.

[1828] **Bonfatti Sido, Censoni Paolo F**., “*Manuale di diritto fallimentare*”, CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 277.

[1829] See Article 698.

[1830] See Article 697.

[1831] See Articles 856-861.

[1832] See Article 855.

- not keeping the books regularly updated;
- altering the list of creditors or simulating debts to obtain a moratorium.[1833]

Non-compliance with Article 686, which ordered the debtor to file for the commencement of his case with the competent Commerce Court within three days from the cessation of payments, was also a cause of the commencement of a criminal action for "simple" bankruptcy. Other sections were added with time to include, for example, the case in which the debtor was closing a *concordato* (reorganization – from the time, of course, in which they were made available by the enacted framework) but did not make payments as agreed with the creditors.[1834] Article 857 also stated that all brokers going bankrupt were by default culpable of this basic form of bankruptcy.

Article 860 addressed the issue of those more relevant criminal acts, punishing the debtor with "fraudulent" bankruptcy. Typical acts that constituted ground for this aggravated form of bankruptcy were:

- misappropriation or falsification of the books of the bankrupt's business activity;
- misappropriation or dissipation assets;
- alteration the list of creditors;
- simulation of debts through filing false claims.

In such instances debtors would be sentenced to a longer term of imprisonment and to hard labor.

Further punishments applied. In all instances in which a debtor was sentenced for a form of criminal bankruptcy he would be excluded from commerce and admission to stock exchanges and trades.

Following medieval traditions, the second part of the title was concerned with the punishment of other culprits such as agents and administrators of the debtor's patrimony; but also insolvency administrators[1835] who, upon committing violations of their duties, could be sentenced to jail. Those who would have aided and abetted the debtor in a case of *bancarotta* could be sentenced to serve up to five years of jail time.[1836] Those creditors who made preferential agreements, obtained personal advantages, or damaged other creditors by obtaining undue advantages were also imprisoned.

4. The Italian Bankruptcy Law of 1942

4.1 The long and adventurous life of the Bankruptcy Law of 1942

In the forties Italian legislators put unprecedented effort into reorganizing the field of insolvency laws. The government took action by drafting a new, specific bankruptcy statute reuniting all proceedings[1837]: the R.D. (*Regio Decret*o – Royal Decree), 16th of March 1942, n. 267 (commonly referred to as the Italian Bankruptcy Law).

The new regulation aimed to increase the levels of effectiveness and efficiency within the system, providing more options to debtors (liquidations and reorganizations) and greater uniformity in the application of the rules.[1838] Several principles which we discussed within the system of 1882 remained relevant parts of the new law, which still had significant connections with its ancestors.[1839]

The Royal Decree was in force for over 60 years and lived an adventurous life.

Its roots, in fact, were planted in a form of government and in ideologies that had little to do with the ones of the modern Italian Republic established shortly after its enactment. Nevertheless, the Italian bankruptcy law of 1942 continued regulating the field up to 2005, serving the purpose of protecting and supporting the efforts of the national economy for over six decades that were characterized by great social and economic changes.

[1833] Article 859.

[1834] See Article 857.

[1835] See Article 864.

[1836] See Article 865 which explicitly mentioned the case of the ascendants and descendants of the debtor of other family members and of the spouse whom knowingly assisted the debtor into committing criminal bankruptcy actions.

[1837] **Bonfatti Sido, Censoni Paolo F.**, "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 3.

[1838] *Id.,* at 3.

[1839] **Fabiani Massimo**, "*Diritto Fallimentare – Un profilo organico*", Zanichelli Editore, Bologna, (2011), at 24-5.

Much happened, to say the least, within the Italian and the international scenario between World War II and the beginning of new millennium. This point is one of the key elements supporting the choice of discussing this model.

We mentioned in Chapter I how studies made in 2003[1840], at the beginning of the process of refounding European insolvency regulations, showed that the Italian framework of the time, despite its ancient roots, applied several of the best practices listed in the World Bank's list of 2001. An extract of the study is presented in the following table:

WORLD BANK'S PRINCIPLES 2001 VERSION	Evaluation of the level of their adoption in Italy
PRINCIPLE 1: COMPATIBLE ENFORCEMENT SYSTEMS A modern credit-based economy requires predictable, transparent and affordable enforcement of both unsecured and secured credit claims by efficient mechanisms outside of insolvency, as well as a sound insolvency system. These systems must be designed to work in harmony.	Fully or almost fully adopted
PRINCIPLE 2: ENFORCEMENT OF UNSECURED RIGHTS A regularised system of credit should be supported by mechanisms that provide efficient, transparent, reliable and predictable methods for recovering debt, including seizure and sale of immovable and movable assets and sale or collection of intangible assets such as debts owed to the debtor by third parties.	Fully or almost fully adopted
PRINCIPLE 3: SECURITY INTEREST LEGISLATION The legal framework should provide for the creation, recognition, and enforcement of security interests in movable and immovable (real) property, arising by agreement or operation of law. The law should provide for the following features: · Security interests in all types of assets, movable and immovable, tangible and intangible, including inventory, receivables, and proceeds; future or after-acquired property, and on a global basis; and based on both possessory and non- possessory interests; · Security interests related to any or all of a debtor's obligations to a creditor, present or future, and between all types of persons; · Methods of notice that will sufficiently publicise the existence of security interests to creditors, purchasers, and the public generally at the lowest possible cost; · Clear rules of priority governing competing claims or interests in the same assets, eliminating or reducing priorities over security interests as much as possible.	Fully or almost fully adopted
PRINCIPLE 4: RECORDING AND REGISTRATION OF SECURED RIGHTS There should be an efficient and cost-effective means of publicising secured interests in movable and immovable assets, with registration being the principal and strongly preferred method. Access to the registry should be inexpensive and open to all for both recording and search.	Partially adopted
PRINCIPLE 5: ENFORCEMENT OF SECURED RIGHTS Enforcement systems should provide efficient, inexpensive, transparent and predictable methods for enforcing a security interest in property. Enforcement procedures should provide for prompt realisation of the rights obtained in secured assets, ensuring the maximum possible recovery of asset values based on market values. Both non-judicial and judicial enforcement methods should be considered.	Partially adopted
PRINCIPLE 6: KEY OBJECTIVES AND POLICIES Though country approaches vary, effective insolvency systems should aim to: · Integrate with a country's broader legal and commercial systems. · Maximise the value of a firm's assets by providing an option to reorganise. · Strike a careful balance between liquidation and reorganisation. · Provide for equitable treatment of similarly situated creditors, including similarly situated foreign and domestic creditors. · Provide for timely, efficient and impartial resolution of insolvencies.	Fully or almost fully adopted

[1840] Data as presented by the **Philippe & Partners, Deloitte & Touche Corporate Finance**, "*Bankruptcy and fresh start: stigma on failure and consequences of bankruptcy*", (2002).

· Prevent the premature dismemberment of a debtor's assets by individual creditors seeking quick judgements. · Provide a transparent procedure that contains incentives for gathering and dispensing information. · Recognise existing creditor rights and respect the priority of claims with a predictable and established process. · Establish a framework for cross-border insolvencies, with recognition of foreign proceedings.	
PRINCIPLE 7: DIRECTOR AND OFFICER LIABILITY Director and officer liability for decisions detrimental to creditors made when an enterprise is insolvent should promote responsible corporate behaviour while fostering reasonable risk taking. At a minimum, standards should address conduct based on knowledge of or reckless disregard for the adverse consequences to creditors.	Fully or almost fully adopted
PRINCIPLE 8: LIQUIDATION AND REHABILITATION An insolvency law should provide both for efficient liquidation of nonviable businesses and those where liquidation is likely to produce a greater return to creditors, and for rehabilitation of viable businesses. Where circumstances justify it, the system should allow for easy conversion of proceedings from one procedure to another.	Partially adopted
PRINCIPLE 9: COMMENCEMENT: APPLICABILITY AND ACCESSIBILITY A. The insolvency process should apply to all enterprises or corporate entities except financial institutions and insurance corporations, which should be dealt with through a separate law or through special provisions in the insolvency law. State-owned corporations should be subject to the same insolvency law as private corporations.	Partially adopted
B. Debtors should have easy access to the insolvency system upon showing proof of basic criteria (insolvency or financial difficulty). A declaration to that effect may be provided by the debtor through its board of directors or management. Creditor access should be conditioned on showing proof of insolvency by presumption where there is clear evidence that the debtor failed to pay a matured debt (perhaps of a minimum amount).	Fully or almost fully adopted
C. The preferred test for insolvency should be the debtor's inability to pay debts as they come due—known as the liquidity test. A balance sheet test may be used as an alternative secondary test, but should not replace the liquidity test. The filing of an application to commence a proceeding should automatically prohibit the debtor's transfer, sale or disposition of assets or parts of the business without court approval, except to the extent necessary to operate the business.	Fully or almost fully adopted
PRINCIPLE 10: COMMENCEMENT: MORATORIUMS AND SUSPENSION OF PROCEEDINGS A. The commencement of bankruptcy should prohibit the unauthorised disposition of the debtor's assets and suspend actions by creditors to enforce their rights or remedies against the debtor or the debtor's assets. The injunctive relief (stay) should be as wide and all embracing as possible, extending to an interest in property used, occupied or in the possession of the debtor.	Fully or almost fully adopted
B. To maximise the value of asset recoveries, a stay on enforcement actions by secured creditors should be imposed for a limited period in a liquidation proceeding to enable higher recovery of assets by sale of the entire business or its productive units, and in a rehabilitation proceeding where the collateral is needed for the rehabilitation.	Fully or almost fully adopted
PRINCIPLE 11: GOVERNANCE: MANAGEMENT A. In liquidation proceedings, management should be replaced by a qualified court-appointed official (administrator) with broad authority to administer the estate in the interest of creditors. Control of the estate should be surrendered immediately to the administrator except where management has been authorized to retain control over the business, in which case the law should impose the same duties on management as on the administrator. In creditor-initiated filings, where circumstances warrant, an interim administrator with reduced duties should be appointed to monitor the business to ensure that creditor interests are protected.	Fully or almost fully adopted
B. There are two preferred approaches in a rehabilitation proceeding: exclusive control of the proceeding by an independent administrator or supervision of management by an impartial and independent administrator or supervisor. Under the second option complete power should be shifted to the administrator if management proves incompetent or negligent or has	Partially adopted

engaged in fraud or other misbehaviour. Similarly, independent administrators or supervisors should be held to the same standard of accountability to creditors and the court and should be subject to removal for incompetence, negligence, fraud or other wrongful conduct.	
PRINCIPLE 12: GOVERNANCE: CREDITORS AND THE CREDITORS' COMMITTEE Creditor interests should be safeguarded by establishing a creditors committee that enables creditors to actively participate in the insolvency process and that allows the committee to monitor the process to ensure fairness and integrity. The committee should be consulted on non-routine matters in the case and have the ability to be heard on key decisions in the proceedings (such as matters involving dispositions of assets outside the normal course of business). The committee should serve as a conduit for processing and distributing relevant information to other creditors and for organising creditors to decide on critical issues. The law should provide for such things as a general creditors assembly for major decisions, to appoint the creditors committee and to determine the committee's membership, quorum and voting rules, powers and the conduct of meetings. In rehabilitation proceedings, the creditors should be entitled to select an independent administrator or supervisor of their choice, provided the person meets the qualifications for serving in this capacity in the specific case.	Partially adopted
PRINCIPLE 13: ADMINISTRATION: COLLECTION, PRESERVATION, DISPOSITION OF PROPERTY The law should provide for the collection, preservation and disposition of all property belonging to the debtor, including property obtained after the commencement of the case. Immediate steps should be taken or allowed to preserve and protect the debtor's assets and business. The law should provide a flexible and transparent system for disposing of assets efficiently and at maximum values. Where necessary, the law should allow for sales free and clear of security interests, charges or other encumbrances, subject to preserving the priority of interests in the proceeds from the assets disposed.	Fully or almost fully adopted
PRINCIPLE 14: ADMINISTRATION: TREATMENT OF CONTRACTUAL OBLIGATIONS The law should allow for interference with contractual obligations that are not fully performed to the extent necessary to achieve the objectives of the insolvency process, whether to enforce, cancel or assign contracts, except where there is a compelling commercial, public or social interest in upholding the contractual rights of the counter-party to the contract (as with swap agreements).	Fully or almost fully adopted
PRINCIPLE 15: ADMINISTRATION: FRAUDULENT OR PREFERENTIAL TRANSACTIONS The law should provide for the avoidance or cancellation of pre-bankruptcy fraudulent and preferential transactions completed when the enterprise was insolvent or that resulted in its insolvency. The suspect period prior to bankruptcy, during which payments are presumed to be preferential and may be set aside, should normally be short to avoid disrupting normal commercial and credit relations. The suspect period may be longer in the case of gifts or where the person receiving the transfer is closely related to the debtor or its owners.	Fully or almost fully adopted
PRINCIPLE 16: CLAIMS RESOLUTION: TREATMENT OF STAKEHOLDER RIGHTS AND PRIORITIES A. The rights and priorities of creditors established prior to insolvency under commercial laws should be upheld in an insolvency case to preserve the legitimate expectations of creditors and encourage greater predictability in commercial relationships. Deviations from this general rule should occur only where necessary to promote other compelling policies, such as the policy supporting rehabilitation or to maximise the estate's value. Rules of priority should support incentives for creditors to manage credit efficiently.	Fully or almost fully adopted
B. The bankruptcy law should recognise the priority of secured creditors in their collateral. Where the rights of secured creditors are impaired to promote a legitimate bankruptcy policy, the interests of these creditors in their collateral should be protected to avoid a loss or deterioration in the economic value of their interest at the commencement of the case. Distributions to secured creditors from the proceeds of their collateral should be made as promptly as possible after realisation of proceeds from the sale. In cases where the stay applies to secured creditors, it should be of limited specified duration, strike a proper balance between creditor protection and insolvency objectives, and provide for the possibility of orders being made on the application of affected creditors or other persons for relief from the stay.	Fully or almost fully adopted

C. Following distributions to secured creditors and payment of claims related to costs and expenses of administration, proceeds available for distribution should be distributed pari passu to remaining creditors unless there are compelling reasons to justify giving preferential status to a particular debt. Public interests generally should not be given precedence over private rights. The number of priority classes should be kept to a minimum.	Fully or almost fully adopted
PRINCIPLE 17: DESIGN FEATURES OF REHABILITATION STATUTES To be commercially and economically effective, the law should establish rehabilitation procedures that permit quick and easy access to the process, provide sufficient protection for all those involved in the process, provide a structure that permits the negotiation of a commercial plan, enable a majority of creditors in favor of a plan or other course of action to bind all other creditors by the democratic exercise of voting rights (subject to appropriate minority protections and the protection of class rights) and provide for judicial or other supervision to ensure that the process is not subject to manipulation or abuse.	Fully or almost fully adopted
PRINCIPLE 18: ADMINISTRATION: STABILIZING AND SUSTAINING BUSINESS OPERATIONS The law should provide for a commercially sound form of priority funding for the ongoing and urgent business needs of a debtor during the rescue process, subject to appropriate safeguards.	Partially adopted
PRINCIPLE 19: INFORMATION: ACCESS AND DISCLOSURE The law should require the provision of relevant information on the debtor. It should also provide for independent comment on and analysis of that information. Directors of a debtor corporation should be required to attend meetings of creditors. Provision should be made for the possible examination of directors and other persons with knowledge of the debtor's affairs, who may be compelled to give information to the court and administrator.	NOT ADOPTED
PRINCIPLE 20: PLAN: FORMULATION, CONSIDERATION AND VOTING The law should not prescribe the nature of a plan except in terms of fundamental requirements and to prevent commercial abuse. The law may provide for classes of creditors for voting purposes. Voting rights should be determined by amount of debt. An appropriate majority of creditors should be required to approve a plan. Special provision should be made to limit the voting rights of insiders. The effect of a majority vote should be to bind all creditors.	Fully or almost fully adopted
PRINCIPLE 21: PLAN: APPROVAL OF PLAN The law should establish clear criteria for plan approval based on fairness to similar creditors, recognition of relative priorities and majority acceptance. The law should also provide for approval over the rejection of minority creditors if the plan complies with rules of fairness and offers the opposing creditors or classes an amount equal to or greater than would be received under a liquidation proceeding. Some provision for possible adjournment of a plan decision meeting should be made, but under strict time limits. If a plan is not approved, the debtor should automatically be liquidated.	Fully or almost fully adopted
PRINCIPLE 22: PLAN: IMPLEMENTATION AND AMENDMENT The law should provide a means for monitoring effective implementation of the plan, requiring the debtor to make periodic reports to the court on the status of implementation and progress during the plan period. A plan should be capable of amendment (by vote of the creditors) if it is in the interests of the creditors. The law should provide for the possible termination of a plan and for the debtor to be liquidated.	Fully or almost fully adopted
PRINCIPLE 23: DISCHARGE AND BINDING EFFECTS To ensure that the rehabilitated enterprise has the best chance of succeeding, the law should provide for a discharge or alteration of debts and claims that have been discharged or otherwise altered under the plan. Where approval of the plan has been procured by fraud, the plan should be subject to challenge, reconsidered or set aside.	NOT ADOPTED
PRINCIPLE 24: INTERNATIONAL CONSIDERATIONS Insolvency proceedings may have international aspects, and insolvency laws should provide for rules of jurisdiction, recognition of foreign judgements, co-operation and assistance among courts in different Member States, and choice of law.	NOT ADOPTED
PRINCIPLE 25: ENABLING LEGISLATIVE FRAMEWORK	NOT ADOPTED

Corporate workouts and restructurings should be supported by an enabling environment that encourages participants to engage in consensual arrangements designed to restore an enterprise to financial viability. An enabling environment includes laws and procedures that require disclosure of or ensure access to timely, reliable and accurate financial information on the distressed enterprise; encourage lending to, investment in or recapitalization of viable financially distressed enterprises; support a broad range of restructuring activities, such as debt write-offs, reschedulings, restructurings and debt- equity conversions; and provide favourable or neutral tax treatment for restructurings.	
PRINCIPLE 26: INFORMAL WORKOUT PROCEDURES A country's financial sector (possibly with the informal endorsement and assistance of the central bank or finance ministry) should promote the development of a code of conduct on an informal out-of-court process for dealing with cases of corporate financial difficulty in which banks and other financial institutions have a significant exposure—especially in markets where enterprise insolvency has reached systemic levels. An informal process is far more likely to be sustained where there are adequate creditor remedy and insolvency laws. The informal process may produce a formal rescue, which should be able to quickly process a packaged plan produced by the informal process. The formal process may work better if it enables creditors and debtors to use informal techniques.	NOT ADOPTED
PRINCIPLE 27: ROLE OF COURTS Bankruptcy cases should be overseen and disposed of by an independent court or competent authority and assigned, where practical, to judges with specialized bankruptcy expertise. Significant benefits can be gained by creating specialized bankruptcy courts. The law should provide for a court or other tribunal to have a general, nonintrusive, supervisory role in the rehabilitation process. The court/tribunal or regulatory authority should be obliged to accept the decision reached by the creditors that a plan be approved or that the debtor be liquidated.	Partially adopted
PRINCIPLE 28: PERFORMANCE STANDARDS OF THE COURT, QUALIFICATION AND TRAINING OF JUDGES Standards should be adopted to measure the competence, performance and services of a bankruptcy court. These standards should serve as a basis for evaluating and improving courts. They should be enforced by adequate qualification criteria as well as training and continuing education for judges.	Partially adopted
PRINCIPLE 29: COURT ORGANIZATION The court should be organised so that all interested parties—including the administrator, the debtor and all creditors—are dealt with fairly, objectively and transparently. To the extent possible, publicly available court operating rules, case practice and case management regulations should govern the court and other participants in the process. The court's internal operations should allocate responsibility and authority to maximise resource use. To the degree feasible the court should institutionalise, streamline and standardise court practices and procedures.	Fully or almost fully adopted
PRINCIPLE 30: TRANSPARENCY AND ACCOUNTABILITY An insolvency systems should be based on transparency and accountability. Rules should ensure ready access to court records, court hearings, debtor and financial data and other public information.	Fully or almost fully adopted
PRINCIPLE 31: JUDICIAL DECISION MAKING AND ENFORCEMENT Judicial decision making should encourage consensual resolution among parties where possible and otherwise undertake timely adjudication of issues with a view to reinforcing predictability in the system through consistent application of the law. The court must have clear authority and effective methods of enforcing its judgements.	Fully or almost fully adopted
PRINCIPLE 32: INTEGRITY OF THE COURT Court operations and decisions should be based on firm rules and regulations to avoid corruption and undue influence. The court must be free of conflicts of interest, bias and lapses in judicial ethics, objectivity and impartiality.	Fully or almost fully adopted
PRINCIPLE 33: INTEGRITY OF PARTICIPANTS Persons involved in a bankruptcy proceeding must be subject to rules and court orders designed to prevent fraud, other illegal activity or abuse of the bankruptcy system. In addition, the bankruptcy court must be vested with appropriate powers to deal with illegal activity or	Fully or almost fully adopted

abusive conduct that does not constitute criminal activity.	
PRINCIPLE 34: ROLE OF REGULATORY OR SUPERVISORY BODIES The body or be independent of individual administrators and should set standards that reflect the requirements of the legislation and public expectations of bodies responsible for regulating or supervising insolvency administrators should fairness, impartiality, transparency and accountability.	Fully or almost fully adopted
PRINCIPLE 35: COMPETENCE AND INTEGRITY OF INSOLVENCY ADMINISTRATORS Insolvency administrators should be competent to exercise the powers given to them and should act with integrity, impartiality and independence.	Fully or almost fully adopted

Nevertheless, the bankruptcy law of 1942, as it was conceived, did not (or could not) match the society it was enacted within, although most principles were considered to be “fully” or “almost fully” adopted and the overall result of the study seemed positive.

This information appears to be, therefore, in conflict with our findings in Chapter II. May the Italian system have been an exception to the rule?

The truth is that the Italian framework of 1942, which we will discuss in greater depth in the next pages, cannot be considered a true “exception” or an exception at all. Two factors are relevant in making this statement: the fact that the law was indeed modified over time and the fact that the approach of the statute remained congruent with the society by which it was enacted.

The Royal Decree was, indeed, modified over time. It was not reformed by the enactment of a new model, but it was changed in all those areas which conflicted with the new form of government and the new democratic Constitution (not to mention with the needs of the contemporary Italian market and economy[1841]) through the action of Italy's highest courts (the *Corte Costituzionale* and the *Corte di Cassazione*), which interpreted its rules. The area that went through the greatest modifications was the procedural structure of the law; the previous process was more rigorous and allowed fewer chances of debate or appeal.

The following table shows a list of relevant decisions of the Italian Constitutional Court that led to meaningful changes and the articles or key elements of the framework that were affected by them[1842]:

Element/Principle	Article	Decision (Before 2005)
Eligibility-Access	1 (2)	Corte Costituzionale[1843] 13-22 December 1989 n. 570
Eligibility-Access	10	Corte Costituzionale 11-21 July 2000 n. 319
Procedural issues/protection of debtor’s rights	15	Corte Costituzionale 2-16 July 1970 n. 141
Procedural issues/commencement of the case	18 (1)	Corte Costituzionale 20-27 November 1980 n. 151
Procedural issues / op position to involuntary bankruptcy	22 (2)	Corte Costituzionale 14 -20 July 1999 n. 328
Procedural issues/op position to certain decrees of the delegated judge	23 (1)	Corte Costituzionale 24 -27 June 1986 n. 156
Procedural issues/op position to certain decrees of the delegated judge	26	Corte Costituzionale 24 -27 June 1986 n. 156 Corte Costituzionale 5 -23 March 1981 n. 42 Corte Costituzionale 19 -22 November 1985 n. 303 Corte Costituzionale 18 -24 March 1986, n. 55
Distribution Process: award of interests to	54 (3)	Corte Costituzionale 31 December 1986 n. 300

[1841] **Fabiani Massimo,** “*Diritto Fallimentare – Un profilo organico*”, Zanichelli Editore, Bologna, (2011), at 28.
[1842] See *Id.*, at 27-8; **Pajardi Piero**, “*Codice de fallimento commentato articolo per articolo da Piero Pajardi – annotato con la giurisprudenza della Corte di Cassazione dall’ 1..1.75 al 31.12.79 e con i relativi riferimenti dottrinali*”, IPSOA INFORMATICA, Milano, (1980); Del Vecchio Francesco, “Questioni di costituzionalità della legge fallimentare”, CEDAM, Padova, 1975;
[1843] The Italian Constitutional Court.

certain secured creditors		Corte Costituzionale 10 -20 April 1989 n. 204 Corte Costituzionale 6-18 July 1989 n. 408 Corte Costituzionale 13-22 December 1989 n. 567 Corte Costituzionale 23 -28 May 2001 n.162
Distribution Process: award of interests to certain secured creditors	55 (1)	Corte Costituzionale 31 December 1986 n. 300 Corte Costituzionale 10 -20 April 1989 n. 204 Corte Costituzionale 6-18 July 1989 n. 408 Corte Costituzionale 13-22 December 1989 n. 567
Distribution Process: award of interests to certain secured creditors	59	Corte Costituzionale 31 December 1986 n. 300 Corte Costituzionale 12-20 April 1989 n. 204 Corte Costituzionale 13-22 December 1989 n. 567
Avoiding Actions: transactions among spouses	69	Corte Costituzionale 10 -19 marzo 1993 n. 100
Procedural Issues: filing of claims and opposition of excluded creditors	98 (1)	Corte Costituzionale 16 -22 April 1986 n. 102 Corte Costituzionale 30 April 1986 n. 120
Procedural Issues: filing of claims and opposition of excluded creditors	99 (5)	Corte Costituzionale 20-27 November 1980 n. 152
“Concordato Fallimentare” (procedural issues)	131	Corte Costituzionale 7 -12 November 1974 n. 255
Rehabilitation process	144	Corte Costituzionale 8-15 July 2004 n. 224
Procedural Issues: consequences of the bankruptcy of a limited liability company on partners	147	Corte Costituzionale 2-16 July 1970 n. 142 Corte Costituzionale 20-27 June 1972 n. 110 Corte Costituzionale 11 -21 July 2000 n. 319
Reorganizations (“concordati preventivi”: Commencement of the case / procedural issues	162	Corte Costituzionale 20-27 June 1972 n. 110
Liquidazione coatta amministrativa: commencement of the case / procedural issues	195	Corte Costituzionale, 27 June1972, n. 110 Corte Costituzionale 2-4 July 2001 n. 211
Liquidazione coatta amministrativa and Amministrazione straordinaria grandi imprese: filing claims / procedural issues	209	Corte Costituzionale 21 Nov. – 2 Dec. 1980 n. 155 Corte Costituzionale 20-22 May 1987 n. 181 Corte Costituzionale 21-29 April 1993 n. 201

Since the procedure embodied in the previous bankruptcy model was in contrast with the reformed legal framework, the system acted to ensure that the law could be operative. Another factor, though, supports the statement that the law of 1942 may have been an exception: the fact that the framework remained unaltered despite the changes in the Italian form of government and economy over more than sixty years. As we will have a chance to discuss in the next pages, though, this point is not in contrast with our findings.

Italian society remained deeply punitive and continued to fear bankrupts; it still does. No real change occurred in this area between the previous form of government and the new, democratic one; or within the local market even in the new millennium. Our findings in Chapter II, therefore, prove to be correct and to match also the Italian scenario.

This relevant example allows us to observe how change can occur. We can state (and we will be able to add more on this topic once we discuss specific elements of the Royal Decree and of its subsequent modifications) that a well-crafted law that matches the principles discussed in Chapter II is likely to have a long duration and to support the economy it is enacted within effectively. Statutes which do not match the basic principles of the societies they are enacted within do a poor job even if they are more “updated”.

The Italian bankruptcy law of 1942 had an extremely long life despite minor adjustments because it did, indeed, match the needs and principles of Italian society.

4.2. An analysis of the most relevant features of the law of 1942[1844]

In the next pages we will discuss a selection of relevant features of the framework of 1942. We will use this part of the analysis to evaluate the process of reform which occurred starting in 2005.

4.2.1 The basic structure and goals of the Royal Decree

The statute of 1942 consisted of 266 articles divided into seven titles which covered all the relevant aspects of the bankruptcy framework, including specific bankruptcy crimes. Different formats of liquidation and reorganization proceedings were made available to solve disputes between a business debtor and creditors.[1845] We will begin by briefly describing the available Chapters or proceedings made available:

- **"*Fallimento*":** the main and most basic form of liquidation and a direct successor of the framework enacted in 1882 and, therefore, of the medieval systems discussed in Chapter IV. A comparison could be made with Chapter 7 of the U.S. Bankruptcy Code. The goal of a *fallimento* was to protect the interests of creditors (and of the economy at large) through a (possibly) swift, fair, equitable, organized, public liquidation of the remaining assets of the bankrupt.
- **"*Liquidazione coatta amministrativa*":** a different liquidation model that applied to specific groups of debtors listed by law and which could not be liquidated under a standard *fallimento*, such as banks or insurance companies. State owned enterprises were also often included among the debtors eligible for a *liquidazione coatta* and not a *fallimento*. This particular form of liquidation, which was first enacted in 1888 (and still is a part of Italian bankruptcy framework today) aimed to protect a variety of relevant public interests connected to the individual traits of the debtors involved.
- **"*Concordato Fallimentare*"**: we already approached this tool during the discussion of the framework enacted in 1882, and also in Chapter IV, while examining more archaic ones. The law of 1942 contained the same dichotomy between *concordati fallimentari* and *preventivi*. Despite sharing several common elements, the two differed greatly in their ultimate goals. The firstaimed to close liquidation proceedings swiftly (both a *fallimento* or a *Liquidazione coatta amministrativa*). There could not be a *concordato fallimentare*, therefore, without the commencement of a liquidation first. This particular option allowed those bankrupts[1846] who could find an agreement with their creditors to pay part of the outstanding debts and close the proceeding, at least partially limiting the stigma and burdens deriving from their default.
- **"*Concordato Preventivo*":** the basic and most powerful form of reorganization. It could be compared to a US Chapter 11[1847] although, as we will see, the stigmatizing matrix of the law of 1942 posed great limitations to its use.

[1844] For a general overview of Italian bankruptcy law before the reforms of 2005 see: **Bonfatti Sido, Censoni Paolo F**., "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004); **Pajardi Piero**, "*Manuale di diritto Fallimentare – sesta edizione*", Eds. Bocchiola Manuela and Paluchowski Alida, Giuffrè Editore SPA, Milano, (2002); **Tedeschi Guido U.**, "*Le procedure concorsuali – Volume I, il fallimento – artt. 1-91*", Unione Tipografico-Editrice Torinese, Torino, (1996).

[1845] Since the law of 1942 was not reformed until 2005, it is worth mentioning at the least in a footnote another proceeding, the **"Amministrazione Straordinaria delle Grandi Imprese" Law April 3rd, 1979, n. 95 (the so called "Prodi Law") and Decreto Legislativo July 8th, 1999, n. 270**. This particular proceeding constituted an extreme attempt to protect major, viable corporations from insolvency. To be eligible the business debtor had to count more than two hundred employees and debts up to more than two-thirds of the available assets. The debtor also had to show clear evidence of the opportunity to cure its temporary difficulties. In 2004 a version of this procedure was designed for companies counting more than 500 employees.

[1846] Insolvent debtors that were already declared bankrupt.

[1847] As we will discuss in the next pages, in fact, several modern reforms of this Italian form of reorganization proceeding occurred through the legal transplant of relevant rules which characterize the American model contained in Chapter 11.

- **"*Amministrazione Controllata*"**: a proceeding designed to support a business debtor facing "temporary financial distress". In order for the proceeding to be successfully commenced, the debtor had to show clear evidence of the possibility of resolving the situation of financial distress and creditors had to express a favorable vote.[1848]

In order to ensure its organic application within the Italian legal system, the new Bankruptcy Law relied heavily on the Civil Code, the Code of Civil Procedure and, when necessary, on other statutes for integrations.[1849]

The newly-enacted model continued to focus exclusively on business debtors. Merchants, traders, corporations and business related operators in general were all at risk of being declared "bankrupts" under the Royal Decree. A number of policies that will be discussed in the next sections excluded (we could say "protected", given the stigmatizing matrix of framework) some groups of debtors, such as farmers, artisans, and governmental entities. Such approach was considered necessary to:

a) avoid paying the costs of major proceedings upon the defaults of excessively small debtors;
b) protect "weaker" debtors from the burdens, punishments, and the consequences of the stigma of bankruptcy in general; bankrupts, in fact, continued to be perceived by society as second-class citizens.[1850]

Before continuing our discussion, it is worth mentioning that, in order to keep a simple and linear approach towards our goals, our analysis in the next sections will focus mostly on two proceedings: the *fallimento* and *concordato preventivo*.

4.2.2 The role of courts, bankruptcy judges, insolvency administrators, and creditors' committees[1851]

The Italian framework in force between 1942 and 2005 involved several kinds of "insolvency administrators"; their role, powers, and names differed depending on proceedings. Liquidations were managed by "*Curatori*" while reorganizations involved "*Commissari Giudiziali"* and "*Commissari Liquidatori*". Despite the increase in costs, the DIP model was not applied; proceedings were always supervised by court-appointed officials to ensure compliance with the rules and to avoid fraud. Insolvency administrators managed the estate in the interest of the creditors and society, under the supervision of the competent bankruptcy courts and of delegated bankruptcy judges.

We will not discuss in detail the powers and duties of each kind of administrator but it is relevant to mention that the role of a *Curatore*[1852] in a liquidation matched Principle 10A fully. Principle 10B could be considered "partially adopted" due to the:

- limits placed on the managerial powers awarded to debtors;
- constant supervision by courts and administrators.

The Italian system did include creditors' committees made up of three to five members.[1853] Their role, though, was of limited importance and mainly focused on monitoring the management of the proceeding with ample powers to:

- control accounting;
- ask for the verification of documents[1854];
- request the removal of the insolvency administrator in case of misbehavior.[1855]

[1848] The 2006 reform of Italian bankruptcy law repealed this tool, which proved to be overall unpopular, and merged it with the revised *concordato preventivo*; creditors were, in fact, often disinterested in actively supporting the debtor and often preferred a standard liquidation.

[1849] **Bonfatti Sido, Censoni Paolo F**., "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 1.

[1850] See Chapeter IV.

[1851] For an analysis on this topic see **Pajardi Piero, Bocchiola Manuela**, "*Gli organi del processo di fallimento*", Giuffrè Editore, Milano, (1991).

[1852] **Bonfatti Sido, Censoni Paolo F**., "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 56-58.

[1853] Article 40.

[1854] Article 41 (2).

Obtaining an opinion of the Committee was mandatory in limited circumstances only, such as cases in which the insolvency administrator of a case wanted to:

- be supported by other experts paid for by the proceeding[1856] (in any case, the final authorization would be given by the bankruptcy judge presiding the proceeding);
- exercise powers ranging outside of ordinary administration.[1857]

Not all opinions, moreover, were binding.

The Committee could also be consulted if the bankruptcy judge deemed it necessary.

Overall, the role of creditors' committees in the insolvency framework of 1942 was not of key importance. This is probably the reason why the study stated that principle 12 was just "partially adopted"[1858].

The key figure in charge of directing the proceeding was the one of the delegated bankruptcy judges who, as stated in Article 25, "directed operations and supervised the appointed administrators"[1859]. Bankruptcy judges were awarded very ample powers. We will not analyze this point in depth, but it is relevant to mention it since, as we will see, one of the most notale aspects of the reforms that took place from 2005 was tilting the balance in this area in favor of insolvency administrators and of creditors' committees.

4.2.3 Commencement of cases: eligible debtors

Following in the steps of the Code of Commerce of 1882, bankruptcy in the Italian law of 1942 remained a purely business-related field. Eligibility was limited to (most) entrepreneurs and corporations.[1860] As we are about to discuss, the Italian law followed the best practices included in the World Bank's Principles in excluding from the main insolvency proceedings banks and insurance companies. This approach allowed those major defaults with a significant impact in the economy and society to be administered under more specific, and better tailored, models.

Further exceptions and exclusions were also included, though.

In order to design access criteria, the law relied heavily on the Civil Code (see Articles 2082, 2083, 2195, 2221). Article 1 (1), of the Italian bankruptcy law of 1942, stated that entrepreneurs engaged in business activities, with the exception of "small entrepreneurs" and state-owned enterprises, were eligible debtors in a *fallimento, concordato preventivo,* or an *amministrazione controllata*. Therefore, the following elements had to be met in order for a debtor to be eligible under one of the insolvency proceedings that we are discussing. The debtor had to be[1861] a private – not public – entrepreneur, of medium or large size.[1862]

i. "Entrepreneur" was defined as a debtor engaged in business / entrepreneurial activity;
ii. "Entrepreneurial activity" was defined as an organized activity run in a professional (not amateurish), organized (not sporadic) manner and aimed at the production of goods or services to be sold or traded for profit on the market;

The following categories are examples of the main exclusions included in the law; several borderline cases would often require much interpretative effort to determine if a particular debtor could be spared or not[1863]:

[1855] Article 37.

[1856] Article 32 (3).

[1857] Article 35.

[1858] See **Bonfatti Sido, Censoni Paolo F**., "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 59-60.

[1859] *Id.,* 53-5. See also **Fabiani Massimo**, "*Diritto Fallimentare – Un profilo organico*", Zanichelli Editore, Bologna, (2011), at 25.

[1860] The Italian insolvency framework, by limiting itself to business debtors, remained closer to its medieval origins. See **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 126.

[1861] The definition is extremely complex and gives raise to uncountable exceptions. We will briefly discuss the most relevant elements that are useful to reaching our goals.

[1862] **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 127-131.

[1863] More exclusions concern those involved in intellectual professions, such as notary publics, lawyers, doctors, experts, etc., depending on some specific parameters. Moreover, a case could also be opened for eligible insolvent

- farmers;
- Governmental entities and municipalities;
- Banks and insurance companies;
- Charities and non-profits;

The most complex and relevant exclusion, though, remained the one protecting small entrepreneurs"

[A] Farmers[1864]

A first relevant exclusion protected farmers.[1865] Determining who was a "farmer" in the meaning of the Bankruptcy Law posed several challenges and needed "external support"[1866]. Article 2135 (1) of the Italian Civil Code defined a "farmer", or an "agricultural entrepreneur", as someone that *directly* cultivated the land or who was personally involved in activities such breeding animals, botany, or forestry.

The element of "direct" human involvement in agricultural activity was, obviously and necessarily, revised greatly over the years. The decree was in force between 1942 and 2005, a time in which the involvement of technology in such economic activities changed radically. In the early years of the law, farmers would not be shielded from bankruptcy if they reached such a size that the majority of the income was not anymore derived from agricultural processes but from industrial ones.[1867] This prong had to evolve and adapt to new developments in the production of agricultural goods; the use of technology and machinery became predominant, with a consequent reduction in manpower.

The rationale, though, remained unaltered; the growth of an agricultural business to the size of a "megacorporation" would not shield the debtor. The focus of the law remained the protectection of "small" business activities that would be unfairly harmed by the application of a harsh and stigmatizing framework. Therefore the size, the volume of business, and the activities of the farmer debtor would be considered an important element to determine their eventual eligibility. If doubts arose, bankruptcy judges would decide case by case.[1868]

[B] Governmental entities and municipalities[1869]

A second important exclusion, which was clearly listed in Article 1 of the bankruptcy law, protected governmental entities and municipalities. A definition of "*Ente Pubblico*"[1870] was provided by the Italian Civil Code in Article 2093; yet a number of criteria were applied to discern between debtors.[1871] In general, the Government identified those particular branches that would be shielded from insolvency proceedings.

In cases in which doubts arose and there was no clear evidence, courts would consider the functions of the debtor and the origin of invested capital. Partially state-owned enterprises, meaning those enterprises

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entrepreneurs within one year from their death, Articles 10-11. See **Bonfatti Sido, Censoni Paolo F**., "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 31.

[1864] To draw an analogy with the U.S. system, it is worth mentioning that fishermen have enjoyed specific protections from bankruptcy since 2001 (D.Lgs. 226/2001).

[1865] See **Tedeschi Guido U**., "*Le procedure concorsuali – Volume I, il fallimento – artt. 1-91*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 26-7. **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at at 133-4.

[1866] In 1986 the D.P.R. December, 22, n. 1986 defined those that could be considered "agricultural activities"; in 2001 the D.lgs. May 18, 2001, n. 228 attempted to provide a fixed parameter to determine agricultural entrepreneurs. In 2004 the D.lgs. March 29, 2004, n. 99 improved the system, introducing the definition of "professional agricultural entrepreneur" (Imprenditore Agricolo Professionale in Italian). Such changes occurred very recently, almost at the same time the reform of the Italian bankruptcy framework startedm and therefore will not be discussed. The paragraph will refer to the traditional difficulties revolving around the agricultural business and bankruptcy.

[1867] Another example included mediators trading livestock who did not enjoy protections because, despite operating in connection with the farming process, they merely transferred the property of animals grown by a farmer.

[1868] **Ricci Edoardo F**., "*Lezioni sul fallimento – I*", Giuffrè Editore, Milano, (1992), at 41-43.

[1869] See **Tedeschi Guido U**., "*Le procedure concorsuali – Volume I, il fallimento – artt. 1-91*", Unione Tipografico-Editrice Torinese, Torino, (1996); at 26-7; See Article 2221 of the Civil Code.

[1870] Public entity.

[1871] **Ricci Edoardo F**., "*Lezioni sul fallimento – I*", Giuffrè Editore, Milano, (1992), at 58.

whose stock or property in general was owned in part by the government or other public entities and branches, for example, could be debtors in bankruptcy proceedings.[1872]

[C] Banks and insurance companies

A third (partial) exclusion which we have already mentioned in several settings protected banks or insurance companies. They would not be eligible under most insolvency proceedings, but they could be debtors in a *liquidazione coatta amministrativa*.[1873] The rationale justifying this exclusion matched the one applied in most of the models we have been analyzing, which is shared also by the World Bank's Principles today: due to their social and economic relevance, and to the strict controls they are subjects to, these classes of debtors were excluded from standard insolvency proceedings. Since, though, banks and insurance companies could still encounter financial distress and incur defaults, more specific and better-tailored proceedings would apply.

A specific tool was designed to provide assistance in such situations. One of the most relevant features of the *liquidazione coatta amministrativa* was the fact that insolvency was not necessary to trigger its commencement. This is a particularly interesting element in a system that relied heavily on this access criteria. The justification for this approach lied in the fact that, in such peculiar situations, action had to be taken swiftly, even if it was not possible to establish beforehand whether the debtor had already reached an irreversible level of default. The authorities in charge could, therefore, order the commencement of the proceeding upon detecting major irregularities. Insolvency, if present, could be investigated (and eventually punished) at a later time. It would still be relevant under a number of aspects, in particular to evaluate the liability of directors, supervisors, experts, officials, and management in general.

[D] Charities, associations, and non-profits in general

A fourth exclusion protected charities and non-profit organizations. This group of debtors often applied business logic in the perusal of their goals, but the fact that they were active in the market without seeking profits justified their exclusion from the insolvency framework.

Those businesses, though, that conducted operations disguised as non-profits in order to cheat the system would not be shielded.[1874]

[E] Small entrepreneurs

The remaining entrepreneurs were non-public: businesses, merchants, or dealers involved, as specifically detailed in Article 2195 of the Italian Civil Code, in producing or trading goods and services for profit.[1875]

A further exception would protectsome of them.

The Italian insolvency law of 1942 excluded from the reach of bankruptcy a group defined as "small entrepreneurs".

Such entrepreneurs conducted operations of (relatively) little value and did not have a significant impact on the economy.

Their limited volume of business and connections did not pose a significant threat in cases of insolvency and were, therefore, deemed to deserve protections from the excessive stigma and the punishments they would suffer in case they defaulted.[1876] Other theories that justified this last exception involves a cost-benefits analysis: it was not reasonable to apply complex and expensive procedures to cases of little importance.[1877]

This approach was considered reasonable and congruent with the historical origins of insolvency law in Italy. Rules to identify small entrepreneurs remained in force for decades.

[1872] *Id.,* at 59.

[1873] Civil code Section 2083; bankruptcy law § 1. Several specific laws also applied, see for example: Law 7 March 1938, n. 141; t.u. d.p.r. 13 February 1959, n. 449. **Ricci Edoardo F.**, "*Lezioni sul fallimento – I*", Giuffrè Editore, Milano, (1992), at 72.

[1874] See Cass. June 20, 2000, n. 8374.

[1875] **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 126-8.

[1876] *Id.,* 128.

[1877] *Id.,* 140. See also **Ricci Edoardo F.**, "*Lezioni sul fallimento – I*", Giuffrè Editore, Milano, (1992), at 59-62.

However, discerning between those entrepreneurs that should be protected and those that should not merely depending on their size presents significant challenges.

In Article 2083, the Civil Code defined "small entrepreneurs" as: small traders, small independent farmers, and those that based their business activity prevalently on their work and or the work of members of the family.[1878] Artisans[1879] and craftsmen were the most iconic examples of small, private, for-profit entrepreneurs to be spared from bankruptcy.[1880] Judging what would be objectively "small", though, was difficult. Lucky and hardworking farmers could develop their activities, growing in size up to becoming true companies, as could talented artisans.

Hence, attempts had to be made to create parameters that could bring more predictability and transparency to the system. Article 1 (2) of the Italian bankruptcy law of 1942 added two more prongs to the definition of "small entrepreneur" in Article 2083 of the Civil Code. To be protected in a bankruptcy setting, the debtor had to[1881]:

a) be found to have an income below a certain amount based on a taxe (called "*imposta di ricchezza mobile*", which was soon repealed[1882]);

b) run a business activity in which less than 900.000 Italian liras had been invested.[1883]

The system that was created incurred various modifications and was ultimately repealed in the eighties, leaving a gap which stood until the reforms of 2005. Difficulties remained, therefore, until the new millennium, and decisions were made on a case-by-case analysis.[1884]

4.2.4 Commencement of cases: voluntary and involuntary filing[1885]

The Italian Bankruptcy Law of 1942 allowed four ways to commence a case upon showing insolvency.[1886] Cases could be commenced:

- voluntarily through the petition of an eligible debtor;
- involuntarily by a petition filed by one or more creditors;
- involuntarily by initiative of public prosecutors;
- involuntarily by initiative of a judge in a civil case.

Any eligible debtor could commence a case voluntarily by declaring his insolvency and by filing the requested documents with the competent bankruptcy court.[1887] Following in the steps of the Commerce Code of 1882, filing continued to be compulsory in all those cases in which an eligible debtor had become insolvent; noncompliance would be the cause of the imposition of heavy civil and criminal punishments. As we will discuss in one of the next sections, procrastinating the commencement of a case was a crime punished by Article 217, Section 4, "*bancarotta semplice*".[1888]

[1878] See also Law August 8 n. 443 of 1985.

[1879] A definition of "artisan" can be found in Article 2 of Law August 8, n. 443, 1985.

[1880] Artisans in particular would be included in particular registers which would allow bankruptcy courts to hold a presumption of exclusion from the bankruptcy regime. See **Tedeschi Guido U**., "*Le procedure concorsuali – Volume I, il fallimento – artt. 1-91*", Unione Tipografico-Editrice Torinese, Torino, (1996); at 19. **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 145-7.

[1881] See **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 141-150.

[1882] Repealed in 1974 (sections 82 and 88 bis D.P.R. 29 september 1973 n 597)

[1883] Originary limit 30.000 Liras. It became 900.000 Liras in 1952 (l. 20 october 1952 n. 1375); Cass. December 22, 1989 n. 570. *Ha dichiarato illegittimita della possibilita di dichiarare piccolo imprenditori su base 900.000 per effetto della svalutazione della moneta,* **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 143-145.

[1884] **Ricci Edoardo F.**, "*Lezioni sul fallimento – I*", Giuffrè Editore, Milano, (1992), at 61; **Jorio Alberto**, "Le crisi d' impresa – il fallimento", Giuffrè Editore, Milano, (2000), at 144; **Tedeschi Guido U**., "*Le procedure concorsuali – Volume I, il fallimento – artt. 1-91*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 16.

[1885] **Jorio Alberto**, "**Le crisi d' impresa – il fallimento**", Giuffrè Editore, Milano, (2000), at 241-2.

[1886] *Id.*

[1887] See Article 6, which allows debtors to file voluntarily and Article 14 listing the necessary documents.

[1888] The article punishes the debtor who worsened his financial default by refraining from filing on time.

Any creditor (even the holders of future, or of secured, claims[1889][1890]) who could prove the insolvency of an eligible debtor could file for bankruptcy with the competent bankruptcy court. Moreover, an involuntary case could be commenced by public prosecutors[1891] in criminal cases and judges in civil controversies[1892] in all those cases in which the insolvency of the debtor would become manifest. More specifically, under Article 7, a public prosecutor had to request the commencement of a bankruptcy case to the competent bankruptcy court whenever, in a criminal case, a debtor was found to:

- have run away;
- have closed his place of business;
- have fraudulently dissipated assets.

The link between insolvency and running away, which we have been discussing since Chapter IV, was still applied and important under the law of 1942 and lasted until the new millennium. Under Articles 6 and 8, a judge in a civil law suit, upon learning of the insolvency of the debtor, had to inform the competent bankruptcy court for the commencement of the case.[1893]

The fact that, statistically, the vast majority of cases were commenced involuntarily was not considered as a negative, but rather as a natural consequence of the role held by insolvency systems within the general legal framework.[1894] Bankruptcy law was structured to protect the interests of a multitude of creditors and stakeholders in those instances in which the debtor would procrastinate on paying his debts, commit crimes, or incur reckless behaviors which would cause his financial default. It was therefore reasonable that creditors would be the ones to take action.[1895]

The truth was that the stigma of declared bankrupt, constituted by the heavy civil and criminal limitations and burdens that we will discuss in the next pages, acted as a powerful deterrent toward filing voluntarily. It discouraged debtors from admitting their difficulties and prevented them from taking timely action (we will make relevant observations on this point also upon discussing the Italian reorganization framework of 1942). Bankrupts were tempted to adopt extreme remedies and hazardous stratagems to delay the commencement of a case, even if that meant incurring further criminal responsibilities.

On this point, it is interesting to mention that debtors and creditors could propose out-of-court agreements to prevent the involuntary filing of petitions. Such agreements would be valid and creditors that breached them could be sanctioned.[1896] At the same time, though, once the matter was presented to a bankruptcy court, the business could be declared bankrupt.[1897]

4.2.5 Commencement of cases: access criteria

Insolvency[1898] constituted the primary access requirement to proceedings in the Italian system of 1942 and was the key test for the commencement of most liquidations and reorganization proceedings (*fallimento, concordato preventivo,* and *amministrazione straordinaria*[1899]).

As we already mentioned, the *liquidazione coatta amministrativa* constituted a good reason to create an exception. The debtor, for example a bank, could be found insolvent after the commencement of the public proceeding.[1900] This exception was necessary to stop the activity of these entities as soon as

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[1889] See **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 241.
[1890] Which was congruent with the goals of proceedings aimed to the protections of creditors. *Id.*
[1891] Articles 6 and 7.
[1892] See **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 245.
[1893] *Id.* at 244-5.
[1894] See **Tedeschi Guido U.**, "*Le procedure concorsuali – Volume I, il fallimento – artt. 1-91*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 40.
[1895] **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 241.
[1896] Cass. June 26, 1992 n. 8012; Cass. February 26, 1990 n. 1439.
[1897] *Id.,* at 242.
[1898] In the U.S. insolvency remains a relevant access criteria in Chapter 9: https://www.washingtonpost.com/blogs/govbeat/wp/2013/12/03/judge-declares-detroit-eligible-for-chapter-9-bankruptcy/?utm_term=.cc446110abb4
[1899] See, for example, Article 5 for *fallimento*; Article 160 for *concordato preventivo;* and Article 1 d.l. 30 January 1979 n. 26 together with others for the "*amministrazione straordinaria delle grandi imprese*".
[1900] Article 195.

irregularities were suspected, to better protect the market and investors. If further investigations showed that the entity was also insolvent, consequences would arise. Indicators such as the failure to comply with regulations and controls were sufficient to justify taking early preventive measures.

The modern concept of insolvency applied in the law of 1942 attempted to improve the parameters provided by in the Commerce Code of 1882 by the application of a liquidity test.[1901] Upon verifying a situation of great difficulties in the management of an eligible debtor, the focus would shift. Creditors would lose the right to protect their claims individually through single executive actions; society would take charge, providing a tool for the protection of "all" claims[1902] and interests.

The Law of 1942 attempted to provide the system with a clear, transparent, and predictable definition of what constituted insolvency.

Article 5 (2) defined insolvency as the debtor's incapacity to regularly repay debts.[1903] The element of the cessation of payments, which was already a key feature of the system in 1882, was developed; this element was found in the inability to face obligations as they came due, regularly. Proving when payments were not "regular" gave rise to much debate. In 1882, a debtor suffering financial losses, or unwilling to pay some disputed debts, was not per se insolvent.[1904] The new framework required several elements to be provided to courts to allow them to make swift and accurate determinations on the debtor's financial conditions. Many of these elements were rooted in traditional approaches to bankruptcy:

- the use of "unusual" methods of payment[1905], such as the *datio in solutum*[1906] – the act of giving assets to creditors to repay debts – were considered a clear sign of the lack of the necessary liquidity to continue operations;
- repeatedly breaching contracts / non-performance of payments[1907];
- a generalized lack of liquidity and procrastination on paying obligations;
- being a defendant in several executive actions.[1908]

Other key indicators of insolvency were directly inherited from the past and medieval statutes, Article 7 listed in particular:

- being a fugitive or, in general, running away from creditors (which included attempting or committing suicide[1909]);
- committing fraud;
- stealing or reducing the value of the available assets;
- paying debts that are not overdue[1910];
- repeated changes of domicile to elude the attempts of debtors to recover;
- selling assets below market value;
- the commencement of eviction proceedings;
- committing "acts of bankruptcy" (see the section analyzing Italian bankruptcy crimes, which includes a list of specific actions that constituted bankruptcy crimes).[1911]

In any case, just as in the framework of 1882, the mere cessation of some payments was not, per se, an indicator that determined the insolvency of the debtor. The reason payments stopped may have been legitimate and had to be verified by a judge.[1912]

[1901] See **Tedeschi Guido U**., "*Le procedure concorsuali – Volume I, il fallimento – artt. 1-91*", Unione Tipografico-Editrice Torinese, Torino, (1996); at 16.

[1902] See **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 207.

[1903] See **Tedeschi Guido U**., "*Le procedure concorsuali – Volume I, il fallimento – artt. 1-91*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 18.

[1904] *Id.,* at 29.

[1905] See **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 214-5.

[1906] *Id.* at 210.

[1907] See Cass. March 28, 2001 n. 4455.

[1908] Article 1.

[1909] See **Tedeschi Guido U.**, "*Le procedure concorsuali – Volume I, il fallimento – artt. 1-91*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 23.

[1910] See Article 65.

[1911] See **Tedeschi Guido U**., "*Le procedure concorsuali – Volume I, il fallimento – artt. 1-91*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 23.

4.2.6 Moratoriums and suspensions of individual actions

We have discussed several times up now, through the analysis of previous frameworks, the importance of moratoriums and their protective effects, which, despite the usual conflicts that are inevitable in this field of law, are equally valuable to creditors and debtors. The Italian framework of 1942 suspended all individual actions of creditors pending a proceeding. Upon commencement of the case, moratoriums protected the estate and provided the necessary time to organize the proceeding.[1913]

The Study of 2003, in fact, gave Principle 10 as fully or almost fully adopted.

We will analyze this topic further in the next pages, upon discussing moratoriums within the reforms of reorganization proceedings which occurred starting in 2005. The most recent additions to bankruptcy law, in fact, have focused on expanding moratoriums, shifting the balance greatly in favor of debtors (maybe excessively).

4.2.7 Creation and management of the estate

The creation and management of bankruptcy estates is a key component of all insolvency frameworks. The Law of 1942 was greatly concerned in providing an efficient structure to dispose of the debtor's assets.

With the declaration of bankruptcy, the debtor would be fully dispossessed of most (with very little exceptions) of his property, which would become part of the estate.[1914] The estate included all of the assets owned at the time of the commencement of the case, including those that would have become property of the debtor subsequently.[1915]

The fact that they may have been in possession of a third party was irrelevant.[1916] The administrator of the case would be awarded ample powers to avoid transactions and obtain the restitution of items or to discard them. Just a few items would be excluded from the estate and enjoyed special protections; a substantial analogy can be traced with the system applied in 1882. The list of Article 46 included strictly personal assets such as:

- the right to a name, to a pseudonym, to one's public image and honor;
- glasses;
- artificial limbs;
- copyrights (not to the extent of any remuneration deriving from them as long as insolvency persisted);
- alimony or pension checks;
- wages (within the limit of what would be strictly necessary to provide for herself and those dependant on her)[1917];
- assets that constituted a dowry[1918];
- the usufruct on assets owned by descendants.

Further exclusions protected those un-seizeable assets listed in Articles 545-546 of the Civil Code which included[1919]:

- sacred and religious items;
- wedding rings; beds; some basic items of furniture; a fridge; linings; clothing as long as these items were not of relevant economic value (this section was expanded over time to adapt to modern times including, for example, fridges or washing machines[1920]);

[1912] *Id.,* 16.

[1913] Some exceptions applied such as the one included in the "Testo Unico" July 16 1905, n. 645 which offered special protections to specific loans.

[1914] Article 42 (1).

[1915] See **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 341.

[1916] *Id*., at 345.

[1917] If the debtor lacked the necessary means to provide for himself and his family, the delegated judge could award sums for his support and the support of his family and the people depending on him. See Article 47 (1).

[1918] Which stood until 2006 (!).

[1919] See **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 358.

[1920] See Law August 5 1971, n. 302.

- the amount of food and fuel necessary to the debtor and his family and dependents for a month;
- weapons that the debtor had a duty to keep due to public service;
- books and tools of the trade necessary to his work;
- medals, letters, and family registers and documents as long as they are not of relevant value or necessary for the management of the case;
- pets.

The Italian framework of 1942 did not allow for homestead exemptions; the bankrupt retained a right to live in the house with his family for a term while the proceeding pended.[1921] Such right would cease upon sale of the property by the trustee. If the bankrupt and his family fell into poverty, they could be awarded social support and alimony under Article 47.

4.2.8 Fraudulent or preferential transactions

Principle 15 was deemed fully or almost fully adopted in the Royal Decree. The history of Italian avoiding actions, in the end, has ancient roots. The traditional approach, which aimed to protect public proceedings, dated back to medieval insolvency frameworks and was connected to the more modern insolvency laws adopted in recent times.

The Italian law of 1942, at Articles 64 to 71, granted ample powers to[1922]:

- interfere with contracts that were not deemed favorable to the proceeding;
- avoid those transactions, payments, or donations[1923] incurred by the debtor before the commencement of the case which would have negative effects on the estate.

Two main actions were made available to administrators. The first, which was limited to the bankruptcy framework, was called "*revocatoria fallimentare*". The second, called "*revocatoria semplice*", was included in the civil code and found application as well in bankruptcy cases. The two actions differed in their requirements and effects. Insolvency administrators had to plan strategically before choosing which to apply to a particular situation.

The *revocatoria fallimentare* was specifically drafted to operate within the insolvency system. It originated from the fact that bankruptcy was almost never delcared at the same time the debtor became insolvent. Therefore, it would be necessary to resolve those changes made during the gap period between when the debtor defaulted and the opening of the proceeding. As discussed also in Chapter II, this is usually defined as the "suspected period".[1924]

The action had a reach-back period limited to one year in the case of the voluntary or judicial perfection of debts which were due, and two years in the case of:

a) payments or transaction in which the value acquired by the debtor is very limited compared to the value of what he has relinquished, sold, transferred[1925];
b) the voluntary perfection of security interests to secure debts that were not yet due.

This particular avoiding power would relieve insolvency administrators of several evidentiary burdens; in most cases, in fact, it would be up to the defendant to show evidence to preserve the effects of the transaction.

The "*revocatoria ordinaria*" was made available in the general legal framework by Article 2901 of the Civil Code (and by Article 66 of the Royal Decree).[1926] It had a longer reach-back period, five years, but it imposed heavier evidentiary burdens. The insolvency administrator had, in fact, to prove two elements:

[1921] Article 47 (2).

[1922] **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 342; **Tedeschi Guido U**., "*Le procedure concorsuali – Volume I, il fallimento – artt. 1-91*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 103.

[1923] Donations were considered to conflict with the insolvency of the debtor and would always be revocable within two years from the commencement of the case. If he was unable to repay debtors, in fact, and a public proceeding needed to be opened, it would be impossible for him to freely give away assets that would, at that point, theoretically be the property of the creditors. See Article 64.

[1924] See Jorio Alberto, "Le crisi d' impresa – il fallimento", Giuffrè Editore, Milano, (2000), at 404.

[1925] Article 67 (1).

- the *eventus damni* or the event that caused harm to the proceeding (loss of value);
- the *consilium fraudis* or the knowledge that such event/behavior will damage the creditors.

Moreoverm an administrator had the right to commence an action. To do so, he would have to step into the shoes of a creditor entitled to it and bring it on his behalf.

Insolvency administrators could often choose among the two actions. Strategies could differ. It often would, in fact, be more convenient to attempt to avoid transactions through a *revocatoria fallimentare,* despite its shorter reach-back period, due to its less burdensome evidentiary requirements.

4.2.9 About the treatment of stakeholder rights and priorities

The study of 2003 deemed that the framework designed by the law of 1942 had "fully or almost fully adopted" Principle 16 of the World Bank's list of Principles of 2001. The system for the subdivision of claims was indeed elaborate and well-structured. Given the complexity of the topic, we will have to limit ourselves to a skeletal overview of basic principles.

The Italian Bankruptcy Law of 1942 subdivided claims into three main groups:

- ***"Prededuzione"*** – administrative expenses; costs of proceeding; expenses necessary for the management of the proceeding (as long as approved by the delegated judge); expenses that derived from a previous proceeding which was converted.[1927] Most of these expenses originated post-petition. These claims were paid first and in full using the available liquidity in the estate.
- ***"Privilegio"*** – a wide variety of pre-petition claims that enjoyed a priority status and would be paid before general unsecured claims. This group protected several different classes of claimants, such as:
    - secured creditors, who perfected their interests and were protected by the value of their collateral[1928];
    - numerous other groups based on countless specific policies included in the Civil Code[1929] or in other special laws. We can mention as examples:
        - workers[1930];
        - experts; accountants; attorneys; notary publics and other professionals[1931];
        - fees and commissions of agents[1932];
        - farmers[1933];
        - artisans[1934];
        - certain kinds of taxes and governmental credits (VAT, for example).[1935]

  These claims would be paid depending on their ranking based on the *pari passu* principle. Classes with higher priority would have to be paid first in full before it would be possible to move to the following class, until the estate, eventually, ran out of money.
- ***"Chirografo"*** (general unsecured claims) – this class grouped all the remaining claims and portions of secured claims that could not be paid through the sale of the collateral. Unsecured creditors would be paid regardless of the type of claim they held, based on the *pari passu* principle.

[1926] **See Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 206.
[1927] **Bonfatti Sido, Censoni Paolo F.**, "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 223-5.
[1928] See Article 54 Bankruptcy Law; Article 2748 of the Italian Civil Code.
[1929] Articles 2745 -2783 of the Italian Civil Code.
[1930] 2751 bis (1) of the italian Civil Code.
[1931] 2751 bis (2) of the italian Civil Code.
[1932] 2751 bis (3) of the Italian Civil Code.
[1933] 2751 bis (4) of the Italian Civil Code.
[1934] 2751 bis (5) of the Italian Civil Code.
[1935] 2751 (1); 2778 (18) and (19) of the Italian Civil Code.

An area in which the framework showed weaknesses the excessive number of "priorities". This is a common flaw among models and also a source of trouble when attempting to increase uniformity, as rules are often drawn on very local needs.

4.2.10 Reorganizations – *concordato preventivo*

The study of 2003, in evaluating Principle 17, entitled "Design Features of Rehabilitation Statutes", determined that this principle was "fully or almost fully adopted" in Italy. As we are about to discuss, though, the reorganization framework enacted in Italy until 2005 presented several peculiarities and consistent differences with the ideal model promoted by the European Union or by the World Bank's best practices. Although it is true, in fact, that the territories of the Italian Peninsula were not new to the concept of reorganizations or of agreements to prevent liquidations, and that such frameworks were even considered the most relevant tool within the insolvency model of a major economy such as Venice[1936], they remained an exception.

The code of 1882 did not include reorganization proceedings as a means to avoid the liquidation of debtors. The form of *concordato (fallimentare)* that was allowed served exclusively as a mean of closure of liquidations. In 1903[1937] Italian law makers drafted rules to include a form of *concordato preventivo* as a protection of honest debtors from the break up of their businesses[1938]; the goal of the new proceeding was to solve temporary financial distress finding, through the court's supervision, a balanced agreement with the creditors.

The new proceeding:

a) allowed the debtor to recover a situation of financial balance and the capacity to regularly pay outstanding obligations;

b) avoided the loss of value in the assets and the liquidation of the company[1939];

c) prevented the loss of jobs and a negative impact in the market.[1940]

Given the burdens placed on liquidations and the stigma surrounding them, one would think that, upon becoming available, reorganizations would have immediately become the preferred option for debtors. Nevertheless, up to 2005, the vast majority of proceedings were still liquidations. The way the reorganization system was drafted included several rbarriers and risks which contributed to discouraging filings.

Within the framework of 1942 liquidations and reorganizations were anchored to the same access and eligibility requirements, including insolvency.[1941] To be eligible for a *concordato preventivo*, debtors had to qualify as medium or large private commercial businesses or entrepreneurs, *and they had to be insolvent*.[1942] This fact caused major difficulties in the development of reorganization proceedings , since:

a) it put eligible debtors in a very uncomfortable situation;
b) it meant debtors could not avail themselves of the support of an organized public proceeding to face their financial distress until the situation deteriorated.

Filing for a *concordato preventivo*, in fact, meant confessing to the competent Bankruptcy Court that a business debtor could, or maybe should, be liquidated[1943], causing draconian consequences. If the

[1936] See Chapter IV.
[1937] Law May, 24th 1903, n. 197.
[1938] **Bonfatti Sido, Censoni Paolo F**., "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 277.
[1939] Reorganizations were a tool to avoid the liquidation and the destruction of a business which was still vital. **Tedeschi Guido U**., "*Le procedure concorsuali – Volume II, le procedure concorsuali minori, disciplina penale e profili fiscali – artt. 160-264*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 4. **Bonfatti Sido, Censoni Paolo F**., "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 277, quoting official documents on Law May, 24th, 1903 n, 197.
[1940] See **Tedeschi Guido U**., "*Le procedure concorsuali – Volume II, le procedure concorsuali minori, disciplina penale e profili fiscali – artt. 160-264*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 6.
[1941] *Id.,* 12-13.
[1942] Art 160 (1).
[1943] See Article 171 of the Royal Decree.

reorganization attempt was unsuccessful[1944], the debtor would most likely be declared bankrupt, suffering all of the civil and criminal consequences connected with the immediate commencement of the liquidation proceeding. As a consequence, a lower number of reorganizations took place compared to liquidations, and only a small percentage succeeded.

The framework included further discrepancies in other key aspects.

In order for a case to be commenced the debtor had to meet additional requirements. Article 160 required the debtor to:

- be regularly registered (ideally for at the least two years);
- have kept regular books and accounting for the two years preceding the filing (the books would be filed in the petition together with the list of creditors).[1945]

Moreover, a debtor that had been declared bankrupt within the previous five years could not commence a reorganization case. The same deadline would apply to debtors that filed an unsuccessful reorganization petition. Finally, the debtor would be ineligible if he had previously committed specific bankruptcy crimes or business crimes against the national economy, industry, or commerce[1946].

Debtors, therefore, often did not take full advantage of this option and preferred to persevere in hiding their insolvency for the longest time possible, hoping that some unexpected income would fix the situation or, in the most desperate cases, to buy time to hide assets.

The Law of 1942 made two different *concordati preventivi* available[1947]:

a) *concordato preventivo* with payment of a percentage of the outstanding credits (had to reach 40% of the unsecured credits within six months of approval of the plan);

b) *concordato preventivo* with conveyance to the estate of all the available assets[1948] (assets which would then be liquidated following the formula adopted in a liquidation[1949]). This model, which we will define as a concordato through a "*cession bonorum*"[1950], was introduced in 1942 and was not included in the law of 1903.[1951]

In the first case, the debtor (who as already observed had to be insolvent and, therefore, not in great financial shape) had to guarantee[1952] the payment of at the least 40% of unsecured claims (and therefore also of 100% of the expenses and of all other costs for the proceeding, and of all secured claims including interests) within six months of the commencement of the case. If more time was needed he would have to guarantee that further expenses and interests would be also paid.[1953]

In the second instance, the debtor would relinquish the property of his assets (with the exception of those protected by Article 46), which would be liquidated to pay claims and expenses.

[1944] Once the stone was cast, it would be impossible to take it back. The proceeding would continue until its harshest consequences.

[1945] **Bonfatti Sido, Censoni Paolo F**., "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 279.

[1946] Art 160 (1).

[1947] **Bonfatti Sido, Censoni Paolo F.**, "Manuale di diritto fallimentare", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 277.

[1948] The exclusions of Article 46 still applied.

[1949] **Bonfatti Sido, Censoni Paolo F.**, "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 287.

[1950] Article 1977 of the Italian Civil Code defines the "*cessio bonorum*" as the situation in which the debtor relinquishes part or all of his assets so that creditors can liquidate them to pay their claims.

[1951] **Bonfatti Sido, Censoni Paolo F**., "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 3.

[1952] By making deposits or providing collateral.

[1953] **Tedeschi Guido U**., "*Le procedure concorsuali – Volume II, le procedure concorsuali minori, disciplina penale e profili fiscali – artt. 160-264*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 61; upon commencement of the proceeding the debtor is given eight days to deposit the entire sum established by the court to cover a part of the costs of the proceeding.

[A] Managing reorganizations

Managing reorganizations in Italy involved several experts and insolvency administrators to ensure high levels of control, although at a significant cost. The debtor would not remain in possession in the American way. She could under certain proceedings operate under supervision[1954] while a Creditors' committee would be formed only in the event of a *cession bonorum*.[1955] Much effort was placed in preventing abuses and ensuring the fairness of the proceeding[1956]; allowing a debtor to "walk away" without paying all his debts was an event to be scrupulously overseen.[1957]

Principle 19 was considered "not adopted" by the study of 2003, although this evaluation is probably not completely accurate. Proceedings, in fact, did involve several insolvency administrators who supervised the operations of the debtor to ensure fairness. The creditors would be convened for a meeting where they would be informed of the situation and of the bankruptcy plan; they would be able to discuss the proposal, emphasize eventual objections, and ask for clarifications.[1958]

A stay would protect the assets included in the proceeding, allowing the necessary breathing room to take the necessary and mandatory steps.[1959] The petition for the commencement of the proceeding would be drafted based on the requirements in Article 161. The debtor would have to[1960]:

- explain the reasons of his financial default;
- explain the reasons that justify the petition for the commencement of a reorganization proceeding as an alternative to the simple liquidation of the business;
- file his books; the list of creditors and a report on the available assets[1961].

The plan would be voted on by creditors. At the least 2/3 of the creditors had to vote and the majority had to accept it.[1962] Secured creditors were excluded from voting unless they renounced at least 1/3 of their secured claim.[1963] Family members would also be excluded from the voting process.[1964]

If the plan was approved, then bankruptcy court would set a hearing within 30 days to allow dissenting creditors to object. Insolvency administrators would express their opinion on its feasibility. Then the competent bankruptcy court would make a final decision within 10 days. In this instance, the court would assess[1965]:

- compliance with the rules;
- the regularity of the process;
- the "economic convenience" of the proposed reorganization;
- whether the necessary majorities were reached;
- whether the deposits and guarantees ensure that the necessary and promised payments could be effectively made;
- whether the debtor could be considered "worthy" of the benefits of a reorganization proceeding.[1966]

Since successfully accomplishing all the necessary steps to close the proceeding would allow the debtor to recover from insolvency without fully repaying her debts, it had to be proven that such a privilege

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[1954] Supervision which may cause the conversion of the case to a liquidation in those cases in which the debtor was found to have committed fraud, to have hidden assets, or to have manipulated the proceeding. See Article 173.

[1955] Article 182.

[1956] **Bonfatti Sido, Censoni Paolo F**., "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 278.

[1957] **Tedeschi Guido U**., "*Le procedure concorsuali – Volume II, le procedure concorsuali minori, disciplina penale e profili fiscali – artt. 160-264*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 61.

[1958] See Articles 174-5.

[1959] Article 168 (1).

[1960] When the necessary requirements are not met the debtor may be declared bankrupt, see Article 162.

[1961] Which would be verified by the appointed insolvency administrator.

[1962] Not reaching the necessary majority would probably cause the bankruptcy of the debtor to be declared. See Article 179.

[1963] Any renunciation operated within the proceeding would not have effects if the reorganization was aborted.

[1964] Further limitations on interested parties apply. See Article 177 (4).

[1965] See Article 181

[1966] Cass. January 17, 1978 n 191.

was entrusted to an honest, deserving debtor.[1967] Honesty had an impact also on the rehabilitation of the debtor and on stigmatizing factors. We will discuss these two topics in the next sections.

4.2.11 The rehabilitation process within the Italian framework of 1942

The Italian law of 1942 did not include discharge rules. It did include, though, a "rehabilitation" procedure which offered debtors with an "outstanding performance" in the proceeding an opportunity to amelerioate part of the punitive consequences of the declaration of bankruptcy.

It is first of all important to mention that the closure of a liquidation did not undo most of the criminal effects of the declaration of bankruptcy[1968], but some civil ones.[1969] The process to achieve such goal was extremely burdensome, though. The debtor would have to:

- pay all his debts; interests, and expenses in a liquidation, which obviously was unlikely, if not impossible;
- successfully complete a reorganization proceeding and be judged worthy of such privilege.[1970]

Rehabilitation was not automatic. Upon meeting all requirements, the debtor had to file a specific petition within one year from closure of the proceeding.

A debtor would be excluded from the beneficial effects of rehabilitation if:

a) the final outcome of a reorganization consisted of a payment to the unsecured creditors of less than 25% of the value of their claims[1971];
b) if the debtor was found guilty of "*bancarotta fraudolenta*" (fraudulent bankruptcy) or other crimes listed in Article 143.

Since the rehabilitation process offered to remove some of the stigma caused by the proceeding, which often also affected people depending on the bankrupt, the debtor was not the only one entitled to file the petition. Heirs would also be allowed do so too in a way that, if the necessary requirements were met, the dishonor caused by insolvency could be (at the least partially) relieved.

4.2.12 Stigmatizing elements in the law of 1942

Stigma was present in several civil and criminal rules that constituted the Italian framework of 1942. Some were general and applied as a direct consequence of the commencement of the proceeding. Others were connected to those that, by analogy with the American Chapter, we could define as "acts of bankruptcy" punished by crimes included in the statute. The harsh sanctions were often challenged under the Italian Constitution promulgated in the December of 1947 and in force from 1948.[1972]

The following articles contained heavy civil burdens:

- Article 48 which was deemed to be in contrast Article 15 of the Italian Constitution (protecting the right of freedom and secrecy in one's mail)[1973];
- Article 49 which was deemed to be in contrast Article 16 of the Italian Constitution (protecting the freedom of free movement and residency)[1974];
- Article 50 which was deemed to be in contrast Article 13 (2) of the Italian Constitution (protecting the right to hold certain offices and jobs).

Article 48 of the Royal Decree mandated that all correspondence sent to the bankrupt had to be handed over to the trustee, who would keep mail regarding the estate; the debtor was allowed to inspect the correspondence. [1975] The goal of this rule was to find balance between the constitutional freedoms

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[1967] See **Tedeschi Guido U**., "*Le procedure concorsuali – Volume II, le procedure concorsuali minori, disciplina penale e profili fiscali – artt. 160-264*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 219-222.
[1968] Article 241 stated that the civil rehabilitation of the bankrupt extinguished the effects of a *bancarotta semplice*.
[1969] **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 364.
[1970] The debtor must be judged worthy to take part to the rehabilitation process, which was a privilege.
[1971] Article 143.
[1972] **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 362-5.
[1973] *Id.,* 362.
[1974] *Id.*
[1975] The trustee would have to keep secret personal information obtained by reading the correspondence; the bankrupt would be allowed to inspect it. See **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 362.

protected by Article 15 and the need to structure an effective, efficient, organized procedure in a situation in which key information could be unavailable to (or may have been hidden from) the insolvency administrator. The contents of this Article were much debated.[1976] From a technical and substantial point of view, defining "mail" did create obstacles with the improvements in technology (the appearance of fax machines for example); such difficulties were exacerbated by the introduction and ample use of e-mail in the new millennium. Ultimately, insolvency administrators gained ample access to all communications regardless of the means by which they were transmitted[1977]; hence emphasizing the importance of keeping authorities in control of the proceeding.

Article 49 mandated that:

a) the bankrupt (including administrators and liquidators of a bankrupt company[1978]) was not to leave her residence unless authorized by the competent bankruptcy judge;

b) that she would be present at any time when summoned by the court, the trustee or the creditors' committee.

This article aimed to increase the levels of effectiveness and efficiency in the proceeding under a logic that seems to have much in common with medieval systems. Having the debtor available and ensuring his cooperation supported the insolvency administrator whose main difficulty was retrieving the information necessary to manage the estate and to locate creditors.

Violations were heavily sanctioned by a specific criminal article included in the bankruptcy law, Article 220. The law did not require, though, the immediate seizure of a bankrupt's passport to ensure compliance, although, if necessary, it could be arranged.[1979] The Italian Constitutional Court was asked several times to express an opinion on the matter but the limitations were not removed.[1980]

Article 50 of the Bankruptcy Law showed a clear connection with a heavily stigmatizing element of the past often designed with purely punitive goals. It established that bankrupts:

a) had to be listed in a public register;

b) had to be limited in obtaining several working positions.

They would be prevented, for example, from becoming:

- insolvency administrators[1981];
- managers in companies or cooperatives[1982];
- accountants, bookkeepers[1983], or attorneys at law.[1984]

Bankrupts, moreover, were prevented from running for public office or employment[1985] and banned from stock exchanges.

Debtors would also be limited in their voting rights. Limitations would be active and passive, meaning that a debtor could not vote or be elected. They would last as of the commencement of the case and of the declaration of bankruptcy and limited to a five-year term (proceedings often lasted longer, in recent times the duration of proceedings was determined to average seven years and recent reforms attempted to reduce it to two to four years).[1986]

[1976] **Pajardi Piero, Bonacina Laura,** "*Gli effetti della sentenza dichiarativa di fallimento nei confronti del fallito*", Raccolta sistematica di giurisprudenza commentata, Giuffrè Editore, Milano, (1995), at 514-5.

[1977] **Bonfatti Sido, Censoni Paolo F.,** "*Manuale di diritto fallimentare*", CEDAM Editrice, ISBN 88-13-25045-2, (2004), at 71.

[1978] *Id.,* at 72.

[1979] *Id.,* at 71.

[1980] See on this topic **Pajardi Piero, Bonacina Laura**, "*Gli effetti della sentenza dichiarativa di fallimento nei confronti del fallito*", Raccolta sistematica di giurisprudenza commentata, Giuffrè Editore, Milano, (1995), at 519.

[1981] See Article 28.

[1982] The Italian Civil Code contained several limitations.

[1983] See Article 31 D.P.R. October 27 1953 n. 1067-8.

[1984] Article 12 (2) Law November 27 1933 n. 1578.

[1985] Article 2 D.P.R. 20 marzo 1967 n. 223.

[1986] Articles 2 and 32 D.P.R. march 30 1967 n. 223.

4.2.13 Bankruptcy crimes within the "*Regio Decreto*" of 1942[1987]

The Italian insolvency framework of 1942 followed the tradition of its predecessors[1988] and included an ample selection of specific bankruptcy crimes sanctioning a wide variety of behaviors committed by bankrupts, creditors, trustees, other administrators of the proceeding, and interested parties in general. Several articles of the law had much in common with the Code of 1882. There were several goals pursued by including such relevant criminal parts; lawmakers mainly aimed to protect the system from fraud and from reckless behaviors that could severely harm the market and society.

This approach indeed contributed to maintaining high levels of stigma and reducing the entrepreneurial spirit of the community; elements that, as amply discussed in Chapter I, for good and substantial reasons, the European Union has tried to reverse for years.

We will briefly discuss the core elements of some of the most significant criminal sections. Our goal will not be to gain an in-depth understanding of all the rules but to perceive the magnitude of the stigma. In the next section on bankruptcy crimes, in fact, we will analyze the changes that have occurred in recent years through the refoundation of Italian insolvency laws.

The law of 1942 had much in common with the framework enacted in 1882; it still punished two specific forms of *bancarotta*, the "simple"[1989] and the "fraudulent"[1990] ones, which remained the core of the crimes an insolvent debtor could be accused of. Both crimes were specifically connected to the commencement of a case and therefore they could not affect ineligible debtors or, in any case, debtors outside of bankruptcy cases.[1991] Sections 216 and 217 include a list of acts that may have been committed by the debtor to willfully damage (or that recklessly caused damage to) the proceeding.

Article 216, *bancarrotta fraudolenta*, punished a bankrupt with three to two years of imprisonment if he, before or during the proceeding[1992]:

- **a)** dissipated, hid, dissimulated or destroyed part or all of his assets, or who fraudulently increased his debts with intent to damage his creditors[1993];
- **b)** stole, destroyed, or falsified in part or all of his books and registers with the intent to obtain an unlawful profit or to harm creditors; or kept them in a way to make it impossible to retrace the history of the business and of its assets.[1994]

Moreover, a bankrupt who, before or during the proceeding, made payments or simulated contracts with intent to favor one or more creditors while damaging the others, was punished with one to five years of imprisonment.[1995]

A bankrupt's conviction also disqualified him from running a business or holding a managerial position for ten years.[1996]

Article 217, *bancarotta semplice,* punished a bankrupt with six months to two years of jail time if, before the commencement of the proceeding, she[1997]:

- a) dissipated her assets, making excessive personal or family expenses[1998];
- b) lost a relevant part of her patrimony in manifestly imprudent operations;

[1987] See **V.V. A.A.**, "*Manuale di diritto penale dell' impresa – parte generale e reati fallimentari*", Monduzzi Editore, Bologna, (1998).

[1988] **Jorio Alberto**, "*Le crisi d' impresa – il fallimento*", Giuffrè Editore, Milano, (2000), at 335-340.

[1989] Article 217.

[1990] Article 216.

[1991] **Tedeschi Guido U**., "*Le procedure concorsuali – Volume II, le procedure concorsuali minori, disciplina penale e profili fiscali – artt. 160-264*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 491-495.

[1992] Article 216 (2).

[1993] Article 216 (1) (1).

[1994] Article 216 (1) (2).

[1995] Article 216 (3)

[1996] **Tedeschi Guido U**., "*Le procedure concorsuali – Volume II, le procedure concorsuali minori, disciplina penale e profili fiscali – artt. 160-264*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 490-654.

[1997] *Id.,* at 553-62.

[1998] Article 216 (1) (1).

c) lost a relevant part of her patrimony, making investments whose outcome was based solely on fate or luck;
d) committed greatly imprudent actions to put off bankruptcy;
e) worsened her default by putting off the declaration of bankruptcy or with gross negligence;
f) did not pay what was promised in a previous *concordato preventivo* or *fallimentare*;
g) did not keep books and registers in an orderly way within three years from the commencement of the case or kept them irregularly.[1999]

A bankrupt's conviction under this article also caused a disqualification to run a business or to hold a managerial position for two years.

Debtors were also punished with up to two years of imprisonment for obtaining credit to continue operations despite their insolvency. Bankrupts would often, in fact, hide their financial difficulties to lure lenders in supporting their business activities.[2000] In this case, debtors would be forbidden from running businesses or holding managerial positions for three years.

The Royal Decree included aggravating and mitigating circumstances[2001] in Article 219. The truth is that, in such a punitive context, circumstances would mostly be aggravating and the above punishments could be increased up to one-half in three circumstances:

a) if any violation caused particularly significant damage;
b) if the bankrupt is found guilty of one or more of the above-listed violations;
c) if the bankrupt did business-related activities while he was under prohibition to run a business.

The only mitigating circumstance which would reduce the penalties up to one-third was if the bankrupt committed any of the acts causing exceptionally mild consequences.

Article 220 punished the bankrupt who listed non-existent claims and hid assets with six to eighteen months of imprisonment. This rule was necessary to prevent common criminal behaviors which we have discussed also in previous models.[2002]

Just as in the framework of 1882 (and in the medieval ones we have mentioned), the Italian law of 1942 did not impose criminal sanctions on the person of the debtor only but also on others. The following articles concern people apart from the bankrupt.

Article 228 punished the trustee or insolvency administrator that acted for his own interest with two to six years of imprisonment; a fine of no less than 400.000 Italian liras[2003], and with disqualification from public offices. **Article 229** punished the trustee or insolvency administrator that received any sum of money aside from what would be liquidated as remuneration by the competent bankruptcy court with three months to two years of imprisonment and a fine from 200.000 to one million[2004] Italian liras. **Article 230** punished trustees that intentionally embezzled sums of money or assets belonging to the estate with up to two years of imprisonment and a fine up to two millions of Italian liras. If it was proven that the sums were kept due to negligence the punishment could be reduced to six months of imprisonment and a fine up to 600.000 Italian liras. Article 231 extended the crimes of Articles 228, 229, and 230 to those appointed to assist trustees or insolvency administrators in their official duties.

These sections aimed to protect the whole framework, and not just the proceedings in which crimes may have been committed, increasing the public's trust in the system.

Article 232 punished whomever fraudulently filed forged claims with one to five years of imprisonment and a fine of 100.000 to 1.000.000 Italian liras (the punishment could be reduced by half in cases in which the forged proof of claim was withdrawn before the process of its verification). The same section punished those that:

- hid, deprived, or concealed assets from the estate;

[1999] **Tedeschi Guido U**., "*Le procedure concorsuali – Volume II, le procedure concorsuali minori, disciplina penale e profili fiscali – artt. 160-264*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 532.
[2000] Article 218.
[2001] Article 219 applied to the crimes at Articles 216 to 218.
[2002] **Tedeschi Guido U**., "*Le procedure concorsuali – Volume II, le procedure concorsuali minori, disciplina penale e profili fiscali – artt. 160-264*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 564.
[2003] 2.000 Italian Liras in the first draft of the law, increased 40 times in 1961 and 5 times in 1981.
[2004] Original fine 1.000 to 5.000 Italian Liras.

- nowing that the seller was insolvent, bought or traded assets for very low prices compared to market estimates.[2005]

In such instances, penalties would be increased if the buyer was an entrepreneur.

Article 233 punished the creditors who sold their votes in a reorganization with six months to three years of imprisonment and a fine of no less than 200.000 liras.

As we will have a chance to discuss in the next section, starting in 2005 the system changed radically. Several bastions of the Italian bankruptcy framework were modified. Reforms struggled to be organic, though, and caused much confusion. The introduction of European targets and international best practices, not to mention the legal transplant of foreign rules and approaches, caused a sudden shift on relevant policies which were developed over hundreds of years.

Bringing organic improvements proved to be, therefore, a true challenge and an effective formula has not yet been found. We will observe, for example, how despite several modifications occurred to the Royal he Decree, criminal rules have remained mostly unmodified; ttruth is that most changes that have occurred in this area have expanded or increased crimes. Although, as we will see, improvements were unexpectedly made very recently. There is hope, therefore, that a better balance may, finally, be found.

5. Reforming Italian bankruptcy laws in the new millennium

Up to now we have discussed three main phases in the evolution of insolvency regulations in the Italian territory:

- the medieval one (in Chapter IV) – a scenario rich in contrasts and innovations which led, over time, to the delineation of those key elements that constitute, even today, the basic matrix of international bankruptcy frameworks. With the exception of the *Serenissima* Republic of Venice, Italian city-states privileged liquidations and stigmatized bankruptcy heavily in order to discourage: a) citizens that were unfit to commence business ventures from even trying, and b) frauds, which were punished retroactively once default occurred;
- the first insolvency system enacted after the unification of the country within the Code of 1882 – a complex business bankruptcy framework rooted in the matrix created by its ancestors, which was enriched, over time, with new options such as the opportunity to file for a *concordato preventivo* as a form of reorganization;
- the *Regio Decreto* of 1942 – a business bankruptcy model rich in options, which attempted to protect the market from the consequences of defaults and frauds. The system adopted a severe approach which privileged liquidations over reorganizations and that stigmatized bankrupts, heavily preventing them from commencing or being involved in further business ventures.

All these steps are part of an evolutionary process that lasted for over nine centuries and followed, despite political and economic changes, the modifications that occurred within Italian society.

As discussed in Chapter I, with the beginning of the new millennium new strategies were set to support the development of the common market. The process of refounding European insolvency regulations was designed to change the different local laws in an attempt to decrease the stigma and increase uniformity. Uniformity, though, as understood at European level, meant the adoption of a specific formula and of principles and policies which had little in common with the original matrix of Italian insolvency laws.

Although it is true, in fact, that Italian experts had attempted to bring change for decades to update the Royal Decree of 1942 on new principles based on modern best practices and to coordinate it with modern Italian society[2006], the magnitude and swiftness of the reforms that were attempted from 2005 could not be foreseen. The consequences that derived from the interaction between Italian laws and the process of refoundation were unexpected. Overall, the numerous laws enacted between 2005 and 2018 lacked coordination and, although they achieved significant modifications and mirrored several

[2005] **Tedeschi Guido U**., "*Le procedure concorsuali – Volume II, le procedure concorsuali minori, disciplina penale e profili fiscali – artt. 160-264*", Unione Tipografico-Editrice Torinese, Torino, (1996), at 604.

[2006] See **Fabiani Massimo**, "*Diritto Fallimentare – Un profilo organico*", Zanichelli Editore, Bologna, (2011), at 34-6.

international best practices through the use of legal transplants from the American model, they did not meet European targets, often causing uncertainty.[2007]

In the next pages we will focus on the reforms that have occurred and on the results that have been achieved to evaluate the process of refoundation.

As discussed in previous sections, the study of 2003 gave a good evaluation of the Italian insolvency framework as it was enacted in the first years of the new millennium. This despite several discrepancies existing between the Italian approach and the best practices that the Union tried to impose to achieve the da Feira goals. Under the Royal Decree at the time, in fact:

- the Italian model was still heavily punitive with a relevant criminal component and a negative impact on levels of entrepreneurship;
- cases were commenced mostly involuntarily and reorganizations were only a small percentage of the total amount of proceedings;
- automatic, quick, and efficient discharge rules were not available even for honest debtors, who were not incentivized in go back to being active in the market;
- proceedings were lengthy (lasting on average seven years).

Despite the good result obtained within the study[2008], Italian laws at the time were going in quite the opposite direction compared to the one at desired at the European level.

Bringing effective and well-tailored changes in such an ancient and complex matrix required a careful process of mediation between the countless interests at stake, which, ultimately, could not occur. When the process of reform gained the necessary support within the Italian Government in 2005, in fact, the midway evaluation of the ten-year plan had already been given a negative outcome; several targets had been missed and pressure for improvements grew quickly within the insolvency scenario.

The first relevant changes to the Royal Decree occurred between 2005 and 2006, and were then adjusted in 2007 when further modifications ensured the coordination of the rules and fixed some minor aspects. But this was just the beginning. This part of the reform process, which could and should have been completed in those years, became just a first step in a marathon which led to almost yearly modifications. We will start this part of our "grand tour" with a quick overview of the different laws that updated the framework until 2015-2016. Then we will analyze some of the most relevant aspects of the different reforms.

In the end of this chapter, we will focus on the projects for future reforms which are particularly relevant to our discussion and will have a significant impact on our conclusions.

5.1 A brief overview of the most significant reforms that took place from 2005

The D.L. March, 14, 2005, n. 35 (Law May, 14, 2005, n. 80[2009]) and the D.Lgs, January, 9, 2006 n. 5 started the process of modification of the Royal Decree with a uniform approach. Some of the key aspects of the previous system were modernized. The reforms:

- reduced the power of bankruptcy judges, leaving more decision making-power to creditors (and in particular to creditors' committees) while allowing more autonomy in making relevant choices to insolvency administrators;
- altered the previous balance between liquidations and reorganizations in favor of the second, with the goal to ensure greater support to businesses in remaining productive instead of evicting them automatically from the market;
- introduced the "*esdebitazione*" (or discharge) articles in lieu of the previous "*reabilitazione"* ones.

Further changes came with the D.Lgs September, 12, 2007 n. 169.[2010] The D.Lgs of 2007 mostly served the purpose of refining the updates made up to 2006, resolving some articles that presented discrepancies. The most relevant reforms made in 2007 concerned:

[2007] See the introduction of: **V.V. A.A.**, "*La nuova legge fallimentare – Commento alle disposizioni della legge fallimentare modificate dal d.l. n. 83/2015, conv., con mod., in l. 6 agosto 2015, n. 132*", Ed. Fabio Santangeli, Giuffrè Editore SPA, Milano, ISBN 9788814213380, (2016).

[2008] **Philippe & Partners, Deloitte & Touche Corporate Finance**, "*Bankruptcy and fresh start: stigma on failure and consequences of bankruptcy*", (2002).

[2009] See **Fabiani Massimo**, "*Diritto Fallimentare – Un profilo organico*", Zanichelli Editore, Bologna, (2011), at 36-8.

- changes in the prongs used in defining “insolvency” as an access criteria (expanding the classes of possible “debtors” in contrast with the modifications of 2006 which had restricted them);
- improved the discharge articles.

With these corrections, the system should have been theoretically reset and fully operative, but that was just the beginning. From 2012, reforms came at an almost yearly pace[2011]:

- **Law 27, January 2012 n. 3** – introducing in the Italian system a specific insolvency framework for over-indebted consumers and natural persons in general;
- **D.L. June 22, 2012 n. 83 (Law August, 7, 2012 n. 134)** – placing great emphasis in further improving the reorganization framework;
- **D.L. June 21, 2013 n. 69 (Law August, 9, 2013 n. 98) –** made further modifications to the reorganization framework;
- **D.L. June 27, 2015 n. 83 (Law August, 6, 2015 n. 132)** – made further improvements to the reorganization framework, adding more options[2012];
- **D.L. November, 16, 2015 n. 180** – mostly focused on improving the frame work for the solution of the crisis of banks;
- **D.L. May 3, 2016 n. 59 (Law June, 30, 2016 n. 119**) – which attempted to bring improvements by increasing the levels of digitalization and technology within the bankruptcy framework.

Overall, therefore, the incessant process of reform and adjustment of the Royal Decree did not support the enactment of a uniform, coordinated, and well-structured new system. Moreover, in 2017 the Italian Government commenced operations to structure of a new draft, which should lead to an organic reform of all aspects of the current frameworks. We will discuss the proposals contained in the new model at the end of the chapter. For now we will focus on reforms took place up to 2016.

In the last section of this analysis, we will discuss the new Italian bankruptcy code as per the modifications approved in early 2019.

5.2 The approach adopted in refounding Italian insolvency laws: speediness

The reforms that took place since 2005 within the Italian bankruptcy system pursued several goals. After 60 years a framework, which had been “crippled” by many decisions of the highest Italian Courts needed to be refreshed and synchronized with:

- modern Italian society;
- globalized markets and the global economic crisis;
- international best practices and European strategies.

In the next sections we will discuss some of the most significant modifications, the way they occurred and their impact.

Our analysis will try to mirror, and build on, the one made on the first draft of the Royal Decree of 1942. It will show the confusion caused by several reforms and will introduce the topic of the latest reviews which are being debated today (the “Rordorf” proposal). Through our brief overview, we will have a chance to see how Italian laws have, in just fifteen years, attempted to make radical changes and the difficulties faced in this process.

[2010] See **Fabiani Massimo**, “*Diritto Fallimentare – Un profilo organico*”, Zanichelli Editore, Bologna, (2011), at 38-40; **V.V. A.A**, “*La nuova legge fallimentare – commento e confronto tra testo nuovo e previgente*”, Unione Triveneta dei Consigli dell’ Ordine degli Avvocati, ISBN 9788860211125, (2005).

[2011] The list of laws or decrees which modified Italian bankruptcy laws in these years or had an impact on them is very long. For practical reasons we will not examine several minor reforms and stick to discussing major reforms which support our analysis. For other minor reforms see, for example: Law n. 69 of 2009; law n. 122 of 2010 or Law n. 98 of 2013.

[2012] See **V.V. A.A.**, “*La nuova legge fallimentare – Commento alle disposizioni della legge fallimentare modificate dal d.l. n. 83/2015, conv., con mod., in l. 6 agosto 2015, n. 132*”, Ed. Fabio Santangeli, Giuffrè Editore SPA, Milano, ISBN 9788814213380, (2016).

In particular, we will discuss how statutes have radically modified the balance between liquidations and reorganizations, attempting to favor the latter compared to the first (an epic reform considering the medieval roots of Italian insolvency statutes). We will also analyze how the reforms have tried to:

- allow access to greater numbers of debtors transforming, the model into a tool to support those facing financial default;
- incentivize voluntary filings;
- prevent the opening of cases when debts would be of very limited quantity, hence saving the costs of a complex public proceeding (and the consequences of stigma, which has been reduced but is still present within society);
- expand access criteria to incentivize early filing, hence reducing the role of insolvency;
- privatize the whole insolvency process, awarding creditors a more central role and more decision making powers in key moments of proceedings;
- provide a quick discharge to honest debtors;
- reduce the levels of stigma (in all areas with the exception of bankruptcy crimes, which were not reformed);

Before we get started, though, we will discuss the approach which has linked different phases of the reforms. We could summarize it with the term "speediness". Italian reforms attempted to bring swift changes and improvements under several points of view. The results, though, have often been unsatisfactory.

First of all, we can mention how the reforms have been enacted in a short time and in a frantic manner through a continuous patchwork of additions and (attempted) improvements. Their almost yearly pace has, as we will discuss in the next sections, caused much confusion. Different factors contributed to prevent reforms form occurring in an organized manner.

Italians took time to find the support necessary to bring change. When they were finally ready, the modifications which were requested by the globalized market were very broad and significant. The might of the economic crisis that would hit the first reformed drafts caused further difficulties in structuring an organized process of reform. Moreover, following the direction set by the Union and by international best practices starting from opposite roots proved to be a true challenge.

Speediness, which we could define in this case as the attempt to bring such relevant and necessary changes within a term of just few years, had a negative impact on the reforms.

The process was not allowed to take place through an effective step-by-step approach. It did not support the modification of the complex balances which characterize the insolvency context, and it did not ensure the necessary levels of coordination with the Italian society.

Moreover, speed became, in the mind of reformers, a synonym of both effectiveness and efficiency; swift reforms had to automatically be considered "good" reforms. This approach was proven wrong in several occasions we will discuss, for example how some rules were modified over and over again, sometimes in very contradictory ways. We will also discuss how the lack of a general strategy led to countless alterations of procedural and substantive bankruptcy rules, but no reform decreased stigma within criminal rules; the criminal bankruptcy framework was actually enriched by new sections.

Speediness can also be found in the several rules were enacted through different laws in order to ensure, and even impose, a shorter duration of proceedings. Although the goal to support the swift administration of cases is laudable (especially within a framework characterized by lengthy proceedings), bankruptcy is complex field of law that requires time. The difference between wasting it and allowing the necessary room to operate proceedings successfully appears to have been underestimated by Italian reformers.

In this area, reforms had contradictory outcomes. Some appeared to be farsighted, others unrealistic.

As an example, we can mention the attempts made to improve the organization of proceedings by structuring liquidation plans. The new Article 104, introduced in 2006, required insolvency administrators to file a p*rogramma di liquidazione* (liquidation plan) as a roadmap of the important steps to be accomplished within the proceeding. The plan would allow creditors to be updated and informed on the steps that would be taken and to make necessary decisions.

This interesting, reasonable, and positive reform, however, suffered through several modifications in the following years (2007, 2015, and 2016). The changes made in 2015 were particularly significant, for they increased sanctions on an insolvency administrator who didn't file the liquidation plan within 180 days from the opening of the proceeding. This became "just cause" for his removal. Moreover, a new article, Article 104 (II)(f), imposed a term of two years for closure of the liquidation proceeding, which could be extended upon motivated petition by the insolvency administrator.[2013]

The new framework, therefore, attempted to mandatorily schedule the duration of liquidations within a very limited time considering all the operations that have to be conducted within relevant proceedings. A farsighted reform made at the beginning of the process, therefore, appears to have been spoiled by the continuous successive changes which occurred in a time of just years.

Another interesting and positive reform was structured to decrease the duration (and number) of cases in 2006 (with minor modifications also in 2007 and 2012). Article 102 established a rule for the immediate closure of liquidations (without the process for the verification of claims) when inspections reasonably showed that there would be no assets or value to distribute among creditors, hence saving costs for the whole system.[2014]

Further interesting steps were taken with the reform of **Article 43** (modified in 2006 and 2015) which awarded priority in deciding pending controversies that involve bankruptcy proceedings.

Other expedients were used to incentivize the swift administration of proceedings. Article 39, for example (modified in 2006 and 2015) prevented insolvency administrators from asking for advancements on their fees until distributions of proceeds had been made to the creditors. The strategy supporting this reform is self-explanatory.[2015]

Another relevant part of the reforms focused on improving the use of technology within the bankruptcy process.[2016] Modifications have been made, for example, to make the use of registered e-mail addresses mandatory in communication between trustees and courts. Again, though, a reasonable step forward did not take into account relevant elements such as the difficulties of foreigners in using such local tools (making it often necessary to invest resources into local advisors).

This last example shows the weaknesses in the Italian process of reform, which:

- was structured to be swift and effective, but ultimately needed continuous reviews and did not manage to effectively achieve its targets;
- had to be innovative but failed to consolidate its improvements – increasing the levels of technology surely is a very positive factor, but not keeping in consideration the needs of foreign interest holders within a globalized system heavily burdens the process;
- was commenced with the clear goal to destigmatize, but despite continuous reforms, actually increased criminal punishments.

We will now discus the process of reform further, analyzing how certain specific rules changed over time.

5.3 An analysis of relevant modifications to the Law of 1942

5.3.1 Management of proceedings: the new balance between debtors, creditors, insolvency administrators, and courts

Significant modifications occurred in the organization and the management of liquidation proceedings (and in general).

[2013] *Id.*, at 50-56.

[2014] **D'Aquino Filippo, Delladio Carlo, Fontana Roberto, Mammone Francesca**, "*Guida alla Legge Fallimentare*", Edizione n. 702, Editore Il Sole 24 Ore spa (2016), at 180-2.

[2015] See **V.V. A.A.**, "*La nuova legge fallimentare – Commento alle disposizioni della legge fallimentare modificate dal d.l. n. 83/2015, conv., con mod., in l. 6 agosto 2015, n. 132*", Ed. Fabio Santangeli, Giuffrè Editore SPA, Milano, ISBN 9788814213380, (2016), at 13-18. See **V.V. A.A.,** " *La nuova mini-riforma della legge fallimentare – Aggiornamento alla legge 30 giugno 2016 n. 119*", Eds. Sandulli Michele and D' Attorre Giacomo, G. Giappichelli Editore, Torino, (2016), ISBN 978-8-7524-361-6, at 45-49.

[2016] See for example Articles 92, 93, 95 and the reform of 2012.

In previous pages we mentioned how the system enacted in 1942 was centered on the key role of bankruptcy judges. The reforms that occurred starting in 2005 were innovative and shifted the balance in favor of a more active participation of interested parties, in particular of creditors, both in liquidations and in reorganizations. The reforms attempted to "privatize", to a certain extent, insolvency matters.

Creditors' committees have recently become a fundamental part of the structure of modern liquidation proceedings. They maintained the powers to monitor and inspect the activities of insolvency administrators but also gained decision making powers on key aspects of proceedings and on non-routine matters. The committee, for example, approves the "liquidation program" of Article 104; it therefore can actively decide the path of a liquidation proceeding, just like all creditors, through their votes, impact reorganizations.

Insolvency administrators have also gained more autonomy, although their operations are always conducted under the supervision of the delegated judge and of the creditors' committee. A new register including information on their appointment in different kinds of proceedings nationwide was introduced in 2015. Making such information public should serve to allow higher levels of fairness and transparency within proceedings.[2017]

Bankruptcy judges have, therefore, lost the power to direct insolvency proceedings and gained a different role focused on the supervision of different activities.[2018] They nevertheless remain the lynchpin of the system. In practice, the Italian model still depends greatly on their support to prevent fraud and ensure fair, effective, and efficient management.

5.3.2 Commencement of cases: improvements to accessibility and eligibility parameters

It is, first of all, important to mention that the Royal Decree, although modified in significant ways, remained concerned with a variety of business debtors. Italy did follow in the steps of several other European Countries and enacted a model addressing the over-indebtedness of non-business debtors (which we will briefly discuss in a later section), but the new regulation was not merged into the pre-existing bankruptcy framework.

The most significant changes in the structure of eligibility requirements concerned:

- small businesses;
- farmers;
- exclusions from bankruptcy.

Following 2005, Article 1 was modified several times over the past few years to increase the levels of transparency and predictability of the system. The law continued to protect small business debtors from liquidations and provided a more accurate definition of what would constitute a "small" business. New parameters were added in 2006.[2019]

The reformed Article 1 provided the following prongs:

a) made investment in the business for more than €300.000;

b) collected gross revenues in the last three years (or from the commencement of business activity) higher than €200.000 per year.

Such parameters were modified and expanded in a three-prong test, once again, in 2007:

> "Under Italian law the liquidity test applies subject to some additional criteria: under Italian Law, an entity cannot be adjudicated bankrupt if all of the following three conditions are met: (1) the insolvent entity achieved a gross income, in the three years before the filing of the petition for bankruptcy, in a yearly amount not higher than €200,000; (2) the capital invested by the insolvent entity in the business in the three years

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[2017] See Article 28.

[2018] Bankruptcy judges would act in those cases in which committees would not take action or could not be formed.

[2019] The threshold must be proven also in voluntary cases meaning that a debtor who wants to be liquidated must show that he meets it.

before the filing of the petition of bankruptcy did not exceed €300,000; and (3) the total amount of debts of the insolvent entity was not higher than €500,000."[2020] [2021]

The "generic" protection for the class of "artisans" or "craftsmen" provided by the Royal Decree, therefore, lost its value[2022] and was substituted by a more analytic and complex test. If an involuntary petition is filed today, a potential debtor has to prove that the test included in Article 1 is not met in any of its parts to be classified as a small business and enjoy protections.[2023]

5.3.3 Debtors excluded from the bankruptcy framework

Several of the reforms that took place from 2005 concerned exclusions from the bankruptcy framework, with new specific groups of debtors enjoying protections.

The boundaries for the protection of farmers [2024] and state-owned enterprises have been redefined. Farmers continue to be excluded from bankruptcy as long as their business is connected to a seasonal cycle. This protection is based on the risks connected to weather patterns[2025] and have been extended also to debtors managing major business activities as long as they were based on a purely natural cycle.[2026] The limits safeguarding state-owned enterprises have remained valid and apply in all those cases in which the debtor is part of the government or a municipality; it is not so in those cases in which shares of a private business are owned by the government.[2027]

A "new" group of debtors has been excluded from bankruptcy since 2012: "innovative start-ups" as defined by Article 25, section 2, of D.L. 179/2012 converted in Law 221/2012.[2028] The modified model set new parameters to protect business debtors engaged in trading, developing, and producing highly innovative and technological products. The goal is to lower the stigma of failure for those new and modern businesses which, although counting on a "limited" turnover (less than 5 million), hold high strategic value.

5.3.4 Commencement of cases: voluntary and involuntary filing

Within the reformed Italian insolvency framework, both voluntary and involuntary access to insolvency proceedings continue to be available, although several modifications have occurred. Italy followed a process aimed at incentivizing voluntary filings and greater recourse to insolvency frameworks in order to support the rehabilitation of debtors. Several factors played a role in supporting willing debtors to take action; the most relevant are:

- the reform of reorganizations;
- the eradication of several section which included civil and administrative punishments;
- the enactment of new discharge rules.

[2020] See **Directorate-General For Internal Policies, Policy Department Citizen's Rights and Constitutional Affairs**, "*Harmonization of insolvency law at EU level*", (2010);

[2021] **D'Aquino Filippo, Delladio Carlo, Fontana Roberto, Mammone Francesca**, "*Guida alla Legge Fallimentare*", Edizione n. 702, Editore Il Sole 24 Ore spa (2016), at 4.

[2022] Cass. March 20, 2015 n. 5685.

[2023] *Id.*; **D'Aquino Filippo, Delladio Carlo, Fontana Roberto, Mammone Francesca**, "*Guida alla Legge Fallimentare*", Edizione n. 702, Editore Il Sole 24 Ore spa (2016), at 6.

[2024] A reform in 2011 (D.L. 6 july number 98 2011; Law 111/2011) anticipates a reform of the tools for the protection and the support of farmers facing financial distress and makes available Articles 182 bis ("*accordi di ristrutturazione dei debiti*") and 183 ter ("*transazione fiscale*"); in 2012 D.L. 179/2012; L. 221/2012 made available also the *"procedura di composizione delle crisi di sovraindebitamento*".

[2025] **D'Aquino Filippo, Delladio Carlo, Fontana Roberto, Mammone Francesca**, "*Guida alla Legge Fallimentare*", Edizione n. 702, Editore Il Sole 24 Ore spa (2016), at 3

[2026] Cass. December 10, 2010 n. 24995 involving a 21 million business with five local units. **D'Aquino Filippo, Delladio Carlo, Fontana Roberto, Mammone Francesca**, "*Guida alla Legge Fallimentare*", Edizione n. 702, Editore Il Sole 24 Ore spa (2016), at 4.

[2027] *Id.,* at 3.

[2028]See:
http://www.sviluppoeconomico.gov.it/images/stories/documenti/The%20Italian%20Startup%20Act%20presentation%20-%20last%20update%2010_02_15.pptx

Although bankruptcy was made more "appealing", it is important to mention that relevant factors continued to exercise a contrary force. The criminal sections that regulate insolvency specific crimes, for example, were expanded, limiting the positive effects of other reforms on the stigma created within the system.

Modifications also occurred in the ways involuntary cases could be commenced.

In 2006, Article 8, which allowed a judge who found a debtor to be insolvent in a civil case to inform the competent bankruptcy court, was repealed.[2029] Article 6 which allowed cases to be commenced by the court on its own motion was also modified, removing this option. This was considered a major reform since it allowed more room for agreements between a creditor filing an involuntary petition and the debtor. Creditors were offered more leverage as they could withdraw the petition if a deal was found and the case could not continue; a debtor could therefore buy time.

However, most of the effects of the old rules were merged with the rewritten Article 7, Section 2, by which a civil judge can/ought to inform a public prosecutor of the insolvency of a debtor. Despite reforms, in fact, public prosecutors continued to retain the power to commence an involuntary case[2030] and a very relevant role in bankruptcy process (a sign of the permanence of relevant criminal components in the bankruptcy system). Moreover, the framework continued to:

a) award powers to avoid transactions between creditors and insolvent debtors;
b) punish fraud with specific bankruptcy crimes.

Another sign of the persistent impact of criminal laws is embodied in Article 217, *bancarotta semplice*, which continues to punish the debtor who refrains from taking timely action in filing a petition upon becoming insolvent.[2031] At the same time, all reorganization proceedings are placed under strict scrutiny, also by criminal courts, to avoid proceedings. Hence, although the reforms have attempted to incentivize debtors in taking early, voluntary action, several elements still contribute to support old approaches.

5.3.5 Commencement of cases: reforms of access criteria

The seed of crucial modifications in the realm of access criteria has been planted in the past few years.

Up to today, insolvency has remained the key factor for the commencement of liquidations within the Italian insolvency framework and Article 5 has remained unchanged. Important reforms were, nevertheless, enacted between 2005 and 2015. The most interesting reform on this topic occurred with the modification of Article 15 in 2006, 2007, and 2012. In its last draft, Article 15 (IX) introduced a threshold that limited involuntary access to proceedings: a debtor would not be declared bankrupt unless he owed more than €30.000[2032] in overdue, uncontested debts. The original limit introduced in 2006 was €25.000; after just few months, in 2008, the limit was raised to €30.000.[2033]

The new rules attempted to prevent the commencement of cases when the total amount of outstanding debts is very limited.[2034] Insolvency, therefore, has ceased to be a death sentence per se.

Another relevant change occurred in the realm of reorganizations with the introduction of a new access criteria. As discussed upon analyzing the first draft of the Royal Decree, the same eligibility requirements applied in reorganizations and liquidations; the debtor had to be insolvent for a case to be commenced. This structure discouraged voluntary filing since the risks of attempting a reorganization and ending up in a liquidation were great.

In recent years, for the reasons discussed in Chapter I, reorganization frameworks have been greatly empowered. The Italian model had to be modified accordingly. Debtors were allowed to access the insolvency system and, in particular, to commence reorganizations, upon finding themselves in situations of "financial distress" (a criteria mentioned as an alternative to insolvency also in the evolution of the World Bank's best practices in this field).

[2029] Cass. July 9, 2013 n. 184.

[2030] Articles 6 and 7.

[2031] See Cass. August 26, 2011 n. 32899. A topic we have discussed also while examining previous frameworks.

[2032] At the time in which the bankruptcy court makes a decision, not at the time of filing. Cass. May 27, 2015 n. 10952

[2033] The new amount from the 1st of January 2008.

[2034] ***D'Aquino Filippo, Delladio Carlo, Fontana Roberto, Mammone Francesca****, "Guida alla Legge Fallimentare",* Edizione n. 702, Editore Il Sole 24 Ore spa (2016), at 32.

Petitioners can, therefore, seek protection through the bankruptcy system and attempt to discharge their debts and to reorganize upon meeting difficulties in managing their business. They do not need to wait anymore until the situation worsens and insolvency is reached. The hope of the drafters of the reforms is that debtors would take advantage of the new opportunities provided by the modified laws to make timely attempts to resolve their difficulties instead of risking a mandatory liquidation and aggravated criminal responsibilities.

5.3.6 Avoidable transactions and fraudulent transfers[2035]

As mentioned in the introduction, the approach to the management of liquidations has changed greatly since 2005. The reforms aimed to increase the efficiency and swiftness of proceedings. In the area of avoiding powers, for example, swiftness was introduced by halving statutes of limitations.

The framework, after the reforms, continues to include both an insolvency action and an ordinary one, mostly following the parameters of the version of the Royal Decree enacted in 1942. The impact of the first, though, was heavily limited to increase the levels of predictability within the system. A rewritten[2036] article 67 was enacted with the very first reforms[2037] to reduce the extension of the reach-back period of the avoiding action. The "suspect period" was halved and so were all the other terms (those which were two years in the framework of 1942 became one, and those that were one became six months long) hence increasing transparency and predictability within the system.

5.3.7 The new discharge framework ("*esdebitazione*"[2038])

In 2006[2039], the framework was modified to include a specific discharge section (called in Italian "*esdebitazione*") in liquidations.[2040] The rules substituted the previous "*reabilitazione*" framework at Articles 142-145 to provide a more modern, complete, and efficient tool to support debtors in obtaining their fresh starts. The new system allows business debtors who are natural persons[2041] to be discharged of the portions of debts which remain unpaid in the proceeding.[2042]

To access such benefit, an honest and cooperative debtor[2043] must file a petition within one year from the conclusion of the proceeding.[2044] The award of the order of discharge is not, therefore, automatic upon successful closure of the case. Moreover, the debtor will not be allowed to enjoy this benefit if:

- frauds have occurred (or the debtor does not cooperate with the proceeding or has delayed the proceeding);
- Article 48 has been violated;
- he has already benefited from a discharge within the past ten years;
- he has been convicted of fraudulent bankruptcy or other crimes against the public economy.

But there is more. The *esdebitazione* will not protect the debtor in "no asset" cases. In order to be discharged at least a minimal part of the outstanding debts must be paid in the proceeding[2045] and, as is customary, not all debts can be discharged.

[2035] See **V.V. A.A.**, "*Fallimento e concordato fallimentare – tomo secondo*", Ed. Jorio Alberto, UTET GIURIDICA, (2016), at 1369-1462.

[2036] Modified in 2006, 2007, and 2012.

[2037] The "new" Article 67 enacted in 2005 applied to bankruptcy cases commenced after the 17th of March, 2005.

[2038] See **V.V. A.A.**, "*Fallimento e concordato fallimentare – tomo secondo*", Ed. Jorio Alberto, UTET GIURIDICA, (2016), at 2604-2656. It is particularly interesting to observe that, at pages 2656-7, the authors comment on the chance of success of the reforms, observing that they may be the cause of abuses by bankrupts and of great losses for the creditors.

[2039] The new discharge sections apply to cases opened after the 16th of July, 2006.

[2040] The rules apply also to the agreements made within the liquidation proceedings or "*concordati fallimentari*".

[2041] Including general partners in partnerships.

[2042] This is an exception to Article 2740 of the Civil Code which mandates that debts are to be paid in full even with future income.

[2043] See Article 142.

[2044] Discharge is not, therefore, automatic. See Article 143.

[2045] It is not important that all classes of debtors receive a share of their claims; as long as it will be possible to make a payment to at the least one creditor; Cass. April 10, 2017 n. 9917.

Article 142[2046] lists claims that cannot be discharged, such as:

- alimony and pension payments[2047];
- debts that originate from activities that are not connected to the proceeding;
- criminal or extra-contractual liabilities.

5.3.8 Reforming the Italian reorganization model[2048]

The field of business reorganizations is one of the areas of Italian insolvency law that has undergone the most extreme makeover in past years, with continuous (and significant) reforms taking place in 2007, 2012, 2013, and 2015. This area has been involved in basically all the steps of the lengthy process of modification. The depth of the reforms, which are still ongoing, show the great gap that existed between the model applied in Italy under the Royal Decree, up to 2005, and the system that Italy and the Union attempted to impose thorough the process of refounding European insolvency regulations in the following years.

The ultimate goals of the process commenced in 2005 were[2049]:

- make proceedings faster;
- prevent liquidations;
- allow more room for negotiations between a debtor and his creditors and interest holders.

The new formula that has been implemented in Italy is characterized by legal transplants based on the US model. The need to support debtors has led to the award of stays and to the creation of a variety of proceedings from which debtors can select.

This is a very complex and technical subject. The continuous changes that occurred make it difficult to draw an effective roadmap of the reforms in the few pages available, while writing an extensive review would take us far from our goals. In the next sections, we will err on the side of limiting our discussion to the most relevant points, which will be simplified.

We will analyze, in particular, those specific aspects that show the difficulties that have been met in setting up the new system. We are interested in observing the use (or abuse) of transplants and in monitoring the challenges faced by the process of refoundation and the results achieved; not in discussing the individual elements of Italian law in depth (a study which would be very interesting given the magnitude of the modifications but that shall be left for another time).

[A] Eligibility and access criteria

The effort in making proceedings more available (which we analyzed when discussing the new parameters to define small business debtors) has impacted reorganizations also. One of the main flaws of the previous system was that the same access requirement, insolvency, was used in liquidations and reorganizations, which caused filing to be potentially risky. To avoid unwanted and unexpected consequences, debtors were incentivized by the old system to procrastinate (often times losing control of the situation until the level of debts became irreparable).

A modern business debtor can access reorganizations upon matching the prongs of Article 1 (2) and incurring a certain level of financial distress, not just upon being insolvent. This innovation constitutes a great incentive to take timely action (we will see in the next sections that this is not the only incentive that has been provided by the reforms).

[2046] As modified in 2006 and 2007.
[2047] Cass. March 11, 2016 n. 4844.
[2048] For an overview on this topic see **Bonfatti Sido, Censoni Paolo F**., "*Lineamenti di diritto fallimentare – second edition*", Wolters Kluwer, Milano, (2017), at 295-373. For an overview of the reforms until 2010 see **V.V. A.A**., "*La legge fallimentare dopo la riforma – concordato preventivo e accordi di ristrutturazione, liquidazione coatta amministrativa – Tomo III Artt. 160-215 disciplina transitoria*" Eds. Nigro Alessandro, Sandulli Michele, Santoro Vittorio, Giappichelli Editore, Torino, ISBN 9788834800164, (2010).
[2049] **Bonfatti Sido, Censoni Paolo F**., "*Lineamenti di diritto fallimentare – second edition*", Wolters Kluwer, Milano, (2017), at 295.

A uniform definition of "financial distress" is not currently provided and interpretations vary. A relevant situation of "inancial distress may be as harsh and troublesome as insolvency[2050], yet the new system allows debtors to plan ahead at earlier stages of difficulty.

The reforms of 2005 also erased the "worthiness" requirement. All debtors can now have access to reorganization proceedings since it is in the interest of society and of the market to allow them to try to save the going concern value of their business.

[B] The relevance of moratoriums within the new Italian scenario[2051]

Changes in the mentality of and approach to reorganization proceedings become evident upon analyzing a reform that occurred in 2012.[2052] That is the year in which the so-called "white reorganization" ("*concordato in bianco*", often called also "*preconcordato*"[2053]) became available.

This new proceeding allows the debtor to file a petition with the competent bankruptcy court. The petition does not have to include a plan or the various types of information that constituted the previous reorganization format, hence the name "white". By filing, the debtor would ask for a term to present the plan for a full reorganization.

Such preliminary petitions – which often contain very little information on issues like the debtor's accounting, the creditors, or strategies to restructure business – have become extremely important in the strategies of debtors. The "term" or moratorium[2054] that can be awarded can last from two to four months and heavily frustrate individual collection efforts. Moreover, debtors can use this time to freeze the situation and elaborate an advantageous strategy.

Of course, dishonest debtors could attempt to use the time they would be awarded to accomplish operations that exceed the scope of the proceeding.

For this reason, during the "stay" the debtor would be put under the supervision of insolvency administrators and of the competent bankruptcy court. The system attempted to prevent illegitimate uses of this tool and the commission of frauds. Debtors would be bound to strict rules in making payments and administering the business. Basically, she would have to somehow preserve the "status quo", preventing losses or alterations which could harm the creditors. If abuses were detected and crimes were committed, the proceeding could be converted into a liquidation.

Despite the levels of supervision that were imposed, this reform had a radical impact on the balance between the rights of debtors and creditors, and had an impact on costs as well.

[C] Modifications to the structure of proceedings

The Italian insolvency law has seen in the past years a great increase in the availability of reorganization frameworks. Aside from being allowed to file for a *preconcordato*, debtors today can structure agreements with banks or use reorganizations to find an agreement with debtors and liquidate their assets, or to continue their business activities.

Relevant factors differ between the last two scenarios. The most significant one regards the mandatory amount of unsecured debts to be paid in order for the proceeding to be successful. As we discussed in the previous pages, under the previous model enacted in 1942 debtors had to be insolvent to access a reorganization, but they also had to show they would pay, through the proceeding, up to 40% of the value of unsecured claims. This requirement was a significant burden in a situation in which the debtor could, if he failed to do so, be declared bankrupt.

The process of reform led to the (temporary) abolition of this prong. Reorganizations could be opened without the need to satisfy a preset minimum percentage of unsecured claims as long as the plan was

[2050] As specified by a further reform occurred with Article 36 of the DL 30th December 2005 n, 273. See Article 160 (3).
[2051] **Bonfatti Sido, Censoni Paolo F.**, "*Lineamenti di diritto fallimentare – second edition*", Wolters Kluwer, Milano, (2017), at 304-311.
[2052] D.L. 83/12; Law 134/12.
[2053] Article 161 (6).
[2054] **D'Aquino Filippo, Delladio Carlo, Fontana Roberto, Mammone Francesca**, "*Guida alla Legge Fallimentare*", Edizione n. 702, Editore Il Sole 24 Ore spa (2016), at 315. The stay is powerful; it prevents individual actions by creditors and voids secured interests on real estate perfected within 90 days before the date of filing.

feasible[2055], an agreement with the creditors could be reached, and it could be proven that this was the best option for the creditors (or that they would not be paid a greater share in a liquidation).

In August 2015[2056], the burden was reinstated although with lower requirements. Under the most recent draft, in fact, Article 160 (4) demands that 20% of unsecured claims must be paid.

The reintroduction of this requirement (which does not apply to those proceedings which, under Article 186, attempt to ensure the continuation of the business activity[2057]) was a relevant step with a clear impact on filing rates. It brought to a great decrease in filing rates.[2058]

[1] Proposing plans

Several modifications have focused on improving the process to propose, verify, and accept plans which, as we have mentioned several times, are the linchpin of reorganization proceedings.

Recent modifications to the framework have allowed, since 2015, not just the debtor, but also other parties in interest, to file reorganization plans.[2059] Creditors that hold a significant percentage of claims[2060] are also allowed to file competing plans and attempt to propose a better solution to the financial distress of the business. Requirements vary depending on the kind of reorganization proceeding.[2061]

[2] Attesting plans

Upon filing a plan, the debtor would have to file also an "*attestazione*" by an expert.[2062] The expert verifies the numbers and certifies under heavy criminal liability the chances of success of the plan, providing a higher degree of reliability.[2063] This point will be discussed further upon analyzing the modifications that have occurred in the past few years to bankruptcy crimes.

[3] Classes of creditors and "silent" votes

The voting process within reorganization frameworks underwent several reforms. We will not discuss this intricate topic in depth for it would take us far from our original goals. It will suffice to point out the main differences standing with the previous system embodied within the Royal Decree.

Reorganizations, today, allow for the subdivision of debtors into classes during the voting process (with respect to different priorities[2064]); a clear transplant from American systems. It also allows a cramdown of dissenting classes under parameters similar to the ones adopted in a Chapter 11.

Before 2015, creditors who did not vote were counted as implicitly approving the plan; this is not so today.[2065] If the creditors or the majority of classes vote to refuse the plan, the decision is binding on the bankruptcy court.

[2055] Several decisions attempted to determine the feasibility of plans during this period of time. See on this topic **V.V. A.A.**, "*Memento Pratico - Risanamento e procedure concorsuali*", Francis Lefebvre (2018), at 188, discussing cases in which a payment of 3% of the unsecured claims was considered satisfactory.

[2056] Law n. 132/2015.

[2057] 186 bis (1).

[2058] **V.V. A.A.**, "*Memento Pratico - Risanamento e procedure concorsuali*", Francis Lefebvre (2018), at 163.

[2059] See Article 163.

[2060] See Article 163 (4) – 10% of the claims listed in the list of creditors field with the petition (some claims such as the credits of parent companies are not included in the total to measure the 10% requirement).

[2061] See **V.V. A.A.**, "*La nuova legge fallimentare – Commento alle disposizioni della legge fallimentare modificate dal d.l. n. 83/2015, conv., con mod., in l. 6 agosto 2015, n. 132*", Ed. Fabio Santangeli, Giuffrè Editore SPA, Milano, ISBN 9788814213380, (2016), at 145-193.

[2062] See Article 67.

[2063] See **V.V. A.A.**, "*La nuova legge fallimentare – Commento alle disposizioni della legge fallimentare modificate dal d.l. n. 83/2015, conv., con mod., in l. 6 agosto 2015, n. 132*", Ed. Fabio Santangeli, Giuffrè Editore SPA, Milano, ISBN 9788814213380, (2016), at 323-330.

[2064] 160 (2).

[2065] Article 164. See **V.V. A.A.**, " *La nuova mini-riforma della legge fallimentare – Aggiornamento alla legge 30 giugno 2016 n. 119*", Eds. Sandulli Michele and D' Attorre Giacomo, G. Giappichelli Editore, Torino, (2016), ISBN 978-8-7524-361-6, at 260.

5.3.9 Stigma within the Italian models of the new millennium

Important modifications were made to the articles that caused high levels of public stigma.[2066]

Article 48 was modified in 2006 and 2007. This article in 1942 included two parts. Article 48 (1) requested all mail sent to the bankrupt to be delivered to the trustee who would keep all documents regarding assets or the estate which the bankrupt, under Article 48 (2), had only a right to inspect. The reform of 2006 redrafted this controversial article, which was (apparently) in conflict with Article 15 of the Italian constitution, in a single article, which imposed a duty on the bankrupt, the insolvency administrators, or liquidators to hand over all their correspondence regarding assets of the estate, including electronic one (e-mails and faxes).

In 2007, the article was rewritten and divided into two sections. A distinction is now made between debtors who are natural persons and those that are corporations. Under Article 48 (1), the bankrupt who is a natural person receives her correspondence and is bound to hand over to the trustee all documents (also e-mails) regarding assets and the estate. Article 48 (2) addresses the issue of corporate debtors. In this case all correspondence is still delivered directly to the insolvency administrator in charge. Violations of this Article are punished under Article 142 (1) (3) and may cost the loss of discharge privileges.

Article 49 as drafted in 1942 was deemed to go against the liberties protected by Article 16 of the Italian Constitution. It was therefore modified and expanded in 2006 to include three parts. The generic prohibition to transfer or modify a debtor's residency was modified to include the obligation to inform the trustee as soon as possible[2067] of any changes. Debtors, moreover, are not bound to stay in their residences unless they permission to leave from a judge anymore, although they must inform the court about any change in their residence or domicile.[2068] Violations are still punished by Article 220 of the bankruptcy law and can cause the loss of discharge.

Article 50 was repealed together with the limitations on voting rights,[2069] although the European push for the creation of public registers of bankruptcy proceedings may have effects on this particular element and open the door for abuses within such an historically stigmatizing environment.

5.3.10 Bankruptcy crimes in the reformed framework[2070]

This will be a rather short section considering its importance.

Surprisingly enough, despite the numerous reforms that have occurred since 2005, very little was modified in the criminal section of the enacted bankruptcy framework. The area which was probably in greatest need of reforms in order to match the approach imposed by the new goals and strategies of the European Union remained almost untouched. Moreover, the most significant changes were the exact opposite of what was expected: they increased and extended the impact of bankruptcy crimes.

The sections that included pecuniary punishments were updated to adapt to the introduction of the euro. They were, though, merely converted into values based on the new coin. Article 229, for example, which punishes the insolvency administrator who is bribed or receives unauthorized income through the proceeding is punished with three months to two years of jail time and a fine ranging between 103 and 516 euros.

Moreover we can observe how Article 236, one of the few newly enacted ones,[2071] was written to punish those experts in charge of attesting reorganization plans under Article 67 (3) (d). In this particular case the crime is sanctioned with two to five years of imprisonment (which is a long term) and a fine from

[2066] See **Bonfatti Sido, Censoni Paolo F**., "*Lineamenti di diritto fallimentare – second edition*", Wolters Kluwer, Milano, (2017), at 71-73.

[2067] **D'Aquino Filippo, Delladio Carlo, Fontana Roberto, Mammone Francesca**, "*Guida alla Legge Fallimentare*", Edizione n. 702, Editore Il Sole 24 Ore spa (2016), at 96.

[2068] Article 49 (1).

[2069] Article 2 (1) DPR 20 marzo 1967 n. 223.

[2070] See **V.V. A.A**., "*La nuova mini-riforma della legge fallimentare – Aggiornamento alla legge 30 giugno 2016 n. 119*", Eds. Sandulli Michele and D' Attorre Giacomo, G. Giappichelli Editore, Torino, (2016), ISBN 978-8-7524-361-6, at 347-360; **Pisani Nicola**, "*Diritto penale fallimentare – Problemi attuali*", Giappichelli Editore, Torino, ISBN 9788834800089, (2010).

[2071] Introduced in 2012.

50.000 to 100.000 euros, which can be increased if the criminal acts were committed to obtain the unjust enrichment of an interested party or if they caused damage to the creditors.

At the moment, therefore, criminal punishments are extremely heavy in terms of years of incarceration but have minimal, or irrelevant, pecuniary sanctions. This factor shows the lack of balance among the different components of the rules. The few hundred of euros that result from the conversion of the old pecuniary sanctions enacted in Italian liras show the lack of convergence with the new rules that are supposed to impose heavy pecuniary sanctions.

Other modifications are relevant to draw a meaningful picture of the worsening of the criminal scenario within Italian bankruptcy laws. When Article 218, for example, was modified in 2005, punishments were extended, not reduced. An increase from up to two years of jail time to six months to three years of jail time affects those that obtain credit while insolvent.

Just a few adjustments were made to decrease stigma. Article 217 introduced[2072] a limitation on the imposition of bankruptcy crimes committed during the accomplishment of an approved reorganization proceeding. This particular addition was made in order to incentivize the commencement of reorganizations over liquidations in accordance with European strategies.

6. Insolvency proceedings for natural persons in Italy[2073]

When discussing early Italian insolvency laws in this chapter, we observed how natural persons (consumers and non-business debtors in general) have been traditionally excluded (or protected) from bankruptcy systems. As observed in Chapter II, this exclusion was common among Member States although, in the new millennium, several measures were taken to improve national frameworks from this point of view. The European Union, the World Bank, and the UNCITRAL began to sponsor the inclusion of this class of debtors within insolvency models to support the struggle of consumers and natural persons in general during the many years of economic crisis, adopting the American system as a model.

Despite the many significant reforms that occurred from 2005, the situation remained mostly unaltered in Italy until 2012, when a set of specific proceedings was finally made available.[2074] [2075] The new frameworks were not, though, included in the bankruptcy law; they constituted a separate system.

We will not discuss these new tools in depth, but some elements of this reform are worthy of notice.

First of all, it is relevant to point out that the enactment of the new proceedings was a two-step process. The first modifications occurred with Law n. 3/2012. The statute did constitute a great innovation since it was the first of its kind in the modern Italian scenario. At the same time, though, it was not complete. Significant modifications and integrations had to be made in the very same year with Decree Law n. 179/2012.[2076]

The process that led to the enactment of the new rules, therefore, shows the same weaknesses that have affected the reform of the business bankruptcy system: a certain lack of coordination, organization ,and planning which led to the necessity of continuous revisions.

Second, the field of the insolvency of natural persons has remained, since 2012, regulated by the above-mentioned statutes. It was not merged into the general bankruptcy or insolvency framework. One of the factors that probably caused this bifurcation (aside from habit) was the difference in the general approaches to the proceedings. The newly enacted framework for non-business debtors did attempt support debtors and to alleviate the effects of stigma.

[2072] D.L. 78/2010; modified in 2012.

[2073] For an overview on this topic see **Bonfatti Sido, Censoni Paolo F.**, "*Lineamenti di diritto fallimentare – second edition*", Wolters Kluwer, Milano, (2017), at 435-441.

[2074] L 3/2012 Articles 6 (1); 7 (2) (a).

[2075] In this chapter we will often refer to these proceedings as proceedings for the insolvency of natural persons although the definition is somewhat inaccurate since the eligible debtors vary in nature. At the same time consumers and natural persons are by far the most relevant new groups of debtors protected by the law on over-indebtedness of 2012. It therefore makes sense, for the purpose of our discussion, to avoid repeating that more entities may file for protection under this law.

[2076] http://leg16.camera.it/561?appro=553.

Third, while bankruptcy proceedings in Italy have historically relied on insolvency as the most relevant access criteria, Law 3/2012 also applied the concept of "over-indebtness"[2077], which we discussed in previous chapters. This is yet another case in which modern regulations are trying to expand access and reduce the impact of insolvency, allowing petitioners to file early and voluntarily.

Fourth, a small detail, the reforms of 2012 designed a framework addressing the needs of "debtors", not "bankrupts". Although this may seem a minor factor, it is an important element showing the impact of the process of refoundation of insolvency frameworks and the attempts made at a local level to de-stigmatize systems.

These new models are therefore relevant as a sign of the major changes in the approach to bankruptcy issues that have been taking place in the past fifteen years and of the impact of legal transplants, which allowed, in a very short lapse of time, the re-structuring of laws with a completely different matrix compared to the traditional/national one.

The fairly recent Italian laws on the topic of the insolvency of natural persons make available three different proceedings which include both rehabilitation and liquidation options:

1. "*L'accordo del debitore*" – a rehabilitation proceeding available to all eligible debtors;
2. "*Il piano del consumatore*" – a rehabilitation proceeding available to consumers only;
3. "*La liquidazione dei beni*" – a liquidation proceeding available to all eligible debtors.

The last was not included in the first statute, Law n. 3/2012; the framework had to be integrated shortly after with D.L. 179/2012.

To be eligible for the above-mentioned proceedings, a debtor must be excluded under all the others which are part of the Royal Decree 267/1942. A list of categories of eligible debtors would, therefore, include:

- **consumers**[2078] (natural persons that contracted debts as non-business debtors);
- **small businesses**[2079] that do not meet the access requirements of Article 1 of the Royal Decree;
- **agricultural businesses**[2080];
- **innovative startups**.[2081]

Municipalities and governmental entities remain excluded from any bankruptcy proceeding.

For a case to be commenced, the debtor must, first of all, meet the "over-indebtedness" requirement.[2082] A case will be dismissed if:

- the petitioner has already been a debtor in a proceeding for natural persons within five years from filing the new petition;
- it is proven that a previously approved plan was not properly executed due to a fault of the debtor;
- the documentation that is provided is insufficient to support the opening of a case.

The law allows for the conversion of cases from rehabilitations into a liquidation.[2083] It also allows, in those cases in which the debtor a) fails to meet the requirements of a rehabilitation plan and b) in the meanwhile becomes eligible for a proceeding under the Royal Decree, for a bankruptcy proceeding to be opened.

As commonly happens in frameworks designed specifically to address the needs of non-business debtors and natural persons, discharge is the much-sought Holy Grail. Discharge under the new Italian model (just as in the Royal Decree) is not automatic; in order for a debtor to be awarded it, a petition has to be filed within a year from the closure of its case.[2084] The petition is placed under the court's assessment

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[2077] "The situation of persisting imbalance between the liquid value of available assets and obligations that leads to a relevant difficulty in meeting the debtor's obligations or the impossibility to pay debts regularly." See Article 6 (2), Law n. 3 of 2012.

[2078] Article 6 (2).

[2079] Articles (6) and 7 (2).

[2080] Article 7 bis (2) excluded from liquidations.

[2081] Article 31 (1) D.L. 179/2012 conv in Law 221/2012.

[2082] The definition of over-indebtedness is provided by Article 6 (2) of Law 3/2012.

[2083] Articles 14 quater and 14 quinquies.

[2084] Article 14 (4) terdecies.

and will be granted to honest and worthy debtors only. In evaluating the debtor's behavior, the court will take into consideration whether:

- the debtor cooperated with the proceeding;
- the debtor took actions to delay operations;
- discharge was already awarded within the previous eight years;
- the debtor attempted to return to being a productive member of society by looking for employment;
- at the least half of the creditors were paid successfully.

The debtor will not receive a discharge if:

- the situation of over-indebtedness that gave access to the proceeding was caused by the debtor's fault or misbehavior;
- the debtor made or attempted to make preferential payments or tried or attempted to hide assets.

Not all debts will be dischargeable. In particular, the debtor will remain liable for paying[2085]:

- alimony and support payments;
- pre-petition and post-petition taxes:
- criminal or extra-contractual liabilities.

Moreover, the order of discharge may be revoked in all those cases in which the debtor, within five years before commencement of the case, committed acts to:

- defraud creditors;
- acted willfully to alter debts or income;
- concealed assets.

The second element, which traditionally constitutes the fresh start for a debtor, is less developed in the Italian system. Exemptions are limited. Article 14, Section 6 refers rules to the Civil Code in Article 545, which lists mainly:

- unseizable assets such as clothing, linens, chairs and tables, beds, kitchenware, wardrobes, fridges, heaters, stoves, washing machines, books, tools of the trade, weapons necessary to public service, food and gasoline to last for a month, and proceeds of the usufruct on assets owned by the sons and daughters of the debtor;
- personal assets such as the right to a name or a pseudonym;
- maintenance and alimony;
- assets which are abandoned by the trustee.[2086]

Pension plans and wages can also be partially protected.

The framework is not free of stigma. The crimes listed in the Royal Decree of 1942 do not apply to insolvent natural persons and to the proceedings of Law n.3/2012. Other punishments still apply, though. In an"accord, the debtor can be punished for:

- increasing or reducing the total amount of debts;
- stealing assets;
- increasing fictitiously the value or number of available assets;
- making preferential payments;
- altering, stealing, damaging, or modifying accounting and documents;
- after commencement of a proceeding, worsening the level of over-indebtedness;
- intentional breaches to the plan.

In a liquidation, the debtor will be liable for:

- altering, stealing, damaging, or modifying accounting and documents;
- omitting assets from the mandatory documents that have to be filed with the petition.

Imprisonment can be imposed on debtors for a term of six months to two years with fines ranging from 1.000 to 50.000 euros.

[2085] *Id.*

[2086] **Bonfatti Sido, Censoni Paolo F**., "*Lineamenti di diritto fallimentare – second edition*", Wolters Kluwer, Milano, (2017), at 80-82.

The debtor is not the only subject of criminal punishment. All those in charge of assisting the debtor and of assessing the feasibility of the plan[2087] can also suffer consequences for their misbehavior, and in particular for making false oaths with regard to:

- the content of plans and supporting documents;
- the contents of a memorandum supporting a liquidation plan;
- the feasibility of a plan in a rehabilitation.

In such cases, imprisonment can be imposed on such third parties for a term of one to three years and fines range between 1.000 to 50.000 euros.

7. The latest updates in Italian insolvency regulations

The scenario depicted by the latest reforms in what arguably is one of the most ancient and historically complex insolvency frameworks is now somewhat chaotic. The years of crisis and economic instability, the need for improvements in the old system, the push by the European Union to direct the process of modification of the laws, all led to an impasse within the Italian system. Much was done to change the system, but not enough seems to have been achieved.

Between 2005 and 2017 the local insolvency framework has gained:

- easier access to reorganization frameworks – but proceedings remain complex and the balance between the rights of debtors and creditors seems to have been altered excessively in favor of the first through the imposition of lengthy stays "free of charge";
- new access requirements that allow debtors to take advantage of proceedings before being insolvent – although the definitions of "financial distress" are not yet clear;
- an increase in the groups of creditors that can access bankruptcy both by a redefinition of the exclusions which provided better prongs to identify "small enterprises" and through the implementation of a whole new model for non-business debtors. However, although other groups of debtors, such as "innovative start ups", were excluded, showing that insolvency in Italy today may be actually considered a tool of support for entrepreneurs and the separation between the business and the non-business systems may not provide debtors with the necessary support;
- an imposed reduction of the duration of proceedings – although the new rules appear to have more of a statistical purpose than a practical impact;
- the implementation of a new discharge system and a decrease in public stigma – although the intensification of criminal rules of bankruptcy appear to have weakened also this improvement;
- the increase in the use of technology within proceedings with grand projects to create national registers, meetings of creditors online, and a centralized system of registered e-mails to communicate with courts and proceedings – although the use of the Italian language only within the system, the relative reliability of the software and of national registered e-mails appears to be a step back in a rapidly globalizing environment.

It appears, therefore, that weaknesses can be found despite all of the reforms that have taken place in the past years.

Overall, we could say that the path that has been followed has not been straight and effective but winding and unclear.

A proposal for a radical reorganization was then brought forward, the so-called "Rordorf" reform[2088].

The new draft, the last in a long list of continuous attempts which have happened at lightning speed in the past years, has promoted new, radical changes. The process for its adoption led to, just a few months ago in January 2019[2089], the approval of a new code which will address all insolvency or over-indebtedness-connected issues.

The proposal suggested a solid reform which will become a code formed of almost four hundred articles. It will unify the Royal Decree of '42 in its latest structure and Law n. 3 of 2012 (with its subsequent modifications). In the mind of the reformer, therefore, both systems would be finally merged into one

[2087] "*Organi di Composizione della Crisi da Sovraindebitamento*".

[2088] From the name of the President of the Commission that drafted it. See Law 155/2017.

[2089] 10th of January 2019. http://www.governo.it/articolo/comunicato-stampa-del-consiglio-dei-ministri-n-37/10687

single framework addressing the needs of eligible debtors. The modifications are numerous and very significant.

We will not focus on the details, since it is not possible to know what will be the destiny of this reform. We will limit ourselves to making a brief overview of the most salient innovations. The following key aspects of the new code ("*Codice della crisi d' impresa e dell' insolvenza*"), aside from the unification of the business/non-business frameworks, constitute some of the most significant innovations of the new framework[2090]:

- definitions – the proposed framework includes definitions to support a clear understanding of the new rules; moreover, the addition of this section also shows the connection between the proposed system and foreign statutes such as the US Bankruptcy Code. Among the relevant definitions there is the one of "financial distress", which the drafters attempt to provide in a clear, useful format. The COMI concept would also be (briefly) defined and discussed;
- abolition of the term "bankrupt" - the new framework will not refer anymore to "bankrupts" or "bankruptcy"[2091]. The "*fallimento*" will be replaced by a new proceeding called "*liquidazione giudiziale*"; this is an epic revolution that changes the course of over 900 years of Italian bankruptcy history;
- the reforms are structured to reduce the costs and duration of proceedings[2092];
- ample access – to allow a great variety of debtors to take advantage of the new law;
- the use of out of court "alert proceedings[2093]"— another relevant goal of the reforms is to support debtors in taking early measures so that proceedings can pay higher shares to the creditors and liquidations can be limited. Articles 24 and 25 include very specific incentives which reward debtors who take early action with reductions on the interest to be paid on their fiscal debts, longer terms to file plans in reorganizations, and even protections from the effects of certain criminal sections when the damages which have been caused are very limited;
- incentives to file for reorganizations – reorganization proceedings are discussed first and hold a privileged position within the newly-designed framework. They take the place of liquidations within the draft. The new code attempts to structure a process to grant that all steps are made to ensure the continuation of business activities, even through another entrepreneur. Liquidations are placed in a residual position;
- emphasis placed in the draft on the protection of employees and also on setting specific rules for groups of companies[2094] – the new draft would include a whole section addressing this issue, showing it to be updated and tuned into international best practices;
- attempts made to support the ample use of technology to provide notifications and information[2095];
- reform of interconnected laws – the reform is extensive. It affects also the civil code and some criminal rules. Criminal sections would remain unaltered to regulate cases until the enactment of the new code. Criminal punishments, in any case, will go through very limited modifications even with the beginning of the new cases[2096];
- improvement of bankruptcy courts – the new model supports specialized judges to improve the quality of the whole process;

[2090] See http://www.governo.it/articolo/comunicato-stampa-del-consiglio-dei-ministri-n-37/10687

[2091] With the relevant exception of criminal rules which, as it will be discussed in this chapters undergo minimal changes and therefore still include the crimes of bankruptcy.

[2092] See Article 2 (1) of Law 155/2017.

[2093] See **V.V. A.A.**, "*Quaderni di Giurisprudenza Commerciale – Le proposte per una riforma della legge fallimentare; un dibattito dedicato a Franco Bonelli*", Eds. Arato Marco and Domenichini Giovanni, Giuffrè Editore SPA, Milano, ISBN 9788814218675, (2017), at 55-77.

[2094] See *Id.,* at 9-37.

[2095] See Article 2 (1) of Law 155/2017.

[2096] https://www.penalecontemporaneo.it/d/6405-approvato-il-nuovo-codice-della-crisi-dimpresa-e-dellinsolvenza-scompaiono-i-concetti-di--falliment

- registrar for trustees and others – the new system will include a registrar to list those companies or experts that are appointed by courts or by other departments of the government.

The new code is a great project which presents all the reforms embodied in the process of refoundation. What is impossible to know today, is if the draft will be able to bring the great improvements it was designed for, or if it will suffer the struggle of the previous reforms. It will take time to know if it be able to support the local market and to support Italian society in (finally) accepting and endorsing a change in tools and approaches which, after hundreds of years, are well rooted in its system.

8. Chapter VI: analysis and conclusions

Our basic overview of the evolution of Italian insolvency regulations, from the unification of the country to modern times[2097], allowed us to identify the effects of the refoundation of European insolvency laws in directing the path followed by a specific insolvency system of a Member State.

While in the U.S. approaches were turned upside-down in a little more than 200 years, Italy continued slowly upgrading its laws while maintaining the same matrix until 2005. It is from this year that change became radical and that key balances seemed to be lost.

We could divide the process of modification of Italian insolvency models in the past decades into four main phases:

- PHASE 1, from 1882 to 1942: in this phase, the whole nation is reset and structured for a united future. Bankruptcy regulations, which are included into the Commerce Code, remain loyal to their medieval matrix. The framework is a purely business one. Reorganizations are not allowed in early decades; petitions are filed mostly involuntarily and debtors are stigmatized and perceived as criminals or second-class citizens.
- PHASE 2, from 1942 to 2005: in this phase, bankruptcy laws acquire a new, more complex and well-crafted structure. The framework remains a purely business one and deeply linked to its predecessors. Reorganizations are allowed but have a marginal role and heavy access requirements are placed on all those debtors that attempt to avoid straight liquidations. The vast majority of cases are still filed involuntarily while civil punishments and crimes continue to fuel stigma.
- PHASE 3, from 2005 to today: in this phase, Italian laws change in a swift and to a certain extent disorganized manner to adapt to the globalized market, to international best practices and European strategies. This is a confusing decade in which attempts are made to swiftly impose new balances and radical changes in key approaches through legal transplants. The influence of the roots of primordial Italian systems, though, remain strong, causing an impasse in the process of reform. Change occurs through at-times contradictory modifications. Overall, the reforms lack the necessary coordination to bring stability through the new approaches and principles.

In just ten years, the following key aspects were deeply modified:

- a purely business system is joined by a new one to support natural persons;
- the groups of eligible debtors are redefined;
- insolvency is joined by new access criteria;
- voluntary access is pushed to match and possibly surpass the rates of involuntary filings;
- reorganizations become a more relevant tool than liquidations;
- discharge rules are enacted;
- public stigma is reduced.

But, as we have discussed, the reforms lacked coordination:

- The system for natural persons is not effectively coordinated to the business one.
- More debtors have access to bankruptcy, but new limits are enacted. Moreover, relevant start-ups are excluded in what appears to be a form of protection

[2097] It is interesting to point out that the lapse of time in which modern Italian laws have been drafted is similar to the one in which federal statutes have been fully operative in the United States but the results have been very different.

(following an old approach), signaling that the law does not efficiently support competition within the market.

- "Financial distress" is added as a criteria to allow early access, but a clear definition is not provided.
- Voluntary access is incentivized but through means, such as the ample stay allowed in reorganizations, that damage creditors excessively ,offering no guarantees of the success of a proceeding. Moreover, the fact that criminal sections did not change, but were actually expanded, contrasts with this approach.

- PHASE 4, the future: this last step is still in embryonic form. We cannot estimate when the Italian model will be able achieve a stable balance. The latest project of reform and the new code to be enacted were worth mentioning and deserved to be included in our final discussion as a sign of improvement. They allow us to hope that the previous reforms included in Phase 3 were nothing but a necessary transition. The new draft proposes great changes and appears to finally attain the reforms which were sought over the previous fifteen years. The code:
    - leads to the enactment of a new complete and well-structured insolvency code – it unifies the separate laws, addressing the needs of business and non-business debtors and giving stability to the whole field;
    - provides clearer definitions on relevant topics;
    - embodies several of the new principles which previous reforms attempted to include within the Italian model. Such principles match the ones proposed by the European Union and studied by international organizations. The framework follows the process of refoundation, leading toward greater uniformity in the European scenario;
    - supports the commencement of reorganizations and limits liquidations;
    - presents elements which are consistent with cross-border regulations and the needs of a modern, globalized credit economy.
    - de-stigmatizes the Italian insolvency scenario by erasing terms such as "bankrupt" or "*fallimento*" and decreasing the impact of insolvency, involuntary cases, and civil punishments. Discharge is also given high importance (although the criminal scenario will remain almost unmodified)
    - supports the administration of proceedings, incentivizing early access, putting specialized judges in charge, and reducing duration and costs of cases.

The fact that such an innovative law is ready to be enacted is a major step forward; whether such changes will be accepted by the contemporary Italian society, though, is unknown.

This part of our study has connects to several important elements for our final discussion.

First, we have discussed how the Law of 1942 seemed to go against the principle that effective and efficient local laws should match the society they are enacted within. There is no doubt, in fact, that this particular insolvency regulation had a very long life, considering that it was enacted in 1943 and reformed in 2005 (although not yet repealed). During these decades the structure of the Italian government and society changed deeply; despite its conflicts with the new, democratic structure of the Italian government, and with the new Italian society in general, this framework was kept in force with the necessary adjustments. We have observed on this point how the Royal Decree is not a true exception since relevant elements within the Italian society did not change; the stigma penalizing bankrupts remained strong. Hence a solidly-structured and well-crafted law managed to continue to support the economy despite constitutional and political reforms.

On this point, we also observed that the analysis based on the World Bank's Principles of 2001 still found the Royal Decree effective and efficien, in 2003, under the majority of the best practices that were listed at the time.

Second, on the evolution of stigma: in the previous chapters we analyzed this factor in its original, medieval from. We have seen its developments in England and the United States and observed the fight to remove it as promoted by the European Union. It appears that, to a certain extent, we are "stigmatizing stigma". As discussed in all of the previous chapters, stigma is related to the negative perception of debtors in society and corresponding rules that punish their economic defaults. The main purpose of such rules,

though, often was not to simply afflict individuals, but to prevent and limit abuses within markets and of bankruptcy systems. As such, this element seems to be the expression of one of the several difficult balances that have to be achieved to enact a successful regulation. Removing stigma or all of the elements that constitute it, without a strategy, does not seem to be an effective move. It appears that the necessary step, which modern systems such as the American one are also struggling to achieve[2098], is to fine-tune the tools to promote a correct and fair use of bankruptcy laws, whatever they may be, finding a balance that supports progress. As discussed in Chapter V, excessively lenient regulations can also cause rebounds and severe negative consequences. It appears, from the documents analyzed in Chapter I and from the observations made on the reforms that have occurred in Italy in Phase 3, that the availability of excessive relief or discharge does not automatically lead to an increase in the levels effectiveness and efficiency of the system or of entrepreneurship within the market. Quite the opposite. Allowing ill-equipped businesses to remain in the market damages competition, reduces transparency and predictability, causes loss of trust in the market, and may lead to chain effects, since creditors may have to file for bankruptcy themselves due to the difficulties in recovering their claims. The American framework itself has been very careful in disciplining this particular aspect over the past decades. This is not to say, of course, that medieval tools such as torture or life imprisonment can find space in modern regulations. We need, nevertheless, to be aware of the risks of promoting excessively risky entrepreneurial adventures or in incentivizing individuals that are not fit for self-employment to take chances.

It may be a miscalculation to impose such radical changes in less than a decade, at a time of great instability, and without sufficient guidance, as happened in Italy. We must acknowledge that time is a key factor in structuring an effective and efficient system. Swift, or “emergency”, modifications to frameworks seem to be successful as a response to market crisis only and for a short period of time.

We have confirmed, therefore, that the task imposed by the Union on local systems through the process of refoundation is a great challenge. It is not surprising that it caused difficulties and that Member States struggled to meet the preset objectives uniformly. We will discuss this topic further in our final analysis and conclusion.

[2098] See the effects and goals of the BAPCPA, for example.

CHAPTER VII.
THE FUTURE OF THE PROCESS OF REFOUNDING EUROPEAN INSOLVENCY FRAMEWORKS AND THE CURRENT IMPASSE

We have gone a long way, developing our discussion through time and space. In particular we have moved across continents to examine how insolvency-related issues have been dealt with within different societies. The analysis of key aspects of discordant local and cross-border models has allowed us to obtain relevant information for our debate and to gain a better understanding of the complex scenario we find ourselves living in today.

We will now review the salient points met in our path; then we will elaborate on the most important elements of the process of refounding European insolvency frameworks, on the causes of the impasse, and on the actions to be undertaken to bring improvements.

In Chapter I, we discussed the reasons that have pushed the European Union to seek the refoundation of its insolvency systems at the local and cross-border level. Change was deemed necessary in order to support the social and economic strategies set for the new millennium and, in particular, the challenging goal to swiftly become the most advanced knowledge-based economy in the world. In order to support this ambitious master plan, though, insolvency regulations had to be harmoniously modified, throughout the whole territory of the Union, following a specific formula which was designed to achieve the targets that were set in the ambitious agenda.

The task proved to be extremely complex.

At the beginning of the new millennium, in fact, European insolvency frameworks presented a certain degree of uniformity which consisted of their highly stigmatizing traits. They deterred new business initiatives, posing great obstacles to the successful deployment of the new strategies. The reformed, uniform, effective, and efficient insolvency systems would aim to reverse this trend by:

- increasing levels of entrepreneurship, pushing European citizens toward self-employment and toward exploiting their business potential;
- increasing the levels of competition within the European market, boosting economic growth;
- incentivizing investments;
- decreasing unemployment rates.

We have defined this great process of reform as the “process of refoundation of European insolvency frameworks”.

We used the term “refoundation” because of the magnitude of the task, the actions to undertake, and the great challenges that had to be faced, which ultimately slowed progress down and caused several important targets to be missed. Member States, struggled to coordinate their actions. The attempts made to eradicate stigma and to achieve higher levels of uniformity did not bring the expected results. Despite almost two decades of studies and reforms much remains to be done.

We have defined this situation as an impasse which remains still unresolved. This impasse has already caused harsh consequences at a time of great social and economic difficulties. We have, therefore, focused our efforts on understanding on the process of refoundation and, in particular, this difficult phase in its development.

In the next chapters, we aimed to gain a better understanding of the “bankruptcy universe”. In Chapters II and III we discussed effectiveness and efficiency in modern insolvency systems for business and non-business debtors at the local and cross-border level – the different fronts in which the Union is actively engaged. We needed, in fact, to determine if the origin of the impasse could be found in the principles, or in the tools, which the EU attempted to adopt and to share with the Member States through the process of

refoundation, or if it was a purely “systemic” event caused by the economic crisis or by political or social elements that could not be addressed solely within the field of insolvency law. Our analysis has allowed us to gain a better understanding of what constitutes, today, a good (suitable to support an economy which competes in the globalized market) bankruptcy formula, and it has also allowed us to make pertinent observations on the interaction between local and cross-border models.

We have found, in fact, that great difficulties are met in achieving the contemporary and coordinated development of both types of frameworks (local and cross-border – as wished for by the EU); we termed this difficult a "riddle". While the first kind of system must match the needs of the local society it is enacted within, the second requires high levels of uniformity among national laws. Positive developments in the first, therefore, seem to cause inevitably negative ones in the second and vice versa. As the European scenario is still characterized by major differences among the societies of its many Member States, local models appear to be bound to remain discordant.

European cross-border models, therefore, seem to be destined, at the least for now, to remain mere procedural frameworks with little impact on substantive aspects of proceedings.

In these two chapters we also found that the structure of the process of refounding European insolvency frameworks matches the principles supported by international studies in the modern scenario. This is a relevant piece of information since it shows that, in theory, the Union moved in a reasonable direction. We have therefore expanded our analysis to understand if the whole impasse was caused solely by the contrast between the needs of local and of cross-border frameworks, or if barriers derived from the approach chosen by the Union or from the structure of the reforms which were enthusiastically sponsored in so many official documents.

In order to do so we started an analysis of relevant insolvency models. In Chapter IV, we began from the origins of bankruptcy laws, focusing on relevant European frameworks. We discussed of our past, to better understand our present and our future. Our focus was placed on examining relevant aspects of medieval bankruptcy models that were enacted in the Italian Peninsula and in England, with particular attention placed on elements such as the stigma of failure and the lack of uniformity among regulations, which constitute the main barriers that are faced by the Union in developing its strategies.

In this chapter, we analyzed the:

- reasons that brought societies to enact specific bankruptcy regulations within medieval legal frameworks – by studying Italian and English systems we also had a chance to compare how this process was developed within different economic scenarios and communities;
- origins of the stigma of failure and the reasons that make it such a difficult factor to eradicate – focusing on the elements that constituted it and its original purpose, to protect fragile medieval economies;
- tendency of insolvency regulations to be very local and to adopt unique characteristics even among societies that share geographic proximity and a common cultural and legal background – medieval systems, in fact, often shared a common matrix and principles, but crafted a multitude of different rules and definitions, causing great diversity even upon addressing the linchpins of this field of law. Proof of this fact is presented to us, even in modern times, by the great variety of approaches applied to determine local definitions of insolvency.

In order to bring improvements in its frameworks and to pursue its ambitious goals, the Union did not attempt to just to achieve a level of uniformity among local models; it pushed systems to converge toward a specific formula which could support its efforts as a main competitor within the globalized economy. To do so it looked elsewhere in an attempt to mirror its most successful rival: the United States of America.

In the new millennium, in fact, the EU urged Member States to change their traditional approaches and to:

- decrease the impact of the stigma of failure;
- support the establishment of a European rescue culture focusing on reorganizations, providing ample discharge, and effective second chances for debtors (instead of on liquidations and punitive measures).
- provide ample voluntary access and protections for several groups of debtors (exclusions from the models were to be limited and well-justified).

These elements, which constituted a new path in dealing with insolvency-related issues, was deeply bound to the American one, which was used as the main source of inspiration within the process of refounding European insolvency frameworks. Such factors, though, appeared to be in contrast with several fundamental principles that, as discussed in Chapter IV, constituted the original matrix of European insolvency regulations.

Contrasts ultimately made it difficult for European societies to change. In order to make progress in our discussion and in order to understand how to remove the impasse, though, we had to examine if these difficulties would be temporary or permanent, reasonable or unreasonable. In Chapter V, therefore, we analyzed relevant aspects of the U.S. system from transplanted British Laws to the modern version of the Bankruptcy Code.

Early American and European laws shared their starting point, which was rooted in heavy punitive factors. Great reforms had to occur in the "new world", which over just two centuries to evolved a very different and apparently more successful (from an economic standpoint) approach to bankruptcy. A relevant part of our research has been focused, therefore, on understanding if this new breed of insolvency system came to life and how it could be successfully adopted by European societies.

In order to gain a better understanding of the pros and cons of this strategy, we first analyzed the evolution of American rules. We have observed how things changed once independence was acquired and through the creation of early state systems. We also went over the steps taken in order to enact effective federal statutes. Our historical analysis focused mainly on the:

- interaction and potential conflicts between American insolvency regulations and other federal or state Laws;
- structure of the American bankruptcy court system;
- tools used to incentivize early voluntary filings and the use of reorganizations compared to straight liquidations;
- application of discharge rules and the development of tools to support fresh starts within the framework;
- structure of American bankruptcy crimes;
- structure of the insolvency system for natural persons or non-business debtors in general.

This process allowed us to identify relevant elements that have caused the evolution of the American model to differ radically from most European ones.

We then focused on the modern American insolvency scenario, discussing relevant elements of the current draft of the Bankruptcy Code, such as:

- differences standing between models that address the needs of business and non-business debtors;
- access criteria and filing;
- stays;
- priorities;
- discharge and exemptions;
- crimes.

All these steps have allowed us to gain a good understanding of what the American system is, how its current balance was crafted, and the difficulties that were met in its implementation and continuous modifications.

At this point in our discussion, we had collected several relevant elements, learning more about the:

- reasons that pushed the Union to change its laws;
- origins of the new local and cross-border policies which were to be adopted uniformly within the territory of the Union;
- strengths and weaknesses of the new models.

We still had to understand the factors which had caused the impasse, though, and which prevented the process of refoundation from being successful in achieving its targets.

We used Chapter VI, therefore, as a sort of a case study to evaluate the impact of the reforms and, in particular, of the use of legal transplants at local level. The Italian bankruptcy scenario was chosen for this task due to several important factors. By merging Chapters IV and VI, it was possible to provide an

interesting overview of how bankruptcy frameworks have evolved within the same territory from their origins up to modern days and of how change occurred and of the difficulties met in this process. Particular emphasis was also placed in discussing early Italian frameworks to show the similarities with medieval ones, and in examining the reforms which took place starting in 2005.

The outcome of such reforms, in fact, shows how the steps taken to modernize the system led to an impasse and the challenges connected with it. Analyzing the difficulties faced in this process within the Italian system allowed us to spot elements which have halted European progress. We learned how the process for the modification of Italian laws was:

- too swift – change was radical and the short time allowed caused much confusion and lack of coordination;
- not matched by the necessary changes in the Italian society – the lack of reforms in the field of bankruptcy criminal law, for example, signaled that stigma was not effectively removed. It is important to remember that the modifications which occurred in the field of criminal bankruptcy actually expanded burdens, rather than decreasing them.

Italian society did not seem to be able to go down the path chosen by the Union.

Our case study, therefore, confirmed that reforms may not be successful, even if they are based on solid international best practices, if they are not tailored to merge with the society they are enacted within.

We truly have gone a long way to understand:

- how European insolvency frameworks have changed in the past centuries;
- how the Union wants them to evolve in the future (and why);
- the difficulties that are faced in achieving this goal.

In the next pages, we will sum up all the information which we have acquired. We will analyze the most relevant elements that have caused the current impasse in the process of refounding European insolvency frameworks and the actions that must be undertaken to bring improvements.

1. An analysis of the elements which constitute the impasse in the process of refounding European insolvency systems.

In Chapter I, we examined the actions undertaken by the European Union at the beginning of the new millennium in order to reform the field of bankruptcy laws at the local and cross-border level. We discussed the choices made by the Union and we observed that the process did not manage to achieve the results that were desired, expected, and scheduled. Several targets were missed and the whole plan for the development of European strategies faced an impasse.

The causes of this impasse in the field of insolvency law have two main origins.

- The first derives from the great systemic difficulties met in developing the general European strategies in the past two decades – the subprime crisis was not, in fact, the only major financial barrier met over the past twenty years. Moreover, the Union struggled to maintain levels of cohesion among Member States. Such major factors had repercussions in the area of insolvency regulations as they required immediate countermeasures which altered key balances and the development of the process of refoundation as it was conceived.
- The second is fully endogenous. It consists of relevant bankruptcy-specific elements which act as barriers to the development of the reforms within the European scenario.

In the next sections, we will focus on the second source of the impasse, as it is the one in which improvements can be achieved through specific bankruptcy studies. We will, therefore, discuss the complexity and importance of the process of refoundation with regard to the following troublesome, bankruptcy-specific elements:

- Schedules – the timing by which such vital reforms were planned;
- Approaches to the modification of the original matrix of European bankruptcy systems;
- The value of international best practices and legal transplants within this process.

Spoiler alert: we will conclude that, although we can identify the main factors which constitute the impasse, the Union will be unable to overcome them swiftly and to meet the original master plan. Much can be done nevertheless to bring relevant improvements and to reset and improve the current strategies so that targets can be attained with time, preventing further *déjà vu*.

1.1 The complexity of refounding European insolvency laws

> "The globalization of business activity is rightfully celebrated as one of the triumphs of the second half of the twentieth century. The benefits stemming from the globalization of commerce are substantial, but international transactions also bring with them important challenges for the world's legal systems."[2099]

Given the current economic scenario, any process of reform, coordination, and modernization of legal frameworks is certainly positive. This is particularly true in the complex field of bankruptcy law. The years of persistent economic crises and the changes occurring within markets made it necessary to carefully balance any reform that could be planned within this area.

It has to be acknowledged, though, that the process of refounding European insolvency models is a grand and unique experiment. It is much different from the usual, often necessary, and, to a certain extent, automatic and "basic" updating of a framework. While, in fact, updates merely ensure that a law is coherent with the principles set forward in the society it is enacted within, the process of refoundation looks to the future. It imposes the enactment of new approaches, rules, and radical changes structured to support the general market strategies of tens of different (and often uncoordinated) Member States.

In describing it, we could be tempted to compare it to the process that took place a little more than 200 years ago in the United States. Both, in fact, attempted to create a new structure starting from discordant local systems. Several factors, though, make the two scenarios irreconcilable and favored the success of the American enterprise.

While, the United States at the time was a "clean slate"[2100], the European Union today is a tangle of complex and historically ingrained models, uses, rules, local laws, and approaches. The unique history of the "old world" is a relevant factor, making the early American and the modern European scenario contrasting starting points and supporting the success of the first over the second. Despite the recent attempts to create a uniform conglomerate (a "United States of Europe", we could say) and the positive results achieved up to now, Member States remain deeply bound to their roots and traditions, and far from the levels of harmonization wished-for by the Union.

The task undertaken at European level is, therefore, a magnificent challenge.

As discussed in previous pages, the results achieved up to today are poor compared to the initial expectations. An impasse has stayed the development of uniform, local, and cross-border models based on the matrix designed and imposed through European strategies. Such an impasse has been caused by several factors.

Some can be considered systemic and have affected all European strategies. The tormented market conditions that have been faced by the Union in the past two decades and the difficulties encountered by Member States in effectively coordinating their actions on several aspects of the ten-year plans have had repercussions on the entire master plan designed by the Union, and hence also within the realm of insolvency law. We will not analyze these elements in depth in this final part as they have been sufficiently mentioned through the analysis of official European documents in Chapter I, and as little could be done with a bankruptcy-specific study to foresee and contain their effects.

We will focus, instead, on the second group, made of bankruptcy-specific elements that have been detected through our analysis. They are:

- Haste may be imposed on the process – the Union has attempted to bring significant changes within the frameworks of the Member States in a very short period of time, following a tight schedule which was imposed by the ambitious goals set for its economy.
- The "market approach" on which the reforms have been based – the tight schedule designed by the Union was conceptualized in the beginning to support the achievement of the da Feira goals

[2099] **Guzman Andrew T**., "*International bankruptcy: in Defense of Universalism*", 98 Mich L. Rev. 2177 (2000), at 2177.

[2100] Despite early English influence which, as we have discussed, had been often rejected already at the time of Colonial models. See the historical part of Chapter V.

and, in general, to support European market strategies. The process to reform bankruptcy laws was therefore structured to fit within and to support a broader economic plan of action.

- The use (and abuse) of international best practices or international transplants in structuring the reforms – as the reform of bankruptcy laws at local and at cross-border level had to fit within the larger plan of action, the Union had clear requirements to meet. It did not aim to achieve a generic level of convergence among the frameworks of the Member States; it aimed to enact a specific formula which could help European economies in achieving their targets. The EU, therefore, in order to improve swiftly the levels of competitiveness of an entire continent, structured the whole process of refoundation basing it on approaches, tools, and principles that did not match relevant elements of the insolvency laws of the Member States. This specific structure was based on modern international best practices and on legal transplants from the model of Europe's most successful competitor, the United States of America (which European official documents routinely used as a reference point).

As we are about to discuss, all these factors hampered the development the process of refounding European insolvency frameworks in the past two decades and did not constitute a solid base for its continuation in the next years.

1.2 Effectively programming the refoundation of European insolvency regulations

Bankruptcy is a complex machine that requires great balance between several important interests to operate effectively and efficiently (or to avoid greatly damaging societies and economies).

Some systems, for example, focus on protecting the interests of the creditors from business bankrupts, who are often perceived as dangerous criminals. The medieval models which we have discussed are a clear example of this approach which we can see deployed also within modern scenarios which are heavily punitive.

Others attempt to bring greater benefits to the societies they are enacted within by ensuring that a great variety of debtors (including non-business ones) do not become market casualties. They do so by allowing ample discharges, protections from discrimination, and effective fresh starts. The modern American approach mirrors this particular balance which is also sponsored by influential international organizations as a successful approach to be deployed within the legal frameworks of countries competing in the modern globalized market.

The variables to be accounted for, though, truly are many and lead to countless possible formulas. In very recent times, the list has been broadened even further by the expansion of the application of insolvency systems to natural persons (consumers and non-business debtors in general). More and more key factors have, therefore, to be kept into consideration upon calibrating a modern system.

In the previous chapters we analyzed relevant rules applied within many different frameworks, old and modern. Each was characterized by an elaborate structure organizing and maintaining a carefully-set balance between all the interests at stake. Processes which led to the modification of such models were, therefore, usually slow and complex.

Quick changes would bring instability and lead, in fact, to a loss in effectiveness and efficiency.

We discussed, for example, how American bankruptcy systems took over two centuries (and a much longer time if we start our discussion from the early English statutes enacted before the colonies acquired their independence) to evolve, moving away from their stigmatizing roots and becoming the model which inspires the refoundation of European insolvency frameworks today.

In our historical overviews, we also analyzed other examples of great reforms which have occurred within the field of bankruptcy law over time. We discussed, for example, how:

- the very definition of "insolvency" has changed from a synonym of "fleeing" to its more modern, economic tests (we also examined how insolvency went from being a key access criteria to holding a much less significant role; a process which took more than 700 years);
- liquidations went from being the only proceeding available to becoming a residual option compared to reorganizations and rehabilitations;
- certain claims got to enjoy a priority status or greater protections over others (we also examined how these interests have changed over the centuries);

- honesty and cooperation have become relevant factors within proceedings that aim to grant to debtors access to relief in the form of discharge and fresh starts.

These major changes did not occur overnight; they took decades, or more likely centuries of attempts, compromises, and failures in order to consolidate themselves.

The European Union, on the other hand, started at Santa Maria da Feira an extremely ambitious ten-year strategy and shaped the necessary process of refoundation of its insolvency systems accordingly. Suddenly, after centuries of stigma, European entrepreneurs and citizens had to be pushed toward exploring and exploiting their business potential. They had to think of bankruptcy as a tool to support their activities (not as a death penalty) and of fresh starters as valuable resources (not as criminals).

As discussed in Chapter I, a plan structured to support entrepreneurship across European borders could not be developed effectively and efficiently if bankruptcy laws stigmatized self-employment and incentivized forum shopping or deterred cross-border business activities.

The contrasts among the approach developed by the new strategies and the previously-enacted regulations, though, was too significant to allow for a swift shift. Although the Union and Member States took action to bring several reasoned changed ameliorations, such as:

- decreasing the impact of punitive tools which permeated their laws;
- adopting new discharge rules;
- incentivizing second chances and fresh starts;
- improving reorganization frameworks;
- shortening the duration of bankruptcy proceedings,

all such major reforms ultimately proved to be too onerous. They caused alterations of relevant balances existing within the local insolvency scenarios and could not achieve the preset targets in a term of just a few years.

It is evident that the time budgeted to achieve such important results uniformly was insufficient. The radical changes that we have just mentioned could not be brought effectively under such a tight schedule and would have almost certainly been missed even if Member States did not have to confront themselves with the market crisis of the century. In the end, even a smaller Union, in a more prosperous time, could not find an agreement for the enactment of a much needed cross-border model for over fifty years.

Europe, therefore, evidently misjudged the demanding task it aimed to accomplish. The actions undertaken to refound its insolvency systems could not be successfully accomplished in the short time that was allowed, even though:

- the general strategies for the first and for the second decade of the new millennium were based on solid studies;
- the direction in which the Union attempted to move was laudable;
- achieving results was in the best interest the whole Union and of the societies that constitute it.

The impasse under this first aspect is, therefore, nothing but the expression of the fact that the European strategies set in the beginning of the new millennium required major reforms to occur too swiftly within a complex field of law which is deeply entangled with relevant aspects of local societies. The setting of the new economic strategies could take place at a much quicker pace compared to the fine-tuning of legal frameworks, and, in particular, of the bankruptcy models that were supposed to support them. This caused the mechanism to stall and to produce poor results.

We should not, therefore, judge the quality of European reforms based on the results that have been achieved up to now. As amply discussed in Chapters II and III, reforms adopted within the European masterplan matched the recent developments in bankruptcy studies. If the process for their consolidation was awarded the necessary time, it could bring positive results and support the growth of the European economy and its capacity to compete within a globalized scenario.

But there is more holding progress back. The peculiar market approach followed by the EU in seeking change has also contributed to an impasse that is stalling the development of modern European systems.

1.3 The market approach adopted to shape the refoundation of European insolvency frameworks

The Union attempted to achieve its goals by setting a precise approach in the process to reform its insolvency laws at the local and cross-border level. Europe did not move toward uniformity in general but attempted to push Member States to adopt a specific scheme which could operate effectively and efficiently and support its common market. We could define it as a "market approach".

Now, this does not appear to be a major innovation (and it surely could not come as a surprise).

Change within insolvency systems cannot be considered alien to the needs of local markets. Quite the opposite: in the end, insolvency laws are traditionally bound to the business environment they are enacted within. We have observed how systems have often been reformed in order to support local economies at times of need. Examples of this approach include early American federal acts which were designed as emergency regulations in times of great economic difficulties.

We also have observed, though, how the nature of such emergency tools caused them to be short-lived and to obtain little success.

The European Union, on the other hand, attempted to plan long-lasting, durable, effective, and solid changes to its insolvency scenario. It structured the linchpins of its reforms so that they could fit within the general market strategies and support them. Official European documents have often linked the reform of bankruptcy systems with the actions needed to support the "proper functioning of the market" as a concrete step towards achieving the objective of "establishing an area of freedom, security and justice".[2101] [2102]

Such process, which does not match the standard modification of insolvency laws based on emergency economic measures, attempted to be an exception to the "golden rule" which we discussed in Chapters II and III. It aimed, in fact, to focus on those market-related targets which were deemed essential to boosting growth and the competitiveness of the Union. The needs of the market would, therefore, shape the laws.

Societies would have then to accept, adopt, and endorse the reforms. This approach, though, ultimately proved unsuccessful and has become one of the major causes of the impasse.

Stigma provides a good explanation for the failure of this strategy. The stigma of failure is rooted in the terrible punishments deployed by medieval societies to prevent insolvency and punish bankrupts. It stuck to our systems and it grew to permeate our societies, becoming extremely difficult to eradicate, because it was effective and efficient in achieving its goals. Reversing this process and teaching European societies that bankruptcy was not to be feared and that honest debtors deserved a second chance free of prejudice was a challenge.

As European societies remained filled with fear, they craved protection from the reforms supported by the process of refoundation. The strong economic motivations endorsed by the Union did not do the trick; communities were not the passive receivers of such majestic innovations. They did not tolerate the radical changes that markets attempted to impose on them through the use of legal transplants.

Hence, the whole system stalled.

1.4 The application of international best practices and the use of legal transplants

Upon drafting European strategies, it was to be expected that more time was necessary to successfully bring in the radical modifications that had been planned for the field of bankruptcy.

[2101] The Preamble of 2002 at point (1) stated that "The European Union has set out the **aim** of establishing an area of freedom, security and justice"; the preamble of the recast Regulation states at point (2) that "The Union has set the **objective** of establishing an area of freedom, security and justice".

[2102] The above-mentioned points of the preamble of 2002 were not modified in 2015 although an introductory point was added: "(1) On 12 December 2012, the Commission adopted a report on the application of Council Regulation (EC) No 1346/2000. The report concluded that the Regulation is functioning well in general but that it would be desirable to improve the application of certain of its provisions in order to enhance the effective administration of cross-border insolvency proceedings. Since that Regulation has been amended several times and further amendments are to be made, it should be recast in the interest of clarity."

The reform of insolvency systems, nevertheless, was not the ultimate goal, but a cog within a massive machine focused on achieving the da Feira goals. Not all individual steps could be prepared or conceptualized to perfection within the complex plan that was being designed. A certain degree of improvisation was necessary to attain the desired levels of growth.

Moreover, the scenario for which the first ten-year plan had been set suffered great modifications due to external factors. The increase in international competition and harsh economic conditions had a deep detrimental effect on all fronts and forced the Union to make numerous unforeseen adjustments. All these elements justify, to a certain degree, the further delays which have occurred.

If the crisis had not hit so harshly at a time of great change, both in the structure of the Union and of its markets, the debacle in reforming insolvency laws would have probably been contained and, overall, less significant. Yet, this is the scenario we found ourselves living in, that we have to confront ourselves with, and that we have to improve (somehow). One more relevant factor must be discussed in our analysis before we present possible improvements to the current European strategies: the impact of legal transplants within the process of refoundation.

The Union attempted to provide support for the swift and ambitious process of reform planned for its bankruptcy laws. It did so by carefully choosing the key elements of the new formula which had to be implemented uniformly within the European scenario. Upon designing the process of refoundation, relevant studies were developed in Europe and the frameworks to be adopted in the near future were carefully crafted, creating a formula which could fit within, and support, general economic strategies.

The new formula was based on international best practices and on elements and approaches to be transplanted from the American system. The Union tried to ensure the success of its speedy, market-oriented reforms by relying on tools which had already been successfully tested within the international scenario and that supported the development of the American economy. The most significant ones were:

- ensuring ample voluntary access to proceedings;
- reducing and ultimately eradicating the impact of the stigma of failure;
- implementing insolvency systems to support non-business debtors;
- implementing a strong reorganization mentality (studying the model provided by Chapter 11);
- providing quick discharges;
- supporting honest debtors in making good use of their fresh starts.

We could say therefore that the EU did indeed do its homework.

We have discussed several times in the previous sections of our analysis, though, how such elements were alien to, or in contrast with, the original matrix of most European insolvency laws. They had, therefore, to be transplanted from the successful frameworks they were enacted within.

As we observed in Chapters II and III, though, the application of international best practices or the borrowing or transplanting of rules from other systems (even if they are well-balanced and competitive), does not ensure the achievement of equal results within a different economic and social setting. The Union, therefore, could not be sure to hit the jackpot simply by transplanting and adopting successful foreign tools.[2103]

Unfortunately, this point seems to have been fully confirmed by our analysis. The attempts made by the EU up to today to speed up the process of reform, and to outperform the American economy by sharing its legal approaches and tools, or by relying on international best practices, have proven overall

[2103] See on this relevant point **Eichgreen Barry**, "*The European Economy Since 1945*", Princeton University Press, Princeton New Jersey, USA, ISBN, 9780691138480, (2007): "Taken to an extreme, this view suggests that the European model will have to converge to that of the United States. If the financial component of the European model comes to resemble that of the United States, then other components will have to come to resemble those of the United States as well, since only that one set of arrangements complements one another efficiently. If Europe instead maintains a combination that is second best, its economy will further and further behind, until at some point there is crisis sufficient to dissolve remaining resistance to the adoption of the Anglo-Saxon model. This conclusion is too strong for at the least two reasons. **First there may be more than one way to crack a nut**. There may be more than one combination of labor-market, product-market, and public-sector institutions, in other words, capable of producing the same level of productive efficiency. Starting from different points, Europe and the United States may converge on different equilibria that are equally efficient at delivering the economic goods", at 420-1.

unsuccessful. The system ultimately stalled. Depite decades of reforms, the differences between European local systems remain significant and stigma is far from eradicated.

The gap separating the American and the European economies is still far from reduced.

Further and different steps need therefore to be made in order to move forward with the process of refounding European insolvency frameworks successfully; the European approach in this area of law has to change rationally for goals to be reached.

2. Pros and cons of the refoundation of European insolvency systems today

2.1 The pros: reasons to continue with this important project

Despite the great efforts of our Unionm it is unlikely that the grand reforms embodied in the process of refounding European insolvency frameworks will occur as initially planned, in a matter of years or a few decades. Adopting and implementing a new system focused on the needs of such a complex economy is a great challenge and transplanting valuable foreign tools will not be enough to succeed. New initiatives have to be undertaken to finally move forward toward achieving the goals which were set almost twenty years ago.

Just as it happened in the past (at the time of the Kok Report, for example), Europe should ponder if it is time to give up or if instead it should stick to this ambitious process.

Despite the difficulties that have been met in the past, the answer is probably positive: the Union should once again persevere. Despite the difficulties that have been faced, in fact, the process remains a key element to unlocking progress within EU. Modifying insolvency laws and achieving greater levels of harmonization is a necessary step toward a better and more successful coexistence between Member States.

Efforts should be renewed, therefore, to improve the process of refoundation, which still is a cornerstone on which to build Europe's future within a globalized market. However, much needs to change.

Several of its constitutive elements are very valuable and have indeed brought progress in our systems, even if several targets have been missed. The process has, for example:

- **provided a path to Member States to follow which is clearly-oriented and farsighted** – it clearly established reasonable guidelines to reform European laws in a form that will support the development of European markets and societies. The principles in which the new European "rescue culture" is rooted are anchored in international best practices and in a formula followed by a competitive modern system. The process is an innovative step forward toward reversing the stigmatizing background shared by most Member States, and supports business initiatives and entrepreneurship in general. This approach can provide relief to the hoards of honest debtors harmed by the crisis within credit economies.
- **outlined those relevant targets to be achieved in order to support trade and investments, preserve jobs, and help economies in absorbing external shocks**[2104] – the fact that the targets set within the process could not be achieved as scheduled does not mean the project should be abandoned. The development of the process was negatively affected by several external factors which would have debilitated any initiative. Moreover, through failure we have acquired more knowledge on how to improve our strategies. The goals that have been set are calibrated on the needs of the Union (for example, the goals of lowering unemployment rates and strengthening the economy) and on the strategies designed to improve our way of living. They will not change, but European strategies can be improved.
- **provided support to the enactment of cross-border models after decades of attempts** – the focus placed on reforming the insolvency scenario has placated the intense debates which had prevented the enactment of cross-border frameworks in the past. In two decades, the Union has achieved this important goal and enacted a framework that now serves a model to other international organizations. More importantly, it also revised it to bring necessary improvements. The discussion

[2104] **(2016) COM 723 Final**, "*Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU*", at 2.

on the project for a Directive is yet another step forward in this key area which is fundamental to support the stream of cross-border commerce.

The basic structure of the process of refoundation is, therefore, solid and worthy of future developments.

The actions that must be undertaken now need to build on the knowledge that we have acquired in the past decades. They need to address the core of the barriers which we have discussed, limiting or removing those bankruptcy-specific elements which cause the persistence of the impasse. Although we cannot achieve perfection, several significant improvements can be attained and will indeed make the difference in supporting the growth of the European Union and the development of cross-border commerce.

The truth is that some of the difficulties we have analyzed do not seem insurmountable even in a complex scenario we are living in. The Union must reorganize its efforts and rethink its strategies, effectively creating its own fresh start. In the next pages, we will discuss concrete actions aimed at improving the process of refounding European insolvency frameworks.

The measures which we will propose will be rooted in our discussion and in the important international studies we have mentioned. They will often propose remedies and improvements based on tools which have proven successful in the past; we believe that the Union should refrain from elaborating complex, experimental measures at a time of great difficulties such as the one the Member States are living in. A safe and concrete path should be designed to achieve progress.

The general goals will not be modified. The European "rescue mentality" is a reasonable approach to modern insolvency issues and the original targets set two decades ago are still valuable today. The Union still needs to:

- strengthen its market(s);
- create a friendly business environment at the local and cross-border level;
- support the growth of entrepreneurship;
- provide cross-border discharges;
- decrease unemployment rates.

We still believe, therefore, in the backbone of the process of refoundation which has already led to positive results. Our analysis in the next sections will discuss how to achieve these important goals by following a more productive path.

2.2 The cons of the process of refoundation and of a careless implementation of the European "rescue culture"

In past years, the Union has implemented great reforms to boost its economic performance. The refoundation of its insolvency frameworks was rooted in the implementation of a European "rescue culture" which could support the growth of its markets. The ultimate goal was to match the same positive results obtained within the American economy:

> "More specifically, such frameworks aim to help increase investment and job opportunities in the single market, reduce unnecessary liquidations of viable companies, avoid unnecessary job losses, prevent the build-up of non-performing loans, facilitate cross-border restructurings, and reduce costs and increase opportunities for honest entrepreneurs to be given a fresh start."[2105]
>
> "The objective is not to interfere with what works well, but to establish a common EU-wide framework to ensure effective restructuring, second chance and efficient procedures both at national and cross-border level. Boosting jobs and growth in Europe requires a stronger rescue culture which helps viable businesses to restructure and continue operating while channeling enterprises with no chance of survival towards swift

[2105] **(2016) COM 723 Final**, "*Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU*", at 5-6.

> liquidation, and gives honest entrepreneurs in distress a second chance. This proposal is an important step towards such a change of culture."[2106]

We have observed, though, how following this path could be tricky. In order to ensure the chances of success, in fact, the process will have to be balanced with the needs and unique characteristics of European societies. The impasse faced by the Union is derived from the failure to structure reforms which could adapt to the context in which they were implemented.

In order to bring progress, therefore, changes have to be made.

Future actions will have to be conceived based on our findings. They will have to:

- refrain from imposing an excessively tight schedule;
- take all the necessary steps to involve societies in the process;
- carefully select the rules, approaches, and principles that have to be harmonized.

Upon renewing European efforts in this important project, it is important to keep in mind the relevant observations made, more than a decade ago, within the "Opinion of the Committee of the Regions on the Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions - Implementing the Community Lisbon Programme - Modern SME Policy for growth and employment":

> "5.3. It is important to underline that entrepreneurship is not the solution to all of society's problems and that not everyone is potentially a successful entrepreneur. The follow up to this paper must remember this fact. The AP should consequently focus on identifying, encouraging and supporting those who want to become successful entrepreneurs, rather than trying to convince people to become entrepreneurs against their better judgment, or indeed compelling employees and the unemployed people to become self-employed."[2107]

> "5.8. The Committee would argue that the pursuit of greater entrepreneurial dynamism should concentrate on the quality of entrepreneurs, not quantity. Encouraging more people to become self-employed, or even involved in a business start-up will not necessarily lead to an increase in successful, sustainable entrepreneurial activity. The displacement effects of an over vigorous start-up policy on existing businesses need to be considered and the AP should include more options for existing businesses."[2108]

Despite what was implied by several official documents published in the past two decades[2109], entrepreneurship does not grant a successful outcome to all those that try. Moreover, the excessive deregulation of credit systems can be dangerous and lead to harsh consequences[2110], such as the irreparable loss of capital, important resources, and assets such as family homes.

Incentivizing a multitude of citizens to become entrepreneurs, or providing all bankrupts with ample discharge, may be dangerous if the necessary steps are not carefully planned. Societies that are still greatly permeated with a stigmatizing mindset and that have not adopted uniform solutions to provide honest entrepreneurs and consumers with effective tools to obtain a meaningful second chance may be unprepared to handle the consequences of the reforms which are being imposed upon them.

But there is more.

A great risk Europe is currently facing is the reduction of the credibility/transparency/predictability of our frameworks and markets, a result that is the opposite of what it aimed for. Unless what the"Opinion

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[2106] *Id.,* at 7.

[2107] "Opinion of the Committee of the Regions on the Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions - Implementing the Community Lisbon Programme - Modern SME Policy for growth and employment"; Official journal of the European union, C 229/08, (2006), at 60.

[2108] *Id.*, at 61.

[2109] See the discussion in Chapter I.

[2110] **Martin Nathalie**, "*The role of history and culture in developing bankruptcy and insolvency systems: the perils of legal transplantation*", 28 B.C. Int'l & Comp. L. Rev. 1, (2005), at 76.

stated is kept in mind upon drafting the reforms, the EU risks burdening local economies with a great number of what we may define as "bankruptcy *kintsugis*."

Kintsugi is a Japanese term for the process through which a broken item, such a pot or a cup, instead of being thrown away or discarded, is repaired in a unique way. The broken item is turned into a work of art as repairs are done with valuable materials such as gold. The broken cup, therefore, is not just restored; it is enriched becoming a work of art and acquires a new, higher status.

In a similar way the modern European approach to bankruptcy aims to support hoards of “broken” individuals or businesses. The honest bankrupt which, in the past, would have been evicted from the market and from society (thrown away) receives support through the “rescue mentality” and a chance to start again and to be successful. Yet the risk connected with making excessive relief available is to create an equally unhealthy (although opposed) balance which damages trades and creditors allowing debtors to believe that they have a right to be helped.

Excessive protections may allow debtors to exit proceedings without investing the necessary energies in their rehabilitation and therefore without acquiring the knowledge and experience needed to avoid similar mistakes in the future. This would deprive the “rescue mentality” of a key element for its success: the fact of turning failure in a learning experience. The “gold” metaphorically used in this process to “cure” and restore bankrupts, in fact, would be constituted by the financial losses suffered by creditors and by the energies spent by society turning the process in a harmful and “unreasonable” remedy.

The process of refoundation must aim to create added-value for European societies. It cannot be designed to mindlessly protect an army of uncompetitive “zombies” which are ultimately destined to be evicted from the market through liquidations, or even worse, to facilitate frauds. The “scars” caused by the insuccesses of modern bankrupts must mark a true new beginning, they must become a sign of maturity and of experience leading to greater levels of reliability and competence.

Communities cannot afford to make such relevant sacrifices without returns. In order to achieve such goal the Member States and the Union need therefore to ensure that all the necessary preparations are made and that changes within insolvency frameworks are carefully planned. In the next sections we will suggest actions that should be commenced in order to move forward in this direction.

3. The fresh start of the process of refounding European insolvency frameworks

3.1 Meeting targets through a careful and reasoned “step by step” approach

From our discussion in Chapter III, we know that obtaining the full harmonization of several local systems may be a utopia. That should not be, therefore, the end goal of European reforms. The Union should aim to reach a sufficient level of harmonization to improve its systems instead.

How long it will take to allow the process of refoundation to reach high levels of effectiveness and efficiency is unknown. The experience gained in the past few decades has shown us, though, that it is not possible to push down on the gas pedal in a complex scenario such as the European one. The Union should focus, therefore, on developing a concrete, one-step-at-a-time approach.

Although several actions can be proposed or planned, it is not possible to foresee their result or to determine an accurate schedule for their development. Their outcome would depend on several factors which would not be directly connected with the field of insolvency laws, such as further economic instability within the globalized market. Moreover, it is not possible to establish if a certain path which has proven successful in other scenarios will produce positive effects also in Europe.

Even if we know more about the barriers which have constituted the impasse, we cannot be sure of the measures that need to be undertaken to surpass them. This said, life isn't easy and Europe certainly cannot stay still; it must make reasonable attempts at reform. The Union must not rush in these reforms, so as to ensure that each action within the process of refoundation can be optimized and that an impasse can be avoided. Modifications must be carefully designed under every aspect.

In the next sections, we will discuss different steps constituting a path to obtain a fresh start within the process of refounding European insolvency frameworks. The measures which we will analyze will be congruent with European strategies, with our findings, and with the continuation of the process as it was originally structured. The strategy will be subdivided into two interconnected phases:

- Phase I: creating the necessary levels of coordination between the measures to reform insolvency laws and key principles of our societies;
- Phase II: harmonizing relevant substantive aspects of the local bankruptcy regulations of the Member States.

These phases will have to be interconnected and sequential. Phase I is a priority. Although Phase II will be developed almost simultaneously, in fact, the Union will have to find effective ways to make changes within its societies before it moves toward implementing rules supporting the European rescue culture.

If the reforms and societies are not synchronized, the process will ultimately be ineffective or even harmful.

3.2 PHASE I: synchronizing European societies with the process of refoundation of insolvency frameworks and with the European rescue culture.

In Chapter I we discussed the range and importance of the reforms that the European Union has attempted to implement in the past few years.

Through this process we have learned how Europe's focus does not aim obtain a generic convergence of the different local systems, but to guide them effectively toward the enactment of a precise formula to deal with insolvency related issues. This new structure, though, has proven to be in conflict with the original matrix of European bankruptcy laws and difficult to implement. The results which have been achieved due to such difficulties have, therefore, been poor.

Our analysis has shown that European systems did present several common traits at the beginning of the new millennium. The local frameworks of the different Member States did converge on multiple relevant aspects connected to the field of bankruptcy. This matrix, which was often based on stigmatizing factors and on deploying harsh punishments to afflict business debtors (and bankrupts in general), did not support effectively the master plan designed by the Union to become the most competitive knowledge-based society within the modern globalized market.

The EU had to provide the Member States with a clear path to follow in order to bring the necessary changes harmoniously and to develop its rescue culture. Despite the numerous studies and official documents published, though, the lack of coordination between the reforms and local societies stalled progress and caused much confusion. In order to plan concrete improvements in the near future, the Union must act so that its new philosophy and approaches can be accepted and supported at all levels.

This is an area in which the Union has remained dormant in past years, but the truth is that relevant initiatives had taken place in early stages of the process.

A particularly notable one occurred in 2002. In that year, the EU developed a very interesting advertising campaign to educate communities about the pillars of the process of refoundation, the da Feira strategies, and the importance of accepting honest failures and supporting entrepreneurialism. The following documents were designed and published at that time by the Directorate-General of the European Commission:

Giving up after a failed business?

Getting up again is in our nature

http://ec.europa.eu/sme2chance

European Commission
Directorate-General for Enterprise and Industry

Nothing ventured, nothing gained.

Sometimes businesses need a second go.

http://ec.europa.eu/sme2chance

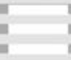
European Commission
Directorate-General for Enterprise and Industry

Business getting out of hand?

Give your business a second chance!

http://ec.europa.eu/sme2chance

European Commission
Directorate-General for Enterprise and Industry

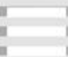


Not sure about launching a business?

The real failure is not trying.

http://ec.europa.eu/sme2chance

European Commission
Directorate-General for Enterprise and Industry



Business in trouble?

Get help now!

http://ec.europa.eu/sme2chance

European Commission
Directorate-General for Enterprise and Industry

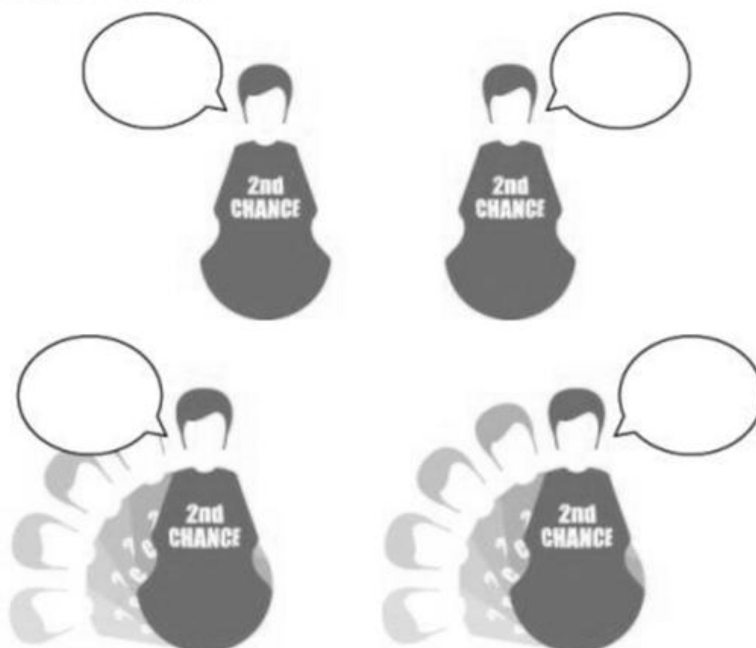
I. VISUALS (IMAGES + TEXT/ SLOGAN)

The road to business success is sometimes winding and bumpy

Business failure does not equal loss of entrepreneurial spirit

Nobody is perfect – entrepreneurs aren't either

Add your message:



II. ADDITIONAL IMAGES

2002 was a year of great optimism. Such optimism was well portrayed by the interesting advertising campaign designed by the Commission, which shared messages such as:

"Getting up again is in our nature"
"Give business a second chance!"
"The real failure is not trying"
"Nobody is perfect – entrepreneurs aren't either"
"It starts with an entrepreneur's risk – and becomes a benefit to us all"
"Balancing business risks is the entrepreneur's everyday challenge"

At that time, the great difficulties which would soon cause the decay of the whole European master plan could not even ne imagined. All energies were focused on implementing the preset strategies and on communicating these innovative messages, hence supporting the destigmatization of European insolvency systems.

Advertising was, therefore, used as a valuable tool to promote the new, and positive, approach toward solving insolvency-related issues.

This particular campaign was not cultivated further, but it was not casual or new. We discussed in Chapter IV how similar tools had been used successfully since the dawn of bankruptcy frameworks, although with the opposite goals: to create and foment the stigma of failure. Art and visual messages were used to instill fear of the consequences of insolvency into every level of societies for centuries.

Paintings, in fact, were used to allow all the citizens of the city-state, (even those that could not read) to identify and publicly shame bankrupts so that such dangerous criminals could be successfully isolated and evicted from the community even before they were exiled. Through the use of this strategy, governments were able to effectively paint bankruptcy as pure evil. This stigma has stuck within European communities to this day, becoming one of the major barriers to the development of effective and efficient systems in modern times.

The use, therefore, of such direct and simple forms of advertising based on positive messages could constitute a brilliant (as it has been tested for centuries already) tool to reverse this status and support the development of European strategies. Deploying effective means of communication to promote the new principles so eloquently embodied in studies and official documents would effectively help societies in sharing them. It would therefore boost progress within the process of refoundation.

This approach goes to the heart of the major difficulties faced by the Union in developing its plans within the field of insolvency laws, but there is more. The deployment of this tool would be relatively cheap compared to the important results that it could achieve. This interesting form of advertisement should, therefore, be carefully studied, cultivated, and developed so that European societies can learn to accept the core components of the rescue mentality and the tools which reforms have attempted to implement and harmonize.

In the next sections, we will discuss the process of encouraging greater uniformity within relevant substantive rules of local European bankruptcy systems.

3.3 PHASE II: harmonizing substantive rules of European local insolvency frameworks

In the previous section, we examined how advertising campaigns can be used to actively support the process of refounding European insolvency frameworks. Such tools:

- have proven successful over the centuries in increasing stigma and should now be used to obtain the opposite result, supporting the new goals of the Union and the development of the European "rescue culture";
- go to the heart of one of the main barriers currently stalling the modification/improvement of insolvency laws in a form consistent with international best practices;
- can be deployed swiftly without excessive costs compared to the positive effects it can bring to societies.

More, though, needs to be done.

The proposal for a Directive of 2016[2111] and the European Insolvency Regulations have an important element in common: they do not address substantive elements of bankruptcy laws. The proposal bluntly admits that this step is too challenging and that it is therefore postponed in favor of more immediate and "feasible" tasks:

> "Along with key principles, more targeted rules are necessary to make restructuring frameworks more efficient. Rules on company managers' duty of care when nearing insolvency also play an important role in developing a culture of business rescue instead of liquidation, as they encourage early restructuring, prevent misconduct and avoidable losses for creditors. Equally important are rules on early warning tools.
> The proposal does not harmonise core aspects of insolvency such as rules on conditions for opening insolvency proceedings, a common definition of insolvency, ranking of claims and avoidance actions broadly speaking. Although such rules would be useful for achieving full cross-border legal certainty, as confirmed by many stakeholders in the public consultation, the current diversity in Member States' legal systems over insolvency proceedings seems too large to bridge given the numerous links between insolvency law and connected areas of national law, such as tax, employment and social security law. Prescriptive harmonisation could require far-reaching changes to commercial law, civil law and company law, whereas flexible provisions risk not bringing about desired changes. Furthermore, the rules on filing and verification of claims mentioned in the Commission Communication of December 2012 are of rather low relevance given the improvements brought by the Insolvency Regulation.
> Instead, the focus of this proposal is on addressing the most important problems that could be feasibly addressed by harmonisation. Insolvency procedures need to be adapted to enable debtors in financial difficulties to restructure early. Rules which would contribute to this need include lifting the obligation to file for insolvency while the debtor is still in a formal restructuring process as otherwise such filing might prevent the restructuring from attaining its goals; and an avoidance actions regime in insolvency procedures to protect transactions concluded in good faith with a view to a debtor's preventive restructuring. The proposal also covers insolvency-related measures with direct impact on the length of procedures, such as judges' specialisation and the professionalism of practitioners, and those with a close link to the preventive restructuring framework, such as protecting new financing from avoidance actions."[2112]

Harmonizing more substantive elements of local insolvency regulations is a necessary and urgent step to support European strategies, without which the whole process of refoundation is at risk.

A renewed perception of bankruptcy and of insolvency models cannot "do the trick" alone.

Change in the form of a strong rescue mentality could be counterproductive for our economies and societies if frameworks are not ready to support it. The history of the evolution of American frameworks, in fact, has shown the risks connected with sudden increases in the availability of credit products within a community[2113]; for example, it can push natural persons and consumers to act recklessly and accumulate unbearable levels of debts. Businesses debtors can also attempt to take excessive advantage of modifications with negative consequences for the market.

Bankruptcy is all about balance. If effective rules providing local and cross-border debt forgiveness in a sustainable manner are not structured during the process to structure reforms, the consequences can be dramatic.[2114]

[2111] **(2016) COM 723 Final**, "*Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU*", at 6-7.

[2112] Id. at 6.

[2113] **Tucker David M.**, "*The Decline of Thrift in America. Our Cultural Shift from Saving to Spending*", published by Praeger Publishers, New York, New York State, (1991).

[2114] **Martin Nathalie**, "*The role of history and culture in developing bankruptcy and insolvency systems: the perils of legal transplantation*", 28 B.C. Int'l & Comp. L. Rev. 1, (2005), at 76.

The “new” European frameworks based on the strategies developed by the Union must, therefore, be carefully designed and developed. Regulations and Directives cannot refrain anymore from addressing relevant substantive aspects of bankruptcy law. As discussed in Chapters II and III, though, our systems cannot be fully harmonized given the high level of interconnection between bankruptcy laws and other local statutes; moreover, our regulations are not ready to be harmonized based on principles which are not yet endorsed by our societies.

Hence, it is necessary make some important choices and adopt a step-by-step approach. The Union has to estimate which tools can be pushed toward greater uniformity and on what schedule/at what speed. Europe has already made relevant steps forward in this direction; as discussed in Chapter I, the University of Leeds published in 2016 an interesting study[2115] comparing several key topics of local insolvency models.

This study, one among many released within the Union in the past decades, focused particularly on:

- directors’ liabilities and disqualification;
- the role of insolvency practitioners;
- avoidance and adjustment actions;
- the process of ranking claims and ordering priorities;
- procedural issues related to insolvency proceedings;
- the Commission’s Recommendation of a new approach to business failure and insolvency;
- second chances for entrepreneurs;
- consumer over-indebtedness.

In the next sections, we will also discuss areas in which greater levels of uniformity can be achieved. We will not compare different local rules to understand their differences, though we will base our analysis on our findings from the previous chapters. In order to give a better structure to our discussion, we will examine each topic following the structure of the international best practices presented within the World Bank’s ICR Principles.

Before we dive into the different elements, though, we need to say that the most relevant areas of our discussion up to now could be divided into three main groups based on how likely they are to be harmonized at European (or international) level:

1. **Bankruptcy-specific rules:** all the tools included in this group will present little connections with other local statutes. Despite their differences (which are often significant), they will be easier to harmonize as they will not alter other balances or interact with important policies outside of the field of bankruptcy law;
2. **Rules deeply entangled with other statutes**: this group stands at the opposite side of the spectrum and includes rules which are deeply entangled with other local statutes. They are, therefore, the most difficult ones to bring toward a greater degree of uniformity.
3. **Miscellaneous rules**: this group is formed by all the remaining tools which are entangled with other local statutes and which require time, effort, and successful strategies to reach higher levels of uniformity. This result may, nevertheless, be achieved.

We will now focus our analysis on specific improvements that can be made within the first and the last group. The second group would be difficult or impossible to tackle. We have to remember, in fact, that even in the United States, some rules are very discordant (see for example our discussion on exemption statutes) and, as discussed in Chapter III, national regulations are unlikely to reach a universal level of uniformity.

The Union will need to rank and prioritize certain actions over others and will not be able to address all of the complex issues of bankruptcy law at once. At the same time, though, it should refrain from avoiding addressing substantive elements of bankruptcy laws in future Regulations or Directives. As we are about to discuss, important steps forward can, indeed, be made.

[2115] **McCormack Gerard, Keay Andrew, Brown Sarah, Dahlgreen Judith**, “*University of Leeds - Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States’ relevant provisions and practices*”, European Commission, Directorate-General for Justice and Consumers Tender No. Just/2014/JCOO/PR/CIVI/0075.

3.3.1 Bankruptcy-specific rules that can reach greater levels of uniformity

[A] C2: Due process – notification and information

The challenges of modern legal systems do not revolve exclusively around complex legal matters. Some of the greatest difficulties which are faced with in the daily administration of modern, globalized bankruptcy proceedings are very basic. Although European systems are all well developed and effective and efficient at the local level, several differences in the structure of models make it difficult even for experts to interact effectively across borders.

Keeping this in mind, we will discuss this principle from a more general point of view; we will not, in fact, limit our analysis to the mere notification process. The rules determining how effective notice can be obtained are deeply rooted in local procedural systems; harmonizing them would be useful, but there is more than meets the eye. In analyzing this area we aim to focus on the value of information, not just on the process to forward it.

Debtors, in fact, have the right and the need to know of proceedings; to be informed on the date of their commencement, the actions undertaken, and their consequences. A great variety of interest holders also need to receive information to protect their rights and to be part of the process. Sending a message, though, does not automatically imply that it will be understood.

When major cases break out, a vast number of heterogeneous interest holders with multiple nationalities and backgrounds are gathered within a single proceeding (or multiple interconnected ones). Not all can afford to hire consultants to understand the dynamics of the proceeding they are involved in and their rights or duties; yet insolvency laws are an extremely tricky field in which to make guesses.

Our discussion presented us with a clear example on this point.

In Chapters V and VI we examined the differences connected to being insolvent within the American and the Italian systems. The relevant criminal consequences still imposed by law in the second scenario and the stigma connected to Italian bankruptcy laws have, in fact, little in common with the modern and friendly approach of the U.S. Bankruptcy Code. Hence, an American entrepreneur in Italy should be made well aware of the consequences bound to the failure of his business before it is too late.

But there is more.

European rescue culture aims to boost the use of reorganizations. This particular tool needs the active participation of all interest holders to operate effectively and efficiently. Parties, therefore, must be provided reasonably-priced support and guidance to play their part, surpassing the great disparities still standing among frameworks in the globalized market and the great complexity intrinsically bound to the field of bankruptcy law.

Virtually anybody involved in the bankruptcy process, therefore, would benefit from having a reliable source of information on how local proceedings work. Providing guidance, though, is tricky because of the structure of our insolvency regulations, which ultimately are diverse, abstruse, and entangled with a variety of local statutes. Ensuring the effectiveness of our systems, therefore, is not just a matter of transmitting messages but of sharing intelligible information.

It would of course be impossible, and useless, to address *all* of the complex issues connected to a local insolvency system in public manuals. Much could be done, nevertheless, to allow interested parties to understand the basic meaning of documents they may receive from a proceeding. Useful tools would include, for examples:

- glossaries providing explained definitions of relevant terms in all languages;
- guides providing information (for example, the kinds of proceedings available, crimes, and basic information on court systems) to allow an interested party to decide if he needs to seek counsel, giving him at the least a road map of the matter he may be interested in;
- standardized forms provided in different languages and official communications translated in a common format – as we have observed, some key aspects of proceedings are often uniform. A creditor in a reorganization should be able, for example, to obtain a form from a web site that informs her on what steps must be taken within a certain proceeding in a clear and comprehensible language. Writing letters in English does not always help. We have to remember, and those that work with proceedings know it very well, that often times

information is incomprehensible to non-experts even in their mother languages due to the high level of complexity of bankruptcy regulations.

With a similar goal in mind, the European Commission designed web pages to provide basic knowledge on European proceedings.[2116] This was an interesting tool which should be expanded and made widely available. It could effectively support, for example, creditors in lodging their claims or in understanding the requirements of foreign proceedings; it would also allow investors to compete on their bids upon attempting to buy parts of an estate, hence increasing its value and consequently the remuneration of claims.

While online information could surely be provided in a meaningful, cheap, and accessible way, basic services could also be offered by local or European agencies. Such offices or call centers could support interested parties in understanding documents and in deciding if they need to seek professional advice. Interest-holders must be assisted so that they can take part to proceedings. This is not an easy process.

Providing European guidance, though, would increase transparency and the feeling of uniformity. It would also allow frameworks to appear more reliable, reducing the stigma surrounding bankruptcy.

One relevant step made by the Union in a connected area regards the creation of bankruptcy registers.[2117] The focus of this reform is to guarantee quick access to the relevant information on existing proceedings.

The creation of a common database for business debtors would be an important step forward to support business within the whole EU. It would allow investors to acquire knowledge about foreign companies and on their eventual difficulties. It could also support the efforts of creditors in collecting their claims. This process, though, is also complex and presents some risks.

Although the Union affirms that all of the Member States have registers, they are not ready for an exchange of information at the moment. Bringing them to the necessary levels of interaction in a Continent in which registered email formats do not operate across-borders will not be easy; the great gaps that separate local systems today are not likely to be closed in the near future. At the same time the form in which this process will take place will also be important and will require some thought.

In heavily stigmatizing environments, information may be used to oust businesses from the market. Knowing that a company with establishments across Europe may be reorganizing its French stores, for example, may cause difficulties to the German or the Italian ones. It must be kept in mind upon designing the rules to deal with groups of companies that the opening of a proceeding of a local branch does not necessarily mean that other local offices are at risk.

Moreover, not all data included within such registers may be complete or easy to decipher (which brings us back to the previous point).

If, in fact, the system is based on local information, it will also reference local proceedings, definitions, and statutes. In order to effectively understan the status of a company, it's necessary to know about local bankruptcy laws and of the potential consequences of the opening of a certain proceeding. For example, a foreign investor alarmed by the commencement of a reorganization proceeding in Italy would have to understand, in order to make good use of information:

- which form of reorganization was chosen (among the ones in use at the moment, or past forms if the proceeding was opened years ago; there probably still are reorganization proceedings opened with the law of 1942 that have not yet been closed);
- the risks of the company being liquidated due to the failure of the reorganization process or of the infringement of criminal rules;
- the possible outcomes upon lodging claims;
- the risks connected with the investment upon buying assets from the estate.

Just knowing that a proceeding has been opened without having access to further knowledge would probably be irrelevant and possibly harmful for the business and interest holders.

Much effort will have to be placed, therefore, in improving interactions among parties within proceedings. Positive results, nevertheless, can be achieved and initiatives are worth the sacrifice. A better

[2116] http://ec.europa.eu/civiljustice/bankruptcy/bankruptcy_ita_en.htm
[2117] https://e-justice.europa.eu/content_insolvency_registers-110-en.do

understanding of bankruptcy systems can help decrease stigma and will support investments and transnational commerce.

[B] C3: Eligibility – exclusions from bankruptcy frameworks

Eligibility criteria are based on important local policies.

This is an area that has been deeply reformed in the past century. Our discussion has provided us with relevant guidelines. We have also analyzed several rules from contemporary and medieval systems.

In the past, societies attempted to limit the groups of debtors that could be declared bankrupt due to the heavy consequences (mainly criminal punishments) which could be imposed on them. In Chapter I we discussed how this trend is being reversed in Europe, as bankruptcy is becoming a tool to rescue a wide variety of debtors. In Chapter II we observed how modern international best practices are also attempting to limit exceptions and exclusions.

The main exclusions that are still deemed to be important usually include banks and insurance companies. These groups are dealt with through more specific statutes due to their significant impact on the economy and because they are highly supervised and regulated entities. In our case study in Chapter VI, though, we observed how modern local systems may still tend to adopt measures to shield certain classes of debtors, based on national policies and needs, hence decreasing the levels of harmonization.

Italian reformers, for example, decided to “protect” modern start-ups from the consequences of bankruptcy hence supporting innovative but fragile business in their attempt to compete within the globalized market. This interesting measure is not an anomaly in the end. To draw an analogy, the American system has “protected” railroads from liquidations for many decades.

The basic principles dealing with exclusions and eligibility in general, although deeply entangled with local policies and rules, can be developed more uniformly through European guidelines. Preventing the proliferation of exclusions would increase transparency and predictability, hence supporting cross-border investments. It would also help coordinate laws and economic measures, helping Member States in taking joint actions.

In the next section, we will discuss of the interconnected area embodied in principle C4.

[C] C4: Applicability and Accessibility – the value of insolvency within modern bankruptcy systems

Principle C4 addresses several key elements of both local and cross-border bankruptcy frameworks.

Applicability and accessibility regard topics such as the definitions of insolvency, financial distress, or over-indebtedness, but also practical elements such as the costs of proceedings or of bankruptcy relief.

Creating common, efficient, and cost-effective tools to access proceedings is a priority for any framework. It would be difficult to include a comprehensive analysis of all the different costs (based also on the different groups of debtors) within our discussion, given the discrepancies in structure and organization of the different local models of the Member States, but this should be a topic discussed in a separate study.

We will focus our analysis, therefore, on another relevant area. In this section we will take advantage of the contents of Principle C4 to discuss of the concept of insolvency and its relevance within modern frameworks and markets.

Insolvency has been the core of bankruptcy laws for centuries and the main pillar of its criminal matrix. Even in the modern scenario the World Bank places great effort into developing the insolvency principles we extensively discussed in Chapter II; the UNCITRAL has designed studies and a model law on the topic of cross-border insolvency; and the European Union has developed insolvency regulations and, more recently, a proposal for a directive on the topics of “restructuring, insolvency, and discharge procedures”.

Insolvency is, therefore, not just a relevant factor within bankruptcy regulations but its most iconic element.

Given its key role, the conceptualization of a uniform standard matching the modern European “rescue mentality” has been often lauded, but little results have been obtained up to now. This goal does seem attainable, though, for several reasons. It must be considered that international best practices have provided relevant information on how to design efficient standards which can stand independently from other local statutes. Moreover, insolvency seems to have lost much of its relevance within modern systems and is therefore easier to harmonize.

In order to define insolvency in the most transparent and predictable manner, societies have deployed over time a variety of tests and rules. The focus has been traditionally placed on determining when it would be the right time for the competent authorities to step in and relieve the debtor from the duty and privilege to manage his assets. Approaches have changed over time also depending on the structure of insolvency models.

Several elements must be kept in mind upon designing a common European standard:

- **Crafting an insolvency test based on the needs of societies**: in Chapter IV we discussed the punitive approaches followed by medieval systems and the evolution of the concept of insolvency from a mere synonym of "running away" up until modern, wealth-related tests. In general, medieval systems needed to react promptly to resolve economic defaults and wanted to take no risks; as a consequence, they considered it acceptable to find a debtor insolvent even if he owned the assets necessary to repay all the outstanding debts, so long as they were not readily available. Modern European systems, on the other hand, attempt to apply a diametrically opposite approach, limiting involuntary proceedings and liquidations while incentivizing early, voluntary access and reorganizations. Hence, societies should support the modern rescue mentality and allow the insolvency test to change.
- **The current scenario:** in Chapter I we mentioned how, despite generic convergence on the understanding of the core essence of insolvency, Member States apply a great variety of rules even within the current modern scenario. Reforms should aim to resolve the situation and reach a greater level of harmonization.
- **The importance of achieving higher levels of harmonization:** in Chapter III we analyzed how lack of uniformity in this area has cross-border repercussions. It negatively impacts the levels of transparency and predictability within systems. It causes models to be less effective and it deters investments. Reaching greater levels of uniformity in this symbolic area of insolvency law would boost the process of refoundation and incentivize societies to take more steps forward toward greater convergence.

Although all these points are true and important, effective reform may be a challenge and could lead to an impasse. Insolvency has been extremely significant within local laws for centuries and modifying it is a great task which has not been undertaken by relevant international organizations, yet.

The current situation, though, supports progress in this area. Modern European systems, in fact, focus on developing a rescue mentality that incentivizes reorganizations, early access, and voluntary filings. Hence, access criteria such as financial distress and over-indebtedness are privileged within this scenario.

Insolvency remains a relevant factor in commencing involuntary case or liquidation proceedings, which are, as we have mentioned several times, a residual option within the modern scenario that the Union is attempting to build. Reforms can, therefore, take place in this area today. This fact should not come as a surprise. Upon analyzing the modern drafts of the American Bankruptcy Code, we have observed, in fact, how insolvency as an access criteria has already acquired a more limited value.

Most of the original obstacles standing in the way of a harmonized definition of insolvency appear to have been removed; hence steps forward should be swiftly made to propose a new test free from connections with local statutes to be applied at the cross-border level within Europe. The process of reform can, moreover, also involve other relevant tests applied within this phase of the process of refoundation: financial distress and over-indebtedness. They can also be brought toward more uniform definitions.

The harmonization of new tests is, in fact, less of an obstacle; their recent adoption makes them less rooted within societies and therefore more malleable.

[D] C5: Provisional measures and the effects of commencement

We have discussed at length the importance of stays and moratoriums. Bankruptcy is complex; a proceeding needs time to develop itself successfully. Stays are necessary to guarantee much-needed breathing room; yet they can also be counterproductive, since they can be used to neutralize the individual actions of the creditors, providing debtors with an unfair advantage.

Finding a good balance is a challenge for every system and shifting punitive systems towards the rescue mentality can be tricky.

We have seen the difficulties in this area within the most recent drafts of Italian insolvency laws. The enactment of proceedings granting wide moratoriums, such as the "*concordato in bianco*"[2118], granted debtors an opportunity not just to prepare their reorganization effectively but also to put pressure on their creditors in an attempt to gain an advantage. For this reason, the American system has developed ways to moderate the impact of such stays.

The Bankruptcy Code has been particularly active in this area. Although it limited criminal punishments, it imposed a reduction of benefits provided to dishonest or uncooperative bankrupts. As discussed in Chapter V, contemporary rules attempt to incentivize compliance with the principles of the model and fairness by barring certain debtors from obtaining relief or protections (such as moratoriums). This approach is important and should be studied in depth since balancing punishments and rewards is one of the great challenges of the process of refoundation.

At the same time, relevant steps can be made to harmonize the application and duration of moratoriums throughout the European territory. These purely bankruptcy tools, in fact, have relevant impacts on the legal and economic framework of a common market. Designing a minimum and a maximum or parameters that determine when it is legitimate to deploy such protections would greatly increase levels of transparency and predictability, supporting transnational investments.

[E] C6 and C7: Management, courts and other aspects of the administration of bankruptcy cases

The management of proceedings is a complex topic deeply entangled with local rules and statutes.

We have observed how the basic structure of bankruptcy frameworks, though, is reaching a certain level of uniformity in Europe. The lists of insolvency proceedings contained within the annexes to the cross-border Regulations have been expanded, and reorganization models have become widely adopted following the European rescue culture. International best practices delineate the key aspects of each model such as the roles of trustees, courts or creditors' committees.

All these elements are crucial, of course, but difficult to uniform.

Cross-border regulations go to great lengths to increase the levels of effectiveness and efficiency when foreign courts, trustees, or other interested parties have to interact. Of course, this is a difficult process. We have discussed ways to improve communication among all the parties of a proceeding but we know that making progress in this area will take much effort and time given the language barriers and the differences among systems.

More should be done, then, to resolve differences concerning the organization of proceedings on relevant points, such as the requirements for someone to become a trustee, the structure of courts, and the appointment of experts. All such factors are very local and difficult to harmonize although, with time, progress can surely be made.

[F] C14: Reorganization proceedings and the debtor-in-possession model

Several aspects of reorganization proceedings are based on the American model. We have mentioned numerous times how a relevant goal of the reforms is to achieve positive results in deploying the European rescue mentality to support the European market in competing more effectively with the American one. In Chapter VI, our case study, we analyzed some of the reforms made within the Italian system to match U.S. formulas; most were based on the ample adoption of foreign tools and on the use of legal transplants.

Several aspects of modern reorganization proceedings can be modified and harmonized within local frameworks (both those designed to support business debtors and those designed to support of non-business ones). Before addressing substantive and procedural rules, though, the Union will have to make a choice. At a time in which the American model is also under review, Europe will have to decide what balance it will attempt to establish upon harmonizing its systems.

It is a fact that the European scenario differs from the American one in several policies.

The European rescue mentality cannot occupy itself only with the economics of bankruptcy and with the desire to close the gap. Although cases are indeed expensive, and although reducing costs would allow higher returns for creditors and swifter proceedings, it would be difficult to think that the European

[2118] Article 161 (6) of the current draft.

scenario might, uniformly in all of its territory, adopt tools such the DIP model. Levels of trust differ too greatly within stigmatizing societies.

As the American system is also studying the opportunity to move toward new balances, Europe should take the initiative and focus on deploying a reorganization formula which matches its characteristics, not just its economic needs or strategies.[2119]

[G] Discharge and other tools to provide debtors with an effective second chance in business and non-business frameworks

A meaningful second chance is the Holy Grail at the end of the bankruptcy quest of any debtor. Upon restarting, in fact, entrepreneurs can learn from their business mistakes and become more successful while non-business debtors can recover from their financial losses and build better lives for themselves and their families.

The recent proposal for a Directive aimed to bring uniformity among the recovery rates of Member States and to free debtors from debt traps through efficient second-chance frameworks.[2120] Such measures are considered necessary to support a more competitive business environment. This path must, nevertheless, be walked carefully.

As amply we have discussed, allowing excessive relief can also lead to negative consequences for the market and societies.[2121] Moreover the application of international best practices and legal transplants alone does not ensure that positive results will be reached within the European environment. The new frameworks will have to be developed with great caution under every aspect.

We have also discussed several tools used to provide business and non-business debtors with an effective second chance. We have analyzed, in particular, elements such as:

- the discharge of debts;
- exemptions;
- protections against discriminations;
- education.

Discharge was immediately addressed by the Union, which pushed Member States toward making quick(er) discharges available for business debtors. This measure was congruent with the strategies of the ten-year plans and with the new approaches developed through the rescue mentality. The steps toward expanding bankruptcy also to consumers or non-business debtors in recent years have also contributed to increasing focus into this important area, which was also included in the proposal for a Directive that addressed the need to make discharges widely available and uniform in their effects and duration.

Exemptions have not been addressed yet. This area will be a true headache in the future. As discussed in Chapter V, in fact, even the United States has struggled (and still struggles) in harmonizing these particular rules which are deeply entangled with key local needs. Compromises will need to be made; however, we should not make this topic more complex than it already is. Through the study of the American system (and its evolution) and of international documents, models can be designed to contain the effects of forum shopping while providing debtors with the tools to recover from their financial distress.

It will take time but coordinated laws can surely be adopted at the European level.

The development of rules to protect debtors against discrimination, based on the American model, should be also swiftly studied and implemented. This element is a key component of a modern statute embracing the rescue mentality. It is an effective and important tool which protects natural persons from stigma (when they deserve it), reducing the weight of their past and allowing them to seek a better future. Debtors will struggle to become productive member of society unless they are offered the opportunities to access employment and necessary licenses without discrimination. Although § 525 of the American

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[2119] For an interesting discussion on this topic see: **Eichgreen Barry**, "*The European Economy Since 1945*", Princeton University Press, Princeton New Jersey, USA, ISBN, 9780691138480, (2007).

[2120] **(2016) COM 723 Final**, "*Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU*", at 3-4.

[2121] **Martin Nathalie**, "*The role of history and culture in developing bankruptcy and insolvency systems: the perils of legal transplantation*", 28 B.C. Int'l & Comp. L. Rev. 1, (2005).

Bankruptcy Code may seem to hold residual value, it has to be made a key factor upon structuring the process of refoundation and the European rescue mentality, for it provides debtors with what they truly need: the tools and opportunities to do better.

But there is more; education has to become an essential part of this process.

This is an element which we discussed in Chapter I, yet often with a different approach that the Union needs to change. Europe needs to "refound" its mentality if it want to support the enactment of effective reforms and the development of the rescue mentality. Providing debtors with a discharge, with assets through exemptions, and with equal opportunities may not be enough.

As stated by the Opinion of 2003, not all are meant to become good entrepreneurs. Not all will be successful and will learn from their mistakes. All, though, will suffer the consequences of failure not just in their business life but also at the personal level. Hence, if the Union wants to walk this path, if it intends to incentivize citizens to boost their business potential and to take risks, it also has to support them with knowledge and networking.

As it is true that some honest debtors may have been "unfortunate", they also may have been incompetent. Exiting a proceeding will not provide the debtor with particular enlightenment. If a debtor lacked the qualities necessary to be successful in the beginning of his business adventure, he may still lack them upon restarting.

Providing debtors with an effective second chance therefore requires a leap of faith by society and the creditors (which are often forced into making their decision by the difficult situation that derives from the default). There is no way to be certain, in fact, that discharging a debtor and leaving him in possession of assets will ensure his success in the future. As it is in the interest of the Union to support restarters effectively, it is necessary to develop strategies to make debtors understand their condition, the harm and difficulties to others that derived from it, and how to make improvements.

This process would allow the rate of success of proceedings to increase. A small businessman that failed, in fact, may restart, becoming rich or failing again; but he could also decide to seek employment if he understood this path was not his to walk. Debtors should, therefore, be supported in evaluating their performance and their future opportunities.

In general we could state that all debtors, business and non-business, would benefit from specific support in the form of education. Society and other interested parties would also improve their position if entrepreneurs and consumers increased their capacities. It is evident, in fact, that the new system which the European Union is attempting to implement(uniformly does not aim to increase the number of liquidations or the domino effect of bankruptcies, but quite the opposite.

Educating debtors, though, is a cost which adds up to an expensive bankruptcy bill.

In Chapter V, we discussed briefly the system adopted in the United States to support natural persons in this area. We mentioned how courses are mandatory and offered in multiple languages. We briefly analyzed the impact of their costs and their duration.

It appears that more should be done upon designing a modern European system for business and non-business debtors.

First of all, in fact, it must be mentioned there is no reason to separate business from non-business debtors in imposing education requirements, although of course the focus of should be different. Europe aims to increase the number of SMEs, which are the thriving force of its economy and the source of its success. This means that we are confronted with a vast number of mom-and-pop corporations which will, and should, grow even further. Family businesses would definitely benefit from further education in specific areas, while managers of larger corporations, on the other hand, would surely not be harmed by a light review of key topics and would benefit from peer-to-peer experiences and networking.

The contents of the courses would, of course, differ andwould be tailored to the different needs of debtors. How to educate people effectively should be studied carefully.

Natural persons would make good use of programs like the ones structured in the United States, although courses should be designed to be lengthier and more complete. Business debtors could make good use of peer-to-peer speeches and of workshops. Discharged debtors could be asked to speak at chambers of commerce or universities of their experiences while petitioners in newly commenced cases

could be requested to attend a minimum number of such lectures. Not meeting attendance requirements as set by law could be evaluated negatively upon awarding discharge.

This process would also to help to increase levels of entrepreneurialism.

We can make another analogy with the past, just like we did upon discussing the value of commercials based on our previous experience with medieval shaming paintings. If, in fact debtors could become criminals by spending time in overcrowded jails, competitive business ideas could arise through dialogue among peers and through new connections. Education, therefore, could truly be a key to unlock the potential the new European models.

[H] Bankruptcy crimes

This is a topic that is often not addressed by modern documents.

In our discussion we have analyzed how the approach to insolvency has changed over time also with regard to crimes. In particular, we have mentioned how, in the beginning, bankruptcy was a purely criminal field of law, while in modern days this component has been greatly limited in most frameworks. The impact of bankruptcy crimes has been circumscribed over the past decades and little is mentioned about it within international best practices, which focus mostly on the topic of disqualifications for business debtors or on punishing uncooperative bankrupts with the negation of the benefits of a full fresh start.

Before the distinction between honest and dishonest debtors became significant, bankrupts would be tortured and banned or punished with imprisonment for debts. The ruinous effects of their disgrace would cause harm also to people closely connected to them. Although they lost much of their medieval connotations, bankruptcy crimes remained a main source of stigma and an element of great pressure on debtors up to modern times.

Balancing this particular area of insolvency laws while attempting to bring the relevant reforms planned by the Union is a great challenge.

While, in fact, criminal punishments cannot be unreasonable or uncontrolled, it is still necessary to provide safety nets upon bringing change and opening our markets to credit products. This is a critical stage in the evolution of our models and in the development of our economies. It is unreasonable to think that opening up our markets to ample and swift discharges and fresh starts at a time of such dramatic economic difficulties could be done free of charge, especially within heavily punitive systems.

Clear boundaries defining those behaviors that can be considered acceptable and those that cannot will be useful, especially at a time in which different approaches and philosophies are not yet harmonized (with the consequent risk of rampant forum shopping and an increase in frauds). All precautions should, therefore, be carefully considered.

Modern European strategies seem not to rely on criminal sanctions to achieve their goals; they attempt to discourage abuse by using other, less stigmatizing tools, such as:

- limiting the effects of protections such as the automatic stay;
- preventing dishonest or uncooperative debtors from obtaining a discharge of their debts;
- limiting access to bankruptcy proceedings either by preventing debtors from accessing a specific Chapter (as it happens for natural persons through the means test in the US, for example) or by preventing them from opening new cases;
- increasing the levels of supervision on behalf of the experts and advisors taking part to the process.

These measures are congruent with the new policies and approaches embodied in international best practices. They attempt to instill honesty in the process, rewarding cooperative debtors while decreasing stigma.

Some side effects can still derive from this approach, though.

Although the American system has managed to make progress in this direction, it is to still be proven if transplanting such tools in a heavily stigmatizing scenario can effectively counter major abuses and frauds, discouraging those wrongful behaviors which have been feared for centuries; or if cunning, dishonest debtors would find it easier to commit crimes. Moreover, applying such measures has a direct impact on the costs of proceedings. Increasing the burdens on attorneys, accountants, experts, and advisors, by exposing them to fines for example (as happens in the American system or even with criminal punishments

in the Italian system), increases their fees and hence makes bankruptcy relief less available those that are most in need.

Although the evolution of bankruptcy proceedings has moved in the direction of limiting the impact of criminal law, and although it is true that harsh and generalized criminal punishments do not match the needs of our modern societies as they discourage entrepreneurialism, bankruptcy remains a field of conflicting interests and a source of potential abuses. Despite insolvency, in fact, interests of great wealth go through Bankruptcy Courts. In this scenario, frauds do occur and crimes are committed ,affecting a variety of interest holders and society at large and decreasing trust in the enacted models.

It should be carefully evaluated, therefore, if in Europe bankruptcy crimes are ready to be placed in a residual position as they are in the United States without causing injustice, or if this process should be afforded more time.

Chapter VI showed how reluctant the Italian system has been in reforming its bankruptcy crimes and how, ironically, criminal sections have been expanded and not reduced in the past few years, despite the continuous enactment of reforms. Even the latest reform of Italian insolvency laws, the one that appears to, finally, create an organized system matching the essence of the principles embodied within the process of refounding European insolvency frameworks, appears to be far from bringing reforms in this field.

The truth probably lies in the middle. Given the original stigma within the European scenario and the complexity of its discordant frameworks, it is unlikely that great reforms can be enacted easily. The new systems will probably need to be protected and supported in their early years. Criminal bankruptcy law can be a good tool to warn debtors and incentivize positive recourse to the new opportunities that will be offered.

[I] Areas which will be more difficult to harmonize

Several other areas within our frameworks will be more difficult to harmonize and will require more time. Among these sections, we can mention Principles C8-C11. Areas such as the collection, preservation, administration, and disposition of assets; stabilizing business operations and treatment of contractual obligations; and avoidable transactions are deeply rooted in local systems. Although improvements can be made also within certain elements of these important aspects of bankruptcy laws, reforms will have to be planned in the future.

Principle C11, on avoiding powers, is a good example of how some part of these principles could be amenable to swifter harmonization. Uniform rules could establish, for example, reach-back periods, hence improving the levels of transparency and predictability of our markets.

C12 probably is the most emblematic principle in terms of high levels of entanglement between local statutes and policies and insolvency models. The structuring of priorities, in fact, is a matter of great local significance. Although some major interests, such as worker interests or the policies that give a higher ranking to administrative expenses, are commonly shared and embodied in international best practices, countless interests depend on the structure of local societies. They will, therefore, differ among Member States.

The existence of significant areas of European systems which cannot be harmonized swiftly should not, though, deter the Union from making progress in others. In the en,d the American system we discussed in Chapter V still is being modified today. There still are relevant areas in which the impact of state statutes causes forum shopping and divergent approaches.

The Union needs to trust that its strategies will be successful and bring improvements as long as three criteria are met: that they are structured according to the needs of the societies of the Member States; that they will take into consideration the peculiarities of the field of bankruptcy law and of the European scenario; and that they budget enough time to develop the necessary actions.

CONCLUSION

Several relevant factors have, therefore, contributed to causing an impasse in the process of refounding European insolvency frameworks. Aside from the general difficulties met at a systemic level during the years of the different financial crises, weaknesses can be found in the timing and in the very approach adopted in bringing the reforms. We have observed, in fact, how:

- The process was not allowed enough time, up to now, to develop itself efficiently and effectively– the high expectations portrayed in official documents discussed in Chapter I and set as a consequence of the da Feira goals were unrealistic. Bankruptcy needs time to change. The significant modifications pursued by the Union could not reasonably be achieved uniformly within all of the Member States within one or two decades.
- The Union attempted to calibrate reforms to support its well-defined market strategies – this purely market-based approach appears, though, to work best in taking emergency measure at times of great economic difficulties. It struggles to support the effective structuring of new, complex models, since, as discussed in Chapter II, it does not involve the necessary modifications within societies. A bankruptcy law that does not match the society it is enacted within cannot operate effectively and efficiently;
- In order to resolve the weaknesses caused by the previous two factors, the Union has relied heavily on legal transplants and international best practices. Relevant aspects of American bankruptcy law have been adopted to bring the wished-for improvements within European systems. The goal was to adopt a system that had already proved successful, hence achieving the same level of performance of the American economy and closing the gap between the two. As observed in Chapter II, though, the application of international best practices does not ensure equal (or optimal for that matter) results among different international scenarios and legal transplants can be rejected by different communities.

All of these specific barriers have appeared insuperable up to now. They have caused great discouragement, which was portrayed within several official documents, and confusion.

Nevertheless we can, and we want to, end with positive conclusions.

Despite missing several preset targets, much has been achieved up to today. The bankruptcy scenario in Europe has indeed changed greatly and positively in the past fifteen to twenty years. The coming of the new millennium gave the Union impetus to organize, for example, an advanced cross-border framework which serves as a model within the international scenario. Moreover, much seems to have been learned from the "mistakes" (if we want to call them so) that have been made in structuring the process of refoundation. The recent choice to develop proposals for Directives to increase uniformity among the systems of the Member States instead of further Regulations, for example, shows maturity and greater knowledge of the barriers that have impeded progress under the previous strategies.

In order to make further steps forward, though, the Union and the Member States must acquire a greater peace of mind. It must be accepted at all levels that achieving major reforms will take time and not just effort. Such important modifications will not occur overnight and, in order to be effective, they will have to match the evolution of each European society.

We must also acknowledge the fact that, given the peculiarities of the field of bankruptcy law, it is unlikely that it will ever become a malleable tool capable of supporting economies through swift modifications based on sudden market needs. Too many complex balances and interests are present for an insolvency model to be able to follow the Brownian movements of the economy. Adopting best practices or encouraging legal transplants will not guarantee the success of our projects or improvements in our levels of competitiveness.

The focus should instead be placed on structuring good, solid reforms based on a specific European formula. Efforts should be made to keep our systems updated and on keeping them effective through regular reviews. Well-written and long-lasting drafts increase transparency and predictability within

systems and can become, despite the temporary difficulties faced due to years of crisis, the new foundation on which to build a harmonized future for our frameworks.

Uniformity should be indeed sought in all those areas where it can be achieved, and they are many.

As long as we keep in mind our roots and we accept the uniqueness of our reality, we can grow harmoniously into a better, common society, making relevant improvements in all fields of our cooperation and certainly in our insolvency frameworks, which will ultimately provide a reliable structure to support our desire to compete and to grow within the globalized market.

SUMMARY

Introduction

Europe set challenging targets for its growth and expansion in the new millennium. The "Lisbon strategy" launched in March 2000 focused all efforts on making of the Union the most competitive and dynamic knowledge-based society in the world by 2010. Different strategies were deployed in several areas to ensure success.

This book focuses on the process developed in accordance with the general plan to reform modern European bankruptcy systems at the local and cross-border level. The ultimate goal of these reforms was to bring changes which could become pillars in insolvency law, thus reaching the grand objectives set in Lisbon. This process is defined in the book as a "refoundation", since the modifications sought were a radpical departure from the path followed for centuries by local European systems.

The master plan of the European Union focused on increasing levels of entrepreneurialism and the number of small- and medium-sized enterprises within its market. The status quo of European bankruptcy systems at the beginning of the new millennium was found to be obsolete and harmful. Major modifications were planned of systems that worked in the exact opposite direction of the Lisbon strategy. Local European insolvency laws at the time heavily punished and stigmatized bankrupts: they labeled them as criminals, excluded them from commerce, preferred liquidations over reorganizations, and imposed numerous harsh penalties.

In order to make swift changes, the Union promoted the adoption of new approaches. It favored the transplant of foreign "debtor-friendly" tools into more punitive local systems, borrowing mainly from the US Bankruptcy Code. The American bankruptcy system was deemed to be the perfect source of inspiration, as it had succeeded in making a similar shift a few decades earlier and supporting an economy that became the most competitive and dynamic in the world.

This study analyzes how this complex and ambitious process has been structured, starting from its origins. It discusses the theories and studies which supported its development and the significant challenges that have caused the failure, described as an "impasse", which has impeded the Union from making necessary progress. In its conclusions, it suggests improvements which can allow the European Union and its Member States to make progress in the future.

The approach that is followed attempts to see things from a different angle. Several studies have gathered, compared, and analyzed information from all the systems enacted by the Member States and other relevant countries such as the United States. The massive amount of information made available by this method, though, means that although these studies excel at giving a broad, big-picture view, smaller details disappear.

This book follows a different method, which allows it to integrate previous research. It draws a more specific path, using a selection of local and international models from contemporary years and past centuries. The discussion shows specific weaknesses that have damaged European strategies and provides alternatives.

Chapter I

Chapter I discusses the "state of the Union" (the European one) and the strategies set for its economic development in the new millennium. It focuses on strategies connected to the field of bankruptcy law and on the process of refounding European insolvency frameworks. The analysis is based on several official European documents and studies released from the nineties until roughly 2016. The extensive use of official documents provides first-hand information on how strategies (systemic ones and those directly focusing on reforming the field of bankruptcy laws) have been developed and on their results. This chapter discusses the goals that were set, how they were modified over time, and the difficulties that were met in reaching them, with a focus on the impasse faced at the local and systemic level in reforming bankruptcy laws. Chapter I introduces two great barriers that have prevented the successful development of the process of refoundation: a) the stigma of failure, and b) the lack of uniformity among the local bankruptcy laws of the Member States.

Chapter II and **Chapter III**

Chapter II and Chapter III are deeply interconnected. They discuss studies by influential international organizations on the structure of efficient and effective modern bankruptcy regulations for business and non-business debtors, at both the local and cross-border level. This part of the study provides the information necessary to evaluate the core elements of the refoundation of European insolvency frameworks and to better assess the reasons for the impasse which delayed its positive development. Chapter II focuses on determining the elements that constitute effective and efficient modern local frameworks and shows how they have developed in the past two decades. The World bank's Principles for effective insolvency and creditor/debtor regimes are introduced as guidelines and used for comparison throughout the rest of the book. Chapter III discusses aspects of international bankruptcy and significant cross-border models, such as the International Bar Association Cross-Border Insolvency Concordat and the UNICITRAL Model Law on cross-border insolvency. The focus is placed on analyzing European Regulations on cross-border insolvency.

Chapter IV

Chapter IV goes back to the roots of European bankruptcy law. It analyzes the factors that pushed medieval societies to enact bankruptcy statutes and how they developed over time, shedding some light on the origins of the two most significant barriers burdening the refoundation of European insolvency systems today: the presence of a powerful stigma against bankruptcy and the lack of uniformity among local frameworks. These topics are discussed from an historical and comparative point of view through an analysis of several Italian and English medieval statutes. The chapter shows that stigma is not negative per se, but a product of necessary policies which have safeguarded the solidity of European societies for centuries. This important role makes it difficult to simply eradicate it in modern times. It also shows that insolvency statutes tend to have strong local traits; the modification of frameworks through the application of foreign principles or rules has always been problematic. Examples of this point include a discussion of how the Republic of Venice and the Duchy of Milan had two opposite approaches to insolvency matters (the former more forgiving, the latter heavily punitive) and the consequent struggle faced by Milanese territories in adjusting to Venetian principles upon being conquered.

Chapter V

Chapter V discusses the evolution of European medieval systems in a new scenario, the American one. English insolvency statutes were the bricks in the foundation for Colonial systems, impacting early state statutes. The chapter analyzes the development of American laws from the Colonial period until the modern Bankruptcy Code, which is studied in greater depth. The Union has considered understanding the modern American insolvency framework as a key point in planning its reforms; the Code has often been a source of inspiration for – and been directly transplanted into – new European local frameworks. Modern American insolvency laws follow a unique path which has proven effective in supporting businesses and consumers, providing quick discharges and effective second chances to honest debtors that need them. The beneficial effects of this system have helped the American economy become the most dynamic and competitive in the globalized market. Europe has rushed in its attempts to obtain a similar positive outcome by transplanting the American formula. The incapacity of European societies, though, to adapt to the significant modifications and new principles that were imposed, which contrasted with the punitive principles that formed the backbone of their systems systems for centuries, led to an impasse which has prevented the process of refoundation from reaching its goals.

Chapter VI

Chapter VI takes the discussion back to Europe. Through an analysis of the evolution of modern Italian bankruptcy statutes, it shows the conflicts caused by the legal transplants. This chapter works as a case study and aims to demonstrate the the origins of the impasse at a local level. Its goal is not to focus on individual rules, but to show the difficulties of structuring long-lasting reforms and in adopting principles which deeply contradicted with the ones that naturally developed within Italian society over the centuries.

The chapter emphasises the failure to speed through several reforms, which took place almost yearly in the new millennium.

Chapter VII

Chapter VII recapitulates and analyzes the important information contained in the previous chapters. It elaborates on the elements that have caused the impasse within the process of refoundation and identifies four main weaknesses: a. the complexity of the task undertaken by the European Union and the Member States; b. the impossibility of bringing radical change in just a few years; c. the negative consequences that originated from basing the reforms on the needs of the market; d. the negative consequences of excessive legal transplants. This chapter argues that Europe underestimated the task; it did not allow enough time to make the changes it had planned. Attempts to speed up the process by transplanting tools that were successful in another scenarios could not ultimately ensure the success of the project. Moreover, the excessive focus on market-based reforms conflicted with other important policies and prevented societies from supporting the process, ultimately causing an impasse. It is also argued, though, that the damage is not irreparable. Although much went wrong, the goals set by the Union were laudable under many points of view and much could still be done to improve the status quo. In particular, we suggest that more can be done to help societies become part of the process hence, helping them reject the stigmatizing roots of European insolvency systems and adopt more modern approaches. For example, we suggest the development of advertisement campaigns focused on explaining that honest business mistakes should be forgiven. It is also suggested that different areas of bankruptcy law be reformed at different speeds. While some principles may be easier to adopt and to harmonize across the different legal settings, others may take a much longer time. The chapter also argues for reforms in specific areas that could support the swifter development of the whole process.

Conclusion

The conclusions drawn by walking this innovative path are ultimately positive. A Union of European countries can count on great resources and on an incredible potential. Important results can be achieved over time. In order to make the necessary steps forward, though, greater patience is necessary. It must be accepted at all levels that enacting successful reforms takes time, regardless of how much effort or careful planning is put into the process. Major modifications of bankruptcy laws, moreover, cannot be based purely on economic interests; the foundations must lie in principles that are shared and endorsed by all of the societies that are involved.

SAMENVATTING

Inleiding

Europa heeft zichzelf ambitieuze doelen gesteld ter bevordering van haar groei en uitbreiding. De in maart 2000 gelanceerde "Lissabon Agenda" heeft als voornaamste doel dat de Europese Unie in 2010 is veranderd in de meest concurrerende en dynamische kenniseconomie ter wereld. Om dit doel te bereiken zijn er verschillende strategieëen in verscheiden gebieden uitgezet.

Dit boek richt zich op het proces dat is ontwikkeld in overeenstemming met het algemene plan om de moderne Europese faillissementssystemen op lokaal en grensoverschrijdend niveau te hervormen. Het uiteindelijke doel was om het insolventierecht te hervormen zodat dit zou kunnen bijdragen om de doelstellingen zoals gesteld in de Lissabon Agenda te behalen. Een dergelijk 'proces' wordt in dit boek omschreven als een "herontwikkeling'' omdat de vereiste aanpassingen radicaal waren en afweken van het 'natuurlijke' evolutionaire pad dat eeuwenland werd gevolgd door de lokale Europese rechtssystemen. In dit onderzoek wordt onder lokale rechtssystemen verstaan de nationale rechtssystemen van de lidstaten van de Europese Unie.

Aangezien het masterplan van de Europese Unie zich richtte op het verhogen van het niveau van ondernemerschap en op de toename van het aantal kleine en middelgrote ondernemingen op de markt, werd de status quo van de huidige Europese faillissementssystemen aan het begin van het nieuwe millennium achterhaald en schadelijk bevonden. Grote veranderingen waren namelijk gepland om de faillissementssystemen aan te passen in de tegenovergestelde richting dan die in de Lissabon Agenda waren gesteld. Onder de lokale insolventiewetten werden insolvente ondernemingen zwaar gestraft en volgde er stigmatiserende faillissementen waarbij de ondernemingen werden uitgesloten van de handel. Liquidaties werden boven reorganisaties verkozen en de bestuurders werden bestempeld tot criminelen.

Om snel veranderingen te bewerkstelligen, heeft de Europese Unie de ontwikkeling van nieuwe benaderingen bevorderd. De voorkeur ging hierbij uit naar het inzetten van debiteurvriendelijke instrumenten die voornamelijk geïnspireerd waren door de Amerikaanse Bankruptcy Code. Het Amerikaanse faillissementssysteem werd beschouwd als de perfecte bron van inspiratie. Enkele decennia eerder was het Amerikaanse faillissementssysteem namelijk succesvol gebleken in het bewerkstellen van een soortgelijke verschuiving en was het daarnaast in staat om de lokale economie dusdanig te ondersteunen zodat het de meest competitieve en dynamische markt werd binnen de geglobaliseerde wereld.

Dit onderzoek analyseert hoe een dergelijk complex en ambitieus proces vanaf de oorsprong is gestructureerd. Het bespreekt zowel de theorieën en studies die haar ontwikkeling hebben ondersteund als de relevante uitdagingen die haar mislukking hebben veroorzaakt zodat de Europese Unie is belemmerd om de nodige vooruitgang te boeken. Dit wordt in dit onderzoek beschreven als een "impasse". In de conclusie worden verbeteringen voorgesteld die de Europese Unie en de lidstaten in staat stellen om in de toekomst de noodzakelijke vooruitgang te kunnen boeken.

De gehanteerde benadering probeert dingen vanuit een andere 'invalshoek' te bezien. Diverse documenten hebben in dit onderzoek bijgedragen aan het verzamelen en vergelijken van informatie uit de lokale rechtssystemen, inclusief de analyse van andere relevante landen zoals onder andere de Verenigde Staten. De enorme hoeveelheid informatie die beschikbaar is, heeft dergelijke studies echter vaak naar een bepaald beperkt niveau van onderzoek gedegradeerd.

Dit boek volgt een andere methode waardoor het eerdere onderzoeken kan integreren. Het tekent een meer specifiek pad met behulp van een selectie van nationale en internationale modellen uit de hedendaagse jaren en de afgelopen eeuwen. De discussie toont de specifieke zwakke punten die de Europese strategieën hebben beschadigd en biedt alternatieven.

Hoofdstuk I

Hoofdstuk I bespreekt de "staat van de Europese Unie" en de strategieën die zijn vastgesteld voor de economische ontwikkeling in het nieuwe millennium. De nadruk ligt op strategieën die verband houden

met het faillissementsrecht en op wat wordt gedefinieerd als het “proces van herontwikkeling van Europese insolventiekaders”. De analyse is gebaseerd op verschillende officiële Europese documenten en studies uitgevoerd in de periode vanaf de jaren negentig tot 2016. Het uitgebreide gebruik van officiële documenten biedt eerstehands informatie over op welke manier strategieën (zowel de systematische strategieën als de strategieën die zich rechtstreeks richten op de hervorming van het gebied van faillissementswetgeving) zich ontwikkeld hebben en geeft inzicht in de resultaten. Dit hoofdstuk behandelt daarnaast de gestelde doelen, hoe deze in de loop van de tijd zijn gewijzigd en de moeilijkheden die zijn ondervonden om deze te bereiken met een focus op de "impasse" die op lokaal en systematisch niveau bij de hervorming van de faillissementswetgeving is ontstaan. Hoofdstuk I introduceert twee grote barrières die de succesvolle ontwikkeling van de herontwikkeling hebben verhinderd, namelijk: a) het "stigma van mislukking" en, b) het gebrek aan uniformiteit tussen de lokale faillissementswetgeving van de lidstaten.

Hoofdstuk II en Hoofdstuk III

Hoofdstuk II en Hoofdstuk III zijn nauw met elkaar verbonden. Ze bespreken de studies van invloedrijke internationale organisaties om de structuur te bepalen van efficiënte en effectieve moderne faillissementsregelgeving, voor zakelijke en niet-zakelijke debiteuren, op lokaal en grensoverschrijdend niveau. Dit deel van het onderzoek biedt de nodige informatie om de kernelementen van het proces van de herontwikkeling van Europese insolventiekaders te kunnen evalueren. Daarnaast kunnen de redenen die aan de "impasse" ten grondslag lagen, die de positieve ontwikkeling van de hervorming heeft vertraagd, beter worden beoordeeld. Hoofstuk II bepaalt de elementen die effectieve en efficiënte moderne lokale kaders vormen en geeft weer hoe deze zich in de afgelopen twee decennia hebben ontwikkeld. Hierbij worden de principes van de Wereldbank voor effectieve insolventie en crediteur/ debiteurregimes als richtlijnen geïntroduceerd en dienen ze ook in de rest van het onderzoek als vergelijkingspunten. Hoofdstuk III behandelt de aspecten van een internationaal faillissement en de belangrijke grensoverschrijdende modellen zoals de zogenoemde ‘International Bar Association Cross-Border Insolvency Concordat’; de UNICITRAL-modelwet inzake grensoverschrijdende insolventie. De focus ligt op het analyseren van de Europese regelgeving voor grensoverschrijdende insolventie.

Hoofdstuk IV

Hoofdstuk IV gaat terug naar de wortels die aan het Europese faillissementsrecht ten grondslag liggen. Het analyseert de redenen die middeleeuwse samenlevingen ertoe hebben aangespoord om specifieke faillissementsstatuten vast te stellen en hoe ze zich in de loop van de tijd hebben ontwikkeld. Door deze analyse kan worden verduidelijkt wat de oorsprong van de twee meest relevante belemmeringen, die het proces van de herontwikkeling van Europese insolventiesystemen vandaag de dag belasten, zijn, namelijk: de aanwezigheid van een krachtig "stigma" en het gebrek aan uniformiteit tussen de lokale kaders. Deze onderwerpen worden besproken vanuit een historisch en rechtsvergelijkend oogpunt door middel van een analyse van verschillende Italiaanse en Engelse middeleeuwse statuten. Het hoofdstuk laat zien dat het besproken "stigma" op zichzelf beschouwd niet negatief is, maar dat het een product is van noodzakelijk beleid dat de soliditeit van de Europese samenlevingen al eeuwenlang heeft gewaarborgd. Een dergelijke belangrijke rol maakt het lastig om het stigma in de moderne tijd uit te roeien. Het laat ook zien dat insolventiestatuten veelal sterke lokale kenmerken hebben en dat de aanpassing van kaders door de toepassing van "buitenlandse" principes of regels, bijvoorbeeld als gevolg van inlijving aan andere gebieden vanwege huwelijk of oorlog, altijd problematisch is geweest. Er wordt op dit punt bewijsmateriaal overgelegd waaruit blijkt hoe de Republiek Venetië en het hertogdom Milaan twee tegengestelde benaderingen van insolventiezaken hadden; de eerste was meer vergevend van aard de tweede zwaar

stigmatiserend. Hieruit vloeide de constante strijd voort voor de Milanese gebieden om zich aan te passen aan de meer stigmatiserende Venetiaanse beginselen.

Hoofdstuk V

Hoofdstuk V beziet de evolutie van Europese middeleeuwse faillissementssystemen in een nieuw scenario, namelijk: het Amerikaanse. Engelse insolventiestatuten waren in feite de 'stenen' die de basis vormden van de koloniale systemen en die tevens invloed hadden op vroege statuten van de Amerikaanse staat. Het hoofdstuk analyseert de ontwikkeling van de Amerikaanse wetten vanaf de koloniale periode tot aan de introductie van de moderne Bankruptcy Code, die vervolgens in dit hoofdstuk dieper wordt bestudeerd. Inzicht in de moderne Amerikaanse insolventiekaders is door de Europese Unie als cruciaal vereiste beschouwd bij het plannen van haar hervormingen. De "Code" is vaak gebruikt als een bron van inspiratie binnen de nieuwe Europese lokale kaders of is zelfs rechtstreeks overgenomen. In de moderne Amerikaanse insolventiewetten is gekozen voor een unieke benadering die effectief is gebleken bij het ondersteunen van bedrijven en consumenten door ontslag van betaling en het toekennen van effectieve tweede kansen aan eerlijke debiteuren. De gunstige effecten die hiervan zijn afgeleid, hebben ertoe bijgedragen dat de Amerikaanse economie decennialang de meest dynamische en concurrerende markt op de geglobaliseerde markt is geweest. Europa heeft haast gemaakt in zijn poging om een vergelijkbare positieve uitkomst te verkrijgen door te proberen om de Amerikaanse formule te integreren. De onmacht van de Europese samenlevingen om zich aan te passen aan de relevante wijzigingen die zijn opgelegd en om zich aan te passen aan de nieuwe principes die contrasteerden met de stigmatiserende elementen die eeuwenlang in hun systeem waren ingebed, hebben echter verhinderd dat het proces van hervorming zijn doelen heeft behaald.

Hoofdstuk VI

Hoofdstuk VI brengt de discussie terug naar Europa om door middel van de analyse van de evolutie van moderne Italiaanse faillissementsstatuten de conflicten aan te tonen die worden veroorzaakt door zogenoemde "legal transplants" die tot stand zijn gebracht in het kader van de toepassing van de herontwikkeling. Dit hoofdstuk is een 'studiecasus' en heeft als doel om bewijs te leveren van de "impasse" op lokaal niveau. Het doel is niet om zich te concentreren op afzonderlijke regels, maar om de moeilijkheden aan te tonen die zijn ondervonden bij het structureren van langdurige hervormingen en bij het aannemen van principes die diep contrasteerden met die welke door de eeuwen heen in de Italiaanse samenleving zijn ontwikkeld. Een nadruk wordt daarbij in dit hoofdstuk gelegd op het mislukken van diverse hervormingen die bijna jaarlijks in het nieuwe millennium plaatsvonden.

Hoofdstuk VII

Hoofdstuk VII recapituleert en analyseert de belangrijke informatie die is gegeven in de vorige hoofdstukken. Het gaat dieper in op de elementen die de "impasse" binnen het proces van herontwikkeling hebben veroorzaakt en identificeert vier belangrijke zwakke punten, namelijk: a. de complexiteit van de taak van de Europese Unie en de lidstaten; b. de onmogelijkheid om binnen enkele jaren radicale verandering tot stand te brengen; c. de negatieve gevolgen die voortvloeiden uit het vormgeven van de hervormingen aan de behoeften van de markt; d. de negatieve gevolgen van de toepassing van buitensporige "legal transplants". In dit hoofdstuk blijkt dat Europa haar taak heeft onderschat. Er was namelijk onvoldoende tijd om de geplande wijzigingen door te voeren. De poging om de taak te versnellen door hulpmiddelen toe te passen die in een ander scenario succesvol waren geweest, kon uiteindelijk niet het succes van het project garanderen. Bovendien was de buitensporige economische focus van de hervormingen in strijd met ander relevant beleid en belette het lokale samenlevingen om het proces te

ondersteunen, wat uiteindelijk tot de "impasse" heeft geleid. In dit hoofdstuk wordt gesteld dat de schade echter niet onherstelbaar hoeft te zijn. Hoewel er in feite veel fout ging, waren de door de Europese Unie gestelde doelen in veel opzichten lovenswaardig en kon er nog veel worden gedaan om de oorspronkelijke status-quo te verbeteren. Dit kan door samenlevingen te helpen deel uit te laten maken van het proces en hen te helpen bij het verwerpen van de stigmatiserende wortels van de Europese insolventiesystemen. Een modernere aanpak, bijvoorbeeld door de ontwikkeling van advertentiecampagnes gericht op het uitleggen dat bijvoorbeeld eerlijke zakelijke fouten moeten worden vergeven, kan daarbij behulpzaam zijn. Er wordt daarnaast ook aangegeven dat de relevante gebieden van het faillissementsrecht met verschillende "snelheden" worden hervormd. Hoewel sommige principes gemakkelijker kunnen worden toegepast en kunnen worden geharmoniseerd voor de verschillende juridische instellingen, kunnen andere veel langer duren. Tot slot wordt er beweerd dat sommige specifieke hervormingen op specifieke gebieden de snellere ontwikkeling van het hele proces kunnen ondersteunen.

Conclusie

De conclusies die worden getrokken naar aanleiding van dit innovatieve onderzoek, zijn uiteindelijk positief. Een Unie van Europese landen kan rekenen op grote middelen en op een ongelooflijk potentieel. Goede resultaten kunnen na verloop van tijd worden bereikt. Om de nodige en noodzakelijke stappen vooruit te kunnen zetten moet er echter een grotere "gemoedsrust" worden verworven op zowel lokaal als grensoverschrijdend niveau. Op alle niveaus moet worden aanvaard dat het doorvoeren van succesvolle hervormingen tijd kost en niet alleen inspanningen of doordachte strategieën vergen. Grote wijzigingen van faillissementswetgeving kunnen bovendien daarnaast niet louter op economische gronden en belangen worden gebaseerd; de basis moet liggen in principes die worden gedeeld en onderschreven door alle betrokken samenlevingen.

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