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# Ranking of Creditors in Insolvency: An Empirical Debate on Optimal Harmonization Practices

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## Introduction

The European Commission and Parliament have long advocated for substantive *and* substantial changes in national insolvency<sup>2</sup> practices, on the premises that disparities between national systems: create obstacles to the functioning of an efficient internal market; hinder economic growth (or recovery), and impact the availability and cost of investments.<sup>3</sup> Furthermore, it is generally understood that integration of capital markets is seriously jeopardized by lack of sufficient harmonization in insolvency law.<sup>4</sup>

The urgency of such intervention is even more pressing in the aftermath of the economic and financial crisis. Excessive levels of leverage in the private sector, the worrying magnitude of the phenomenon of non-performing loans (NPLs), and long-lasting inefficiencies in the market for distressed assets<sup>5</sup> all recommend the adoption of uniform policies pursuant to article 114 TFEU.

To achieve a (more) level-playing field, empirical studies were commissioned<sup>6</sup> with the aim of: facilitating the rescue of viable but financially distressed companies;

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<sup>2</sup> Depending on the jurisdiction, there are different understandings of the meaning of ‘insolvency law’. This paper adopts the English version of the notion. Therefore, the term ‘insolvency law’ is used to refer to corporate practice, while the term ‘bankruptcy law’ is relegated to cases dealing to individuals. Occasionally, in direct quotations from other authors, this distinction may not be respected.

<sup>3</sup> EC Communication “Towards the Completion of the Banking Union” Com (2015) 587.

<sup>4</sup> “Five Presidents’ Report” on “Completing Europe’s Economic and Monetary Union”, 22 June 2015.

<sup>5</sup> Reference is made to the lack of an efficient distressed debt market, and to the small number of private and public asset management companies (AMCs).

<sup>6</sup> Among others, see Directorate-General for Internal Policies of the European Parliament, *Harmonisation of Insolvency Law at EU Level*, PE 419.633; Directorate-General for Internal Policies of the European Parliament, *Harmonization of Insolvency Law at EU Level with Respect to Opening of Proceedings, Claims Filing and Verification and Reorganisation Plans*, PE 432.766.

ensuring timely restructuring, and promoting a fresh start for honest, but unfortunate, entrepreneurs. Based upon the evidence collected both at European and international level,<sup>7</sup> the European institutions adopted several soft-law measures, including: proposals,<sup>8</sup> recommendations,<sup>9</sup> communications,<sup>10</sup> and action plans.<sup>11</sup>

The “*Insolvency Initiative*”<sup>12</sup> could be explained as an attempt to redress the unsatisfactory levels of harmonization achieved by these non-binding instruments.<sup>13</sup> More remarkable results were obtained where hard-law measures<sup>14</sup> were enacted. As a result, the Commission has committed itself to submit mandatory approximation proposals in several areas of insolvency law by the end of 2016, including opening requirements, and directors’ liability for late filing, avoidance actions, creditors’ ranking and preventive restructuring frameworks. These are likely to result in a legislative instrument, which should be published on 26 October 2016, according to the latest available information.<sup>15</sup> What is still debated, however, is the form and the content of this legislative instrument, and different options are currently source of debate.<sup>16</sup>

If compliance to European insolvency rules is a matter of “when” rather than “whether”, a set of ancillary questions arises. It is still to be clarified “what” should be harmonized, and “how”. This paper focuses on one aspect of substantive harmonization (ranking of creditors). On the basis of the evidence collected during an empirical study carried out in Italy, it tries to provide tentative answers to the following inquiry: How should we harmonize?

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<sup>7</sup> IMF Country Reports No. 15/205 (p. 57) and 15/204 (p. 22), July 2015; World Bank Doing Business Report 2016, available at: <<http://www.doingbusiness.org/reports/global-reports/doing-business-2016>> [last viewed 30 March 2016]; OECD, ECO/EDR (2014) 6, 23 December 2013.

<sup>8</sup> EP Resolution PT\_TA (2011) 0484.

<sup>9</sup> EC Recommendation *A New Approach to Business Failure and Insolvency* COM (2014) 1500.

<sup>10</sup> EC Communication on the Single Market Act II COM (2012) 573; EC Communication *A New European Approach to Business Failure and Insolvency*, COM (2012) 742; EC Entrepreneurship 2020 Action Plan COM (2012) 795.

<sup>11</sup> Action Plan on Building a Capital Market Union, COM (2015) 468.

<sup>12</sup> Directorate-General Justice & Consumers of the European Commission, *Inception Impact Assessment Report*, 2 March 2016, available at: [http://ec.europa.eu/justice/civil/files/insolvency/impact\\_assessment\\_en.pdf](http://ec.europa.eu/justice/civil/files/insolvency/impact_assessment_en.pdf) [last viewed 30 March 2016].

<sup>13</sup> For a Commission’s valuation of the results achieved by means of the 2014 EC Recommendation, see the Evaluation of 30/09/2015 attached to the Action Plan on Building a Capital Market Union, COM (2015) 468.

<sup>14</sup> See Regulation (EC) No. 1346/2000 as replaced by June 2017 by Regulation (EU) No. 848/2015 and EU Recovery and Resolution Directive No. 2014/59/EU.

<sup>15</sup> Conference on “*Convergence of insolvency frameworks within the European Union - the way forward*”; Brussels, 12 July 2016.

<sup>16</sup> Alternatives include a minimum harmonization Directive, a full harmonization Regulation as well as the creation of a self-standing, autonomous but optional set of rules which reminds of recent proposals debated in the United States – see Robert K. Rasmussen, ‘Debtor’s Choice: A Menu Approach to Corporate Bankruptcy’ (1992/1993) 71 *Tex. L. J.*, 51. For further details, see below note 87.

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With reference to creditors' ranking and statutory priorities within insolvency law, this question bears no easy answer. On the one hand, Recital 22 of the preamble to the recast Insolvency Regulation<sup>17</sup> acknowledges that:

“as a result of widely differing substantive laws it is not practical to introduce insolvency proceedings with universal scope throughout the Union (emphasis added). [...] Furthermore, the preferential rights enjoyed by some creditors in insolvency proceedings are, in some cases, completely different”. On the other, the EU Parliament recognizes that “the current lack of harmonization with regard to the ranking of creditors reduces predictability of outcomes of judicial proceedings.”<sup>18</sup>

thus seeming to advocate for the solution dismissed in the recast Regulation. Finally, the Commission also acknowledges that some MSs recognize a priority<sup>19</sup> status to MSMEs' claims.

This paper reports the empirical evidence (both qualitative and quantitative) gathered by the author on the Italian legal treatment of (specific) small entrepreneurs<sup>20</sup> as claimants. This evidence, alongside the additional considerations impacting the Italian insolvency legal system and community, are used to discuss the possible alternatives that the EU legislator may adopt in pursuing substantive harmonization in this area of law. The paper concludes with the author's view on the optimal approach to substantive harmonization, at least under the current circumstances.

This paper is divided into five substantive sections followed by a general conclusion. The first section refers to the existing scholarly debate on the opportunity to recognize statutory priorities within insolvency law. The second section reports the current situation in Italian law - which identifies several priority treatments - and the results of the previously mentioned empirical study on the treatment of the claims of artisan entrepreneurs.

Having observed that the priority mechanism falls short both of attaining theoretical support from the academic community, and achieving the statutory goals that first justified its introduction, the third section questions the very foundations advocating against its abolition. It analyses the quasi-constitutional nature of the priority status of artisan entrepreneurs, and the existence of a business and legal environment strongly supportive toward its recognition. This leads the author to conclude the time

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<sup>17</sup> Regulation (EU) 2015/848. The equivalent in Regulation (EU) 1346/2000 is recital 11.

<sup>18</sup> EP Resolution PT\_TA (2011) 0484, *sub AB*. As a general approach, the European Parliament tends to be more prudent than the Commission on the feasibility and extent of any harmonization effort which involves substantive provisions of insolvency law.

<sup>19</sup> This paper makes use of the expression of 'priority' rather than 'preferential' claimants, except in case of direct quotations from other authors. The use of the expression 'preferential claimants' may overlap with description of a claimant requested to return the debtor's repayments received during the course of transactional avoidance but prior to insolvency proceedings being triggered.

<sup>20</sup> 'Imprenditori Artigiani' or 'Artisan Entrepreneurs'.

is not ripe for repealing these statutory priorities from the legislative framework, and imposing harmonised solutions at the EU level.

The fourth section proposes a way forward. Assuming that marginal differences within insolvency practice do not hinder cooperation in cross-border cases, it considers how soft-law, and non-binding EU and international recommendations have pushed the Italian legislator to set up a Study Commission,<sup>21</sup> and the beneficial effects stemming from this approach.<sup>22</sup> Given that other MSs<sup>23</sup> have undertaken similar reform processes since the European Commission and Parliament expressed the urgency to adopt a fresh approach to insolvency,<sup>24</sup> the Italian “success story” is not an isolated case. Further developments should therefore build upon these considerations to come up with a solution to this impasse.

The final section describes the limits and shortcomings of the proposed solution, while simultaneously highlighting the reasons that support the recommended approach. The last section concludes by highlighting the merits and expected benefits of the minimum standard harmonization approach.

#### **Statutory Priorities: *Quid Curat?***

The relative merits of a unified treatment of statutory priorities, alongside the reduction in their scope, have been the subject of heated and extensive debate. The arguments marshalled by the proponents of this line of thought, are sophisticated, complex, and operate at the macro-level. The following paragraphs attempt to summarize these debates highlighting their relevance to insolvency practice today, while exploring their wider implications for the harmonisation debate.

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<sup>21</sup> Decree of the Ministry of Justice, 28 January 2015.

<sup>22</sup> At the moment, a proposal for a systemic reform of the Italian insolvency law has been adopted by the Council of Ministers [10 February 2016] and is currently being debated in the Parliament

<sup>23</sup> Despite the lack of reply from four MSs (Denmark, which has opted out the Insolvency Regulation and its recast, Malta, Cyprus and Ireland), a recent EU Commission’s study, published on 30.9.2015, concluded that “*a few Member States have undertaken reforms*” [Croatia, Hungary, Poland, Romania, Slovenia, and Spain] (at 1), while in others [Lithuania, the Kingdom of Netherlands, Sweden, and the United Kingdom] the matter is still being debated. The study concluded that “*the main elements of the Recommendation are implemented in different ways in Member States*” (at 2), and that “*several Member States consider that they already largely comply with the Recommendation, [while] a significant number of those which do not comply have not launched any reforms to date*” (at 5) - 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*, available at: <[http://ec.europa.eu/justice/civil/files/insolvency/02\\_evaluation\\_insolvency\\_recommendation\\_en.pdf](http://ec.europa.eu/justice/civil/files/insolvency/02_evaluation_insolvency_recommendation_en.pdf)> [last viewed 29 July 2016]. These conclusions are no longer actually valid because, since the publication of this study, several other MSs have implemented reforms in their insolvency framework or, at least, opened a debate to possible amendments.

<sup>24</sup> These efforts were not considered sufficient by the EU Commissioner of Justice Věra Jurová who, at a recent conference in Brussels (12 July 2016) on the subject of “Convergence of Insolvency Frameworks within the European Union - The Way Forward”, argued that “*implementation of the Recommendation was sketchy, even in those Member States that started reforming their insolvency laws*” - speech available at: <[https://ec.europa.eu/commission/2014-2019/jourova/announcements/speech-commissioner-vera-jourova-conference-modernising-insolvency-and-restructuring-law-eu\\_en](https://ec.europa.eu/commission/2014-2019/jourova/announcements/speech-commissioner-vera-jourova-conference-modernising-insolvency-and-restructuring-law-eu_en)> [last viewed 29 July 2016].

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‘Common pool’/creditors’ wealth maximization theorists<sup>25</sup> reject the idea that priorities should be recognized in the law, since parties would never agree *ex ante* on their recognition and enforcement.

“Commercial law must establish the appropriate sequence in which creditors of a debtor must primarily bear the consequences of his insolvency”.<sup>26</sup>

These commentators argue that losses “*have to be shouldered by parties regardless of their relative blameworthiness*”.<sup>27</sup> They fear that creditors enjoying state-created priorities may be incentivised to initiate the liquidation process, or may demand similar priority treatments outside insolvency.<sup>28</sup> They conclude that

“the protection of non-creditor interests of other victims of corporate decline, such as employees, managers, and members of the community, is not the role of insolvency law”.<sup>29</sup>

Their recommendations have been adopted in some jurisdictions.<sup>30</sup>

Rather surprisingly, also the proponents of opposing communitarian and multi-value visions (collectively known as ‘proceduralists’) have reached similar conclusions on this particular subject, despite otherwise disagreeing with the above-mentioned commentators on the key principles and purposes of insolvency law. Proceduralists

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<sup>25</sup> Among the most widely acknowledged law and economics scholars are Thomas H. Jackson and Douglas G. Baird. They argue that the essential role of insolvency law is to provide collectivized machinery for the administration of the debtor’s estate. In their view, this area of law should not be used as a proxy to redistribute pre-insolvency property rights, which should be governed by traditional commercial rules. See Thomas H. Jackson, *The Logics and Limits of Bankruptcy Law* (Harvard University Press 1986); and Douglas G. Baird, *Elements of Bankruptcy* (6<sup>th</sup> edn, Foundation Press 2014). See also Douglas G. Baird and Thomas H. Jackson, ‘Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy’ (1984) *University of Chicago Law Review* 51.

<sup>26</sup> David E. Allan and Ulrich Drobnig, ‘Secured Credit in Commercial Insolvencies: A Comparative Analysis’ (1980) 44(4) *The Rabel Journal of Comparative and International Private Law* 615, at 646.

<sup>27</sup> Vanessa Finch and Sarah Worthington, ‘The Pari Passu Principle and Ranking Restitutionary Claims’ in Francis Rose (eds), *Restitution and Insolvency* (2000, LLP, London), at 7.

<sup>28</sup> Thomas H. Jackson, ‘Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors’ Bargain’ (Apr. 1982) 91(5) *The Yale Law Journal* 857, at 904.

<sup>29</sup> Vanessa Finch, *Corporate Insolvency Law* (2<sup>nd</sup> ed) (2002, CUP, Cambridge) at 28.

<sup>30</sup> For instance, Austria introduced ‘class-less’ insolvency under the Insolvency Law Reform Act (IRÄG) 1982 - i.e. no priority treatment recognised - other than for secured creditors. Limited exceptions to this general rule result from special fields, such as the Pension and Insurance Law. Germany has abolished all categories of priority creditors from its *Insolvenzordnung*, so it sits in a position similar to the Austrian one. However, following the financial crisis and calls for re-introducing the privilege for tax claims, some pre-commencement tax claims have been labelled as ‘administration claims’, thus payable in preference to other unsecured creditors (§.55 para 4 InsO). In addition, the financial industry managed to make close-out netting agreements insolvency-proof, thus obtaining a *de facto* priority treatment over them. As for England, after the abolition of the Crown preference by means of the *Enterprise Act 2002*, priorities are restricted to certain sums owing to employees, and certain levies on coal and steel production (sch. 6, para 15A, Insolvency Act 1986). However, the United Kingdom cannot be defined as a priority-free jurisdiction if we consider the effect on *pari passu* distribution of the “prescribed part” (below note 40). For a comprehensive analysis of the ranking of insolvency claims in each of the considered jurisdictions, see Dennis Faber et al, *Ranking and Priority of Creditors* (2016, OUP, Oxford).

recognize the paramount role of the *pari passu* rule.<sup>31</sup> They therefore contend that rateable distribution among unsecured creditors should remain the default praxis,<sup>32</sup> unless there are good reasons to depart from it.<sup>33</sup> The problematic aspect is that decades of scholarly debate brought no agreement on how to identify the ‘good reasons’ or “*persuasive justifications*”<sup>34</sup> for supporting those statutes, which prefer selected creditors to other contributors.

Things do not improve if we analyse the academic contributions, which focused on the priority treatment granted to MSMEs. In addition, proposals that recommended extending the priority to small claims<sup>35</sup> rather than MSMEs have been dismissed, since there is no proof that the smaller the loan, the more vulnerable the creditor. Finally, empirical studies demonstrated that even insolvency practitioners (hereinafter, IPs) do not support the introduction of new priorities, or retention of existing ones.<sup>36</sup>

Alongside the academic debate, international and regional organizations have advocated for the reduction or abolition of priority ranking in insolvency. For instance, the European Commission has commissioned a recent study to verify, *inter alia*, if different substantive laws in the area force creditors “*to assess risk by reference to individual countries rather than on a Europe-wide basis*”.<sup>37</sup>

It follows that, for the time being, the only classes of creditors and claims that seem to have a stronger case for priority treatment are employees, revenue authorities, tort creditors, and environmental clean-up costs. However, even with reference to them,

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<sup>31</sup> Vanessa Finch observes: “*in considering exceptions to pari passu, it is the relative cases for preferring the different types of creditors that are at issue*” (emphasis as in the original contribution); Finch (above note 29) at 627.

<sup>32</sup> Against Look Chan Ho, ‘Goode’s Swan Song to Corporate Insolvency Law’ (2006) 17(6) *European Business Law Review* 1727, according to whom it is misleading to claim the fundamental importance of the principle, and then eagerly recognize exceptions to its general application, or to limit its scope to a multi-layered understanding.

<sup>33</sup> Paul Heath, ‘Preferential Payments on Bankruptcy and Liquidation in New Zealand: Are They Justifiable Exceptions to the *Pari Passu* Rule?’ (1996) 4 *Waikato Law Review* 24. By reinstating the paramount relevance of the *pari passu* principle, the author questions even the opportunity of the employee preferential status. He observes that “[w]hen assessing whether priority should be given to employees, one must also bear in mind the consequences of excluding the wider class of claimant of this type and also the danger of according priority to a class of creditor which naturally includes working shareholders who function in a management role and who also have a contract of employment”, at 43.

<sup>34</sup> Christopher F. Symes, *Statutory Priorities in Corporate Insolvency Law - An Analysis of Preferred Creditor Status* (2008, Ashgate, Farnham). at 1.

<sup>35</sup> David Milman, ‘Priority Rights in Corporate Insolvency’ in Clarke A. (eds), *Current Issues in Insolvency Law* (1991, Stevens, London), at 78.

<sup>36</sup> According to Professors Andrew Keay and Peter Walton, 97% of practitioners responding to a survey in the United Kingdom indicated they would not advocate the introduction of any other new class of priority creditors; Andrew Keay and Peter Walton, ‘Preferential Debts: An Empirical Study’ [1999] *Insolvency Lawyer* 112, at 116.

<sup>37</sup> G. McCormack et al., ‘Study on a New Approach to Business Failure and Insolvency’ (2016) at 4, available at: <[http://ec.europa.eu/justice/civil/files/insolvency/insolvency\\_study\\_2016\\_final\\_en.pdf](http://ec.europa.eu/justice/civil/files/insolvency/insolvency_study_2016_final_en.pdf)> [last viewed 27 July 2016].

there are dissenting opinions,<sup>38</sup> with commentators recommending the total abolition of priorities in insolvency law, and others arguing for a more multifaceted approach. Alan Schwartz, for instance, argued for the adoption of “*corrective justice*” mechanisms that should benefit those creditors (including small trade claimants) who are either unaware or unable to react to security. However, he concluded that advocating for a change in the priority list, which would favour those creditors, may cause more harm than good, and eventually dismissed his own proposal.<sup>39</sup>

Jacob S. Ziegel argued that priority treatment is justified only with reference to those small trade creditors that do not have enough customers to spread the risk.<sup>40</sup> Vanessa Finch herself adopted an ambivalent approach on the subject, contending that “*the English system of borrowing combines with corporate insolvency law’s priority regime to discriminate against small companies*”,<sup>41</sup> and advocating for a move from ‘lifeline’ towards ‘facilitative’ and ‘risk-distribution’ approaches.

To summarise, the majority position among commentators is in favour of drastically reducing or even abolishing any form of priority. Similar conclusions have been advocated by Parliamentary Committees aimed at modernizing insolvency practice,<sup>42</sup> as well as in the debate for harmonizing the substantive practice in insolvency law within the European Union.

Dissenting opinions have not gained wide support in the academic community, and lack the persuasiveness of opposing theories. Nevertheless, existing statutes still recognize *ex post* priority treatments to certain creditors.<sup>43</sup> It is subsequently about

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<sup>38</sup> For example, in the European Union, countries like Germany and the United Kingdom do not recognize a priority treatment for the collection of taxes.

<sup>39</sup> Alan Schwartz, ‘Security Interests and Bankruptcy Priorities: A Review of Current Theories’ (Jan. 1981), 10(1) *The Journal of Legal Studies* 1.

<sup>40</sup> Jacob S. Ziegel, ‘Preferences and Priorities in Insolvency Law: Is There a Solution?’ (1994-1995) 39 *St. Louis University Law Journal* 793. The author expressed criticisms towards the 10% solution proposed in the U.K. by the Cork’s Committee, not simply for lack of theoretical justification, but also for lack of practical benefits. He concluded that, if the proposal had been enforceable at the time of his study, the average unsecured creditors’ return would have increased from 5% to 6.7%. In his words, “*hardly enough to bring joy to a creditor’s heart*”, at 804. Nevertheless, a similar mechanism was implemented by means of s.176A of the Insolvency Act 1986 thanks to the *Insolvency Act 1986 (Prescribed Part) Order 2003*. This law prescribes that part of the proceeds arising from the realisation of the assets covered by a floating charge must be set aside and made available to satisfy unsecured debts. It is calculated as a percentage of the value of the company’s property subject to a floating charge: namely, 50% of the first £10,000 of net floating charge realisations plus 20% of anything thereafter, subject to a cap of £600,000.

<sup>41</sup> Vanessa Finch, ‘Security, Insolvency and Risk: Who Pays the Price?’ (Sept. 1999) 62(5) *The Modern Law Review* 633, at 633.

<sup>42</sup> See Kenneth Cork, *Report of the Review Committee on Insolvency Law and Practice* (Cmnd.8558), (London 1982), §.1397: “*the elaborate system of priorities [...] is the cause of much public dissatisfaction, and [...] there is a widespread demand for a significant reduction, and even a complete elimination, of the categories of debt which are accorded priority in insolvency*”. See also Australian Law Reform Commission, *General Insolvency Inquiry* (Report No 45), (Canberra 1998), Chair Ronald W. Harmer, §.152: “[a]s far as possible the fundamental principle of insolvency law which requires a rateable distribution among unsecured creditors should be reinforced. The existence in the insolvency laws of a long list of priority creditors runs contrary to this principle”.

<sup>43</sup> Apart from Italy, other jurisdictions recognize a patchwork of different types of priority and preferential claims- examples include the United States [11 U.S.C. §.507(a)], and Belgium. In Canada, different

high time the reasons for their recognition and persistence were reviewed and reconsidered.

### **Statutory Priorities: *Italia Curat***

As mentioned before, no jurisdiction adopts a pure version of the *pari passu* principle of distribution, not even among unsecured creditors. In actual fact, there are countries where deviations from the rateable distribution concept become the rule rather than the exception. Italy can be listed amongst those countries.

This section analyses the situation of statutory priorities in Italy, and in particular, its decision to grant preference to certain MSMEs, alternatively called ‘artisans’ or ‘artisan entrepreneurs’. It also reports the result of an empirical study aimed at verifying whether the legislative choice is capable of achieving the statutory goals. This section reinstates the centrality of priorities in the harmonization debate. It proves that the original goals that justified the introduction in the Italian statutory framework of this priority ranking have not been achieved. In other words, this section demonstrates that statutory priorities in general, and the privilege recognized to artisans in particular, should be either reformed or abolished. The question that will remain unanswered at the end of this section is whether such a change should be imposed by the European Union (for instance, by means of a Regulation), or if a higher degree of autonomy should be left to the Italian legislator.

#### *Priority Ranking in Italy*

Under the existing Italian insolvency legislation, there are roughly 114 statutory exceptions to the principle of rateable distribution among unsecured creditors. This without considering rights *in rem* and the preferential treatment of the expenses accrued during the insolvency procedure.<sup>44</sup>

Commentators have tried to determine the reasons that push some legislations to single out so many claimants from the wider category of unsecured creditors, and

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priorities are recognized depending on the procedure; and not only by federal, but also by provincial statutes. The Russian’s Federation Federal Insolvency Law 2002 also recognizes different priorities depending on the business filing for insolvency protection. In addition, the country adopts a tiered system for the payment of claimants. Another jurisdiction with a long list of preferential creditors is France, even though in the last decade the position of non-preferred creditors has improved. France is one of the very few jurisdictions where secured creditors may not satisfy their claims over the secured assets in priority to all other claims. Mexico provides special protection for labour claims, while Dutch insolvency legislation recognizes a priority status to certain tax claims [art. 21(1) of the Tax Collection Act 1990], and salary and social security premiums [art. 3:288(e) of the Civil Code]. Further priorities have also been recognized by special statutes. Recent reforms in Poland (2015) have abolished the priority ranking of tax claims. Nevertheless, other pre-commencement creditors, such as employees and farmers for supplies of products from their own farms, enjoy a priority treatment under the revised legislation. Finally, South Korea and Spain recognize priority status to certain claims from MSMEs or natural persons respectively for work personally done (i.e. self-employed workers). For a comprehensive analysis of the system of priorities in the considered jurisdictions, Faber et al (above note 30).

<sup>44</sup> Available at: <<http://fallimento.it/redazione/Privilegi/index.htm>> [last viewed 21 July 2016].



from the rateable principle that should guide the distribution of proceeds among them. It has been rightly observed that in some countries, priority claims “*perform the function undertaken by security credits in other systems*”.<sup>45</sup> Nevertheless, in my opinion such an exorbitant and striking deviation from equality in distribution can be satisfactorily explained only as the by-product of ongoing political and economic pressures.

Irrespective of the majority position mentioned in section I,<sup>46</sup> Italian legislation recognizes a priority ranking to certain MSME claimants, should one of their debtors enter into an insolvency procedure. An *ex ante* approach, which aims *inter alia* to prevent those companies experiencing financial distress as a consequence of partial or non-payment of their invoices.

According to article 2751 *bis* (5) of the Civil Code,

“[a] general privilege on movable property is granted to claims relating to [...] claims of an artisan enterprise [as defined according to the enforceable law] and of cooperative societies or institutions for production and work, for the compensation of services rendered and the sale of manufactured products”.<sup>47</sup>

This article was introduced by means of law no. 426/1975, to grant additional protection to certain creditors (including artisan entrepreneurs) who were considered “worthy” of special consideration by the Italian Constitution.<sup>48</sup>

This rule represents a serious obstacle to the European Commission’s call for closer approximation in substantive insolvency practice, since it is likely that substantive harmonization at EU level would require repealing the measure from national practice. This is a controversial request, especially if the mechanism achieves its statutory goals.

To determine its degree of success, it is necessary to observe if (1) the law clearly singles out *only* the creditors worthy of special consideration, and (2) a significantly higher and consistent recovery rate is granted to those claimants by means of the recognition of this priority status. To answer the first question, an analysis of the enforceable law and judicial practice of the Italian courts was undertaken. To answer

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<sup>45</sup> José M. Garrido, ‘The Distributional Question in Insolvency: Comparative Aspects’ (1995) 4 *International Insolvency Review*, 25, at 41.

<sup>46</sup> For a summary see (among others): Ziegel, above note 40; Garrido, *ibid*; José M. Garrido, ‘No Two Snowflakes the Same: The Distributional Question in International Bankruptcies’ (2011) 46 *Texas International Law Journal*, 459.

<sup>47</sup> Susanna Beltramo, *The Italian Civil Code and Complementary Legislation* (West/Thomson Reuters, 2012), at 699. The words in brackets were added by law no. 35/2012, and were translated into English from Italian by the author of this note. The term “cooperative societies” is better understood as “cooperative companies”.

<sup>48</sup> Article 35(1) of the Italian Constitution lays down that “*The Republic protects work in all its forms and practices*”, while article 45(2) specifies that it is up to the law to “*safeguard and promote artisanal work*”. These are the translations in English of the Italian text made by the author of the present note.

the second issue, an empirical study was conducted. The following sub-sections describe the results of these efforts.

*'Artisans' in Italian Law and Courts*

The profession of 'artisan' has always been associated with the making of art (it. "artefatto", lat. *arte + factu*, made in an artistic fashion) and hand works (it. "manufatto", lat. *manu + factu*, made by hand). The Italian legislature developed the legal notion of 'artisan' against this background. Therefore, it comes as no surprise that the first legal understanding of 'artisan' was closely related to the commonly accepted belief of this labourer as a craftsman, who primarily made his living in a workshop, relying mainly on manual work.

This is the position adopted by the first "modern"<sup>49</sup> statute that mentioned this group of workers. Pursuant to law no. 830/1925, the notion of 'artisan' was to be used only with reference of those self-employed people who exercised their craft in an artistic workshop, alone or with the exceptional assistance of a salaried apprentice, and with the occasional use of 'mechanical means'.<sup>50</sup>

Neither the Civil Code (enacted in 1942) nor the Constitution (enacted in 1948) provides a specific definition of 'artisans'. Only article 2083 of the Civil Code lays down that the category of 'small entrepreneurs' is formed by

"farmers who personally cultivate the land, artisans, small tradesmen and those who engage professionally in an activity organized mainly with their own work and that of the members of their families."<sup>51</sup>

Despite the lack of any clarification on the meaning of 'artisan', their inclusion within the category of 'small entrepreneurs' is telling. The *ratio legis* which underpins the choice, is to confine the category of artisans to only those entrepreneurs who exercise a professional activity prevalently on their own, or with the occasional help of members of their families.<sup>52</sup> In other words, entrepreneurs not substantially dissimilar from salaried workers. A notion that courts clearly had in mind when interpreting the scope of the yet-to-be enacted priority in insolvency, as it will become evident later in this subsection.

It was not until 1956 that a new definition of 'artisan' was provided. The pre-1956 notion of 'artisan' adopted by the legislator was narrow for contemporary standards, but less so if we contextualize it within the economic and social situation that the

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<sup>49</sup> 'Modern' refers to legislation enacted after the unification of the different states that formed the Italian peninsula, and the settlement of a central government in Rome (17 March 1861).

<sup>50</sup> For an analysis of the preliminary evolution of the legislation on artisans, see F. Cavazzuti, 'Le Piccole Imprese' in F. Galgano (eds), *Trattato di Diritto Commerciale e di Diritto Pubblico dell'Economia* (1978, Cedam, Padova).

<sup>51</sup> Beltramo (above note 47), at 441.

<sup>52</sup> These advantages originally included the exemption from keeping accounting entries, the registration in a special section of the Companies' House register, and the exemption from insolvency procedures.

country experienced in the first half of the 20<sup>th</sup> century. Mechanical instruments were expensive, people tended to live in small villages in the county, and Italy was still in the early stages of industrialization. It is therefore safe to assume that a relevant part of autonomous, self-employed workers fit in the definitions of ‘artisan’ and ‘small entrepreneur’.

Nevertheless, in the aftermath of the Second World War, improvements in the economic conditions and innovation introduced by the industrialization process meant that craftsmen were required to make use of more sophisticated and expensive tools to remain competitive in the marketplace. Those who did not embrace technological innovations were squeezed out, or relegated to the upper-end of the market (i.e. artistic production).

To avert this risk of losing legislative protection and financial benefits, the economic community (and the entrepreneurs’ unions) lobbied for adopting a more encompassing notion of artisan entrepreneurs. The legislature replied to these calls by means of law no. 860/1956, which recognized the industrialization of the artisan practice, and provided a definition of artisan entrepreneur valid “*for any purpose of the law*”.<sup>53</sup> Entrepreneurs could subsequently still be qualified as ‘artisans’ despite: incorporating themselves in some of the existing corporate forms; employing a limited number of salaried workers; and making use of more sophisticated mechanic tools to produce goods *and* services. This word became increasingly synonymous with “*piccola impresa di qualità*” (small quality industry).<sup>54</sup>

In 1975, the statutory priority was introduced (law no. 426/1975). The purpose of this statute was to grant additional protection to those entrepreneurs who matched the criteria set out in art. 2083 of the Civil Code. From this date onwards, the distinction between the two definitions of ‘artisan’ in Italian law brought even more remarkable consequences. While the recognition of administrative and financial benefits was merely subject to the criteria set out in the special law, insolvency priority was recognized only where the creditor could satisfy the criteria laid down in both the special law (law no. 860/1956) and the Civil Code (articles 2751 *bis* (5) and 2083). The circumstance that the special law laid down a definition of ‘artisan’ valid “*for any purpose of the law*” had never represented a barrier to this interpretation, since jurisprudence<sup>55</sup> has proven more sensible in validating the intention of the lawmaker.

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<sup>53</sup> This specification appears tautological, but in reality is extremely important. Law no. 860/1956 was mainly enacted to determine the criteria that certain self-employed entrepreneurs should respect in order to benefit from tax rebates and other preferential treatments. The specification that the definition is valid ‘at any effect of the law’ means that, in the legislator’s view, the judiciary should have looked *only* at the statutory criteria set out in the 1956 law to determine if an artisan is a small entrepreneur according to art. 2083 of the Civil Code.

<sup>54</sup> A. Gambino, ‘Aspetti, Limiti e Prospettive dell’Impresa Artigiana’ (1979) *Il Fallimento e le Altre Procedure Concorsuali* 689, at 699.

<sup>55</sup> While in the US the term is understood as a synonym of ‘philosophy of law’, this paper employs the word in the UK fashion, as a synonym of ‘case-law’.

This position has been reinstated in several rulings. For instance, back in 2000,<sup>56</sup> the Supreme Court held that

“the qualification of an individual entrepreneur as an artisan [...] requires the prominence of the contribution of labour over invested capital, and of personal or even manual work, from the owner of the enterprise”.<sup>57</sup>

Additionally, back in 1998,<sup>58</sup> the Supreme Court clarified that

“law no. 860/1956 [...] shall be considered as a natural integration, specification and clarification of article 2083- both under a qualitative and [...] a quantitative perspective. However, an enterprise cannot be defined as ‘artisanal’, merely because it matches the quantitative requirements set out in articles 1 and 2 of law no. 860/1956”<sup>59</sup> (emphasis added).

In 1985, a new statute (law no. 443/1985) replaced the 1956 framework, to further extend the definition of ‘artisan’ set out in the special law. However, in a better coordination effort with the Civil Code provisions, this act no longer provided the artisanal definition “*for any purpose of the law*”. In reference to the “mechanics”, it included the production of semi-finished products among the output of artisanal activity, and cancelled the requirement of ‘artistic production’ for a company to be considered artisan. Later on, laws no. 133/1997 and 57/2001 conceded that artisans could incorporate their workshops and activities in the form of limited liability companies, even with more than one shareholders.

However, partly because of the dissatisfaction of the business community, and partly out of a need to provide a higher degree of certainty in the interpretation of the law, law no. 35/2012 - which amended art. 2751 *bis* (5) of the Civil Code - specified that there is only one definition of ‘artisan’, and that is the definition set out in the special law (“*as defined according to the enforceable law*”).<sup>60</sup>

In other words, the recent legislator ignored the historic and economic reasons behind the choice of having two notions of ‘artisan’, and advocated for the adoption of a uniform, unified and rather wide definition based on a mechanic application of rigid criteria.

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<sup>56</sup> Eraldo c. Fall. soc. Ocn - PPI, C. Cass. no. 15785/2000, in *Giust. Civ. Mass.* 2000, 2598.

<sup>57</sup> This is the translation in English of the Italian text made by the author of the present note.

<sup>58</sup> Ditta Allibardi Salotti c. Fall. Gherardi, C. Cass. no. 456/1998, in *Giust. Civ. Mass.* 1998, 105.

<sup>59</sup> This is the translation in English of the Italian text made by the author of the present note.

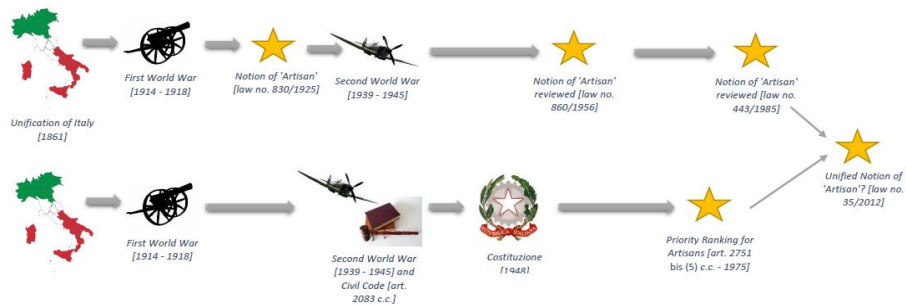
<sup>60</sup> This is the translation in English of the Italian text made by the author of the present note.

Law	Content
Law no. 830/1925	Notion of ‘artisan’ as self-employed craftsman; little mechanical help.
Civil Code (royal decree no. 262/1942)	Art. 2083: ‘artisans’ are small entrepreneurs, <i>if</i> personal work prevails over the work of the members of their families and over capital.
Constitution (1947/1948)	No definition of ‘artisan’.
Law no. 860/1956	‘Artisan’ defined for any purpose of the law as a self-employed entrepreneur <i>or</i> a company, which may produce goods <i>and</i> provide service while employing salaried workers and making use of mechanical tools.
Law no. 426/1975	Introduction of art. 2751 <i>bis</i> in the Civil Code. ‘Artisans’ (as defined by art. 2083 c.c.) are recognized a priority ranking among unsecured creditors in insolvency proceedings.
Law no. 443/1985	‘Artisans’ no longer defined for any purpose of the law, but definition is anchored to loose quantitative criteria and procedural requirements.
Laws no. 133/1997 and no. 57/2001	‘Artisans’ could enjoy the benefits of limited liability.
Law no. 35/2012	Amendment to art. 2751 <i>bis</i> (5) of the Civil Code: to identify artisans, it is necessary <i>and</i> sufficient to look at the criteria set out in the special legislation (e.g. law no. 443/1985 as subsequently amended).

To summarise:

- Until the enactment of the Civil Code, Italy only had a notion of artisan enterprise based on qualitative and quite stringent (for modern standards) quantitative criteria;
- The Civil Code and law no. 860/1956 introduced two autonomous notions of artisans, which were used in different contexts and for achieving separate goals. If an entrepreneur matched the requirements set out in the special law, he/she could claim the administrative and fiscal benefits recognized by its mean. Alternatively, if the requirements set out in the Civil Code were met, he/she could also claim the benefits reserved for small entrepreneurs;
- Law no. 426/1975 introduced the special treatment for those artisan entrepreneurs in insolvency, but only should those entrepreneurs match both the criteria set out in the Civil Code (art. 2083) *and* in the special law;

- Further amendments of the special notion of ‘artisan’ did not invalidate the widely accepted interpretation that priority in insolvency could be recognized only to those enterprises that matched the criteria set out both in the Civil Code and in the special legislation, to the general dissatisfaction of MSMEs (who advocated for relying only on the criteria set out in the special legislation, without reference to the qualitative requirements set out in art. 2083);
- The most recent legislator (law no. 35/2012) decided to unify those notions, and rely on a purely quantitative notion - the solution for which MSMEs had been advocating. Whilst the lower courts seem to have accepted the new legislative will<sup>61</sup>, the matter still has to be brought in front of the Supreme Court.



It is undeniable that quantitative criteria and procedural requirements have the merit to identify ‘artisan entrepreneurs’ *ex ante*, with a sufficient degree of certainty. However, it is equally indisputable that the category of creditors who fall within the revised legislative definition largely exceeds the purposes for which the priority ranking was introduced (and justified) back in 1975.

In addition, there is potential for abusive treatment in cross-border cases, since one of the requirements for the recognition of priority status is the company being listed in a separate section of the companies’ register. What if a company incorporated in another EU MS matches all the other substantive criteria, without being incorporated in Italy?<sup>62</sup>

<sup>61</sup> E. s.r.l. in liquid., Tribunale Ravenna 23 Dec. 2014, in *Redazione Giuffrè 2014*; equally Trib. Milano 14 June 2013 (unreported), available at: <<http://www.istitutoproform.org/fall/?p=34>> [last viewed 25 July 2016].

<sup>62</sup> This circumstance is in itself incompatible with freedom of establishment as provided by art. 49-52 TFEU.

To add a further degree of complexity, with the exception of some isolated cases<sup>63</sup> (backed by some commentators),<sup>64</sup> the Supreme Court<sup>65</sup> and the majority of lower courts<sup>66</sup> have been consistent in ruling that *only* those ‘artisan enterprises’ which possess both the qualitative criteria set out in the Civil Code (article 2083) and the quantitative criteria set out in the special legislation (law no. 443/1985) are entitled to the priority ranking.<sup>67</sup> It is still too early to determine if the 2012 amendment would result in a change of this consolidated jurisprudence.

This sub-section proved the existence of a significant mismatch between the creditors who (in the 1975 legislator’s mind) should have benefitted from the priority ranking, and those who are actually entitled to priority under current legislation.

The legislative choice to adopt a uniform notion of ‘artisan’ based on quantitative rather than qualitative criteria may work properly if the main concern is ‘certainty’ in the application of the law. However, it proves wanting for insolvency law purposes, where attention should be paid to other elements. It follows that the priority scheme as currently framed is a relatively blunt instrument, unable to carve out non-adjusting creditors, i.e. those who are unable to adjust the explicit or implicit lending terms to take into account the fact that the borrower has granted security on some or all its assets.<sup>68</sup>

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<sup>63</sup> Decreto Tribunale Milano 14 June 2013, Eredi di Frigerio Angelo di Leonardo Frigerio & C. S.n.c. c. Fall. Immobiliare Costruzioni IM.CO. S.p.a. (unreported), available at: <<http://www.ilcaso.it/giurisprudenza/archivio/9874.pdf>> [last viewed 14 June 2016]; App. Torino, 30 April 1986, in *Fall.*, 1987, 817; Eraldo c. Fall. soc. Ocn - PPI, C. Cass. no. 15785/2000 in *Giust. Civ. Mass.*, 2000, 2598; and Ditta Allibardi Salotti c. Fall. Gherardi, C. Cass. no. 456/1998, in *Fall.*, 1986, 915.

<sup>64</sup> G. Bozza and G. Schiavon, *L'Accertamento dei Crediti nel Fallimento e le Cause di Prelazione* (1992, Giuffrè, Milano), at 928.

<sup>65</sup> See among others F.lli Zanchetta S.n.c. c. S.V., C. Cass. no. 7116/2015, in *Diritto & Giustizia*, 10 April 2015; Soc. Battocchia Termo c. Fall. soc. Edil 200, C. Cass. SS.UU. no. 5685/2015, in *Giust. Civ. Mass. 2015*; Annapiù Tricot di Carrer Anna Maria & C. S.n.c. c. Fallimento Harold S.r.l., C. Cass. no. 11024/2013 (unreported). Similar conclusions were reached in older judgments, such as Fall. Deiani e altro c. Leonesio, C. Cass. no. 11963/1990, in *Giur. It.*, 1991, I(1), 1014; and Soc. De Benedetti c. Fall. soc. Rossi, C. Cass. no. 7366/1998, in *Giust. Civ. Mass.* 1998, 1603. Unfortunately, all these judgments refer to the law applicable before the 2012 amendments. In fact, despite some of them being given after the enforcement of the modifications, the Supreme Court clarified that the new version of art. 2751 *bis* (5) does not apply to insolvency procedures filed before 2012 (see Cass. SS.UU. no. 5685/2015, cited above in this note). As such, the Supreme Court has not yet had the opportunity to clarify whether the 2012 amendments modified the commonly accepted criteria for determining whether a company is an ‘artisan’ or not.

<sup>66</sup> Among others, see Trib. Udine, 11 June 1982 and 22 August 1983, in *Giur. Comm.*, 1984, II, 49; and Trib. Genova, 4 August 1982, *Banca Borsa Titoli di Credito*, 1983, II, 567.

<sup>67</sup> In other words, the prevailing opinion in the judiciary is that – for the purposes of art. 2751 *bis* (5) of the Civil Code – ‘artisans’ should be small entrepreneurs whose work (and that of the members of their family) prevails over the work of any other employee and on the assets (as per art. 2083 of the Civil Code). Additionally, their company should meet the criteria set out in law no. 443/1985.

<sup>68</sup> Finch, above note 41, at 652.

*The Empirical Study*

To determine the efficiency of the priority mechanism, a survey was undertaken on 1,193 liquidation procedures closed in the years 2013 and 2014 in seven districts within four Italian regions.

This study is entirely replicable. It is based upon reports and legal documents uploaded by IPs and judges on a privately-owned web platform called Fall.co. The use of this system - which has since been replaced by a state-owned, purposefully developed platform - was voluntary, even though those courts that relied on it, strongly encouraged IPs and civil servants to make use of it.

Apart from those district courts that did not rely on this informatics platform - and could not therefore be considered for the purposes of this study - the researcher did not include large districts (such as Bologna, Milan or Venice) in his sample. This was due to the number of procedures to analyse (which would have been overwhelming for a study carried out by a single person), and because the evidence otherwise obtained would have largely prevailed in number over that gathered from the other circuits. Geographical variety has been preferred to the analysis of a larger number of cases in order to counteract possible biases arising from local practices.

The research covers almost two years from proceedings closed in 2013 and up to July 2014. It was considered (and would have been preferable) to gather data from proceedings closed less recently, and compare the recent with the older findings. Unfortunately, the possibility was dismissed due to the impossibility of gathering such evidence.



**No. of liquidation procedures analysed: 1,193**

a) Closed for reasons unrelated with payment of creditors	54	(4.52%)
b) Closed for distribution of assets/money	450	(37.72%)
(of whom)		
• within 730 days (2 years)	11	2.44%
• between 730 and 1,825 days (2 to 5 years)	163	36.22%
• over 1,825 days (> 5 years)	276	61.34%
c) Closed for lack of assets/money	303	(25.39%)
(of whom)		
• within 730 days (2 years)	101	33.33%
• between 730 and 1,825 days (2 to 5 years)	136	44.88%
• over 1,825 days (> 5 years)	66	21.68%
d) Closed for full payment of creditors	4	(0.33%)
e) Unable to establish the reasons	382	(32.04%)
<u>No. of procedures sub (b), (c) and (d): 757 (63.45%)</u>		
▪ without artisan enterprises or similar creditors	475	(62.74%)
▪ with artisan enterprises or similar creditors	282	(37.26%)
Average recovery rate: <u>33.05%</u>		
□ full payment	84	(29.78%)
▪ within 730 days (2 years)	0	
▪ between 730 and 1,825 days (2 to 5 years)	20	23.8%
▪ over 1,825 days (> 5 years)	64	76.2%
□ no payment	169	(59.92%)
▪ within 730 days (2 years)	19	11.24%

▪ between 730 and 1,825 days (2 to 5 years)	84	49.7%
▪ over 1,825 days (> 5 years)	66	39.06%
▫ distr. rate between 0% and 50%	21	(7.44%)
▫ distr. rate above 50%	8	(2.86%)

At first glance, the results seem to vouch for the effectiveness of priority treatment. The experienced simple average recovery rate ('mean' value) for artisan enterprises was 33.05%.<sup>69</sup> In almost one out of three cases (29.78%), artisans received the full reimbursement of their claims from the insolvent estate. These values alone are remarkably higher than others experienced by MSMEs in other countries, where they are classified as unsecured creditors. In actual facts, they are similar to the recovery rate experienced by *secured* creditors in some EU MSs.<sup>70</sup>

Furthermore, existing law extends the priority status to the interests that accrued before the debtor filed the insolvency petition<sup>71</sup> and, should no payment or partial payment be made, Italian tax law recognizes the fiscal benefits to the creditor.

A closer analysis of the collected data, however, highlights mixed results. The most frequently occurring 'modal' values were either 0% (nihil) or 100% (integral) recovery, depending on the year and the district considered. In almost 2 out of 3 cases (59.92%), artisans received no payment at all at the end of the proceedings. Fiscal benefits are recognised only when the liquidation procedure has closed, and it is clear that no payment will be made for the benefit of the claimants. Taxes, such as income tax and VAT, need to be paid upfront - when the invoice is issued. As such, it is only after the end of the liquidation procedure (potentially lasting several years), that the creditor can claim back the amount paid. Furthermore, this rebate is recognized not in cash, but as a deduction from future duties.

<sup>69</sup> Despite being subject to great variability, this value is remarkable, especially if compared to the results of other studies (despite them being focused on the recovery rate of secured creditors). On the one hand, according to a recent study commissioned by the Bank of Italy among financial institutions, the average recovery rate in liquidation procedures in 2014 was 28%. However, this value refers mainly to *secured* claims - see Luisa Carpinelli et al., 'The Management of Nonperforming Loans: a Survey Among the Main Italian Banks' (2016) 311 *Questioni di Economia e Finanza* (Banca d'Italia, - also available at: <[https://www.bancaditalia.it/pubblicazioni/qef/2016-0311/QEF\\_311\\_16\\_ENG.pdf?language\\_id=1](https://www.bancaditalia.it/pubblicazioni/qef/2016-0311/QEF_311_16_ENG.pdf?language_id=1)> [last viewed 29 July 2016]). On the other, according to a World Bank Report on Italian creditors, *secured* creditors can count on a recovery rate of 63.1 cent per dollar - see "World Bank: 2015 Doing Business Report - Going Beyond Efficiency", available at: <<http://www.doingbusiness.org/data/exploretopics/resolving-insolvency#close>> [last viewed 29 July 2016]

<sup>70</sup> According to the World Bank Doing Business Report 2015 mentioned above, secured creditors in Croatia may expect a recovery rate of 30.5%, of 32.7% in Romania, and of 34.9% in Greece. These values are only fractionally higher than the average recovery rate of artisans in Italy who, despite the statutory priority, are still listed among unsecured creditors (and therefore are paid only in subordination to secured creditors).

<sup>71</sup> With a limit of up to 2 years - see art. 2749 of the Civil Code.

Length of procedures emerged as another problematic aspect. Evidence proves that the longer the duration of the procedure, the higher the return to the claimants. Only 2.44% of the cases analysed in the sample resulted in a partial or full distribution of proceeds within 2 years. The most recent available data shows (arguably because of the amendments introduced in August 2015)<sup>72</sup> that the average duration for formal<sup>73</sup> insolvency procedures concluded in 2015 fell to 7 years and 5 months,<sup>74</sup> down 8 months from 2014. These figures, however, refer to all insolvency proceedings (including rescue ones, which were not considered for the purposes of this study), and do highlight a wide geographical variance.<sup>75</sup> Additionally, unlike this study, these figures also do not make the vital distinction between the duration of insolvency proceeding leading to a substantial distribution to creditors, from those resulting in no distribution due to lack of available assets.

Qualitative interviews with entrepreneurs and practitioners, as well as case analysis and literature review, evidences further matters of concern. Artisan entrepreneurs have proven to rely more on quasi-immediate fiscal benefits (such as tax deductibility for write-offs) over recovery rates, since the latter are usually paid only at the conclusion of lengthy<sup>76</sup> and expensive<sup>77</sup> formal or hybrid insolvency proceedings.

To conclude, while the recovery rate of artisan entrepreneurs is comparably high, this value is far from consistent so artisans do not rely on it. Furthermore, the length of time required for any distribution to take place, as well as the existing tax policies, do little to prevent creditors falling into these same financial difficulties ultimately created by their defaulting debtors.

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<sup>72</sup> Law Decree No. 83/2015 published in Gazzetta Ufficiale No. 147 of 27 June 2015, turned into Law No. 132/2015 published in Gazzetta Ufficiale No. 192 of 20 August 2015.

<sup>73</sup> For the purpose of this abstract, the notion of “formal” insolvency proceedings also includes “hybrid” preventive restructuring procedures as defined in European Commission, Directorate-General for Economic and Financial Affairs, ‘The Economic Impact of Rescue and Recovery Frameworks’, Ref. Ares(2015)3579794, 31 August 2015.

<sup>74</sup> Available at: <<https://know.cerved.com/en/study-and-analysis/duration-bankruptcy-proceedings-concluded-2015-italy#>> [last viewed 16 June 2016].

<sup>75</sup> In the most ‘efficient’ circuits, insolvency procedures last on average between 3 and 4 years, while the slowest ones may take on average 15 years.

<sup>76</sup> According to a recent study from the Bank of Italy (available at: <<https://www.bancaditalia.it/publicazioni/note-stabilita/2015-0002/index.html>>, [last viewed 30 March 2016]), the average duration of a liquidation proceeding in Italy is more than 6 years, while the average length for a foreclosure proceeding exceeds 4 years. Other studies show an even bleaker picture, and conclude that in 2015 the average duration of Italian insolvency proceedings (formal and hybrid) was 7 years 5 months, while back in 2014 the average duration was in the region of 8 years and a half. See: <<https://know.cerved.com/en/study-and-analysis/duration-bankruptcy-proceedings-concluded-2015-italy#>>, [last viewed 16 June 2016].

<sup>77</sup> According to Italian insolvency law (Royal Decree No. 267/1942), creditors do not need legal assistance either to submit their claims or throughout the insolvency procedure. However, a lack of adequate expertise, as well as ongoing habits, results in entrepreneurs – especially running small and medium-sized enterprises – being heavily reliant on the expertise of insolvency lawyers and practitioners for conducting proceedings..

These dismal results negatively affect the efficiency and health of the credit system. According to the most recent data, Italian banks have over 350 billion euros in bad loans (18.1% of total loans), around 200 billion of these being categorised as NPLs.<sup>78</sup> Loans of the lowest category (“*sofferenze*”) amount to about 154 billion euros, which in turn represent 29.4% of all bank exposures with enterprises.

This section clarified that, back in 1975, certain craftsmen called ‘artisans’ were granted - for policy reason - a priority ranking among unsecured creditors, to give them a better chance of surviving the distress experienced by one or more of their debtors. The main reason underlying this decision was to grant an additional layer of protection in insolvency to those small entrepreneurs that were not substantially dissimilar to salaried workers. Accordingly, as the jurisprudence highlighted, until recently it was required that the entrepreneur generated his income mainly with his personal work, or with that of the members of his family.

While the judiciary tried to interpret the statutory priority in accordance with its policy goals (at least to a certain extent), successive amendments of the existing legislation broadened the scope of the exception. As a result, the statutory evolution of the notion of ‘artisan’ is inconsistent with the interpretation of the judiciary. Indeed, in combination with current insolvency practices, it has ultimately contributed to thwarting the effectiveness of the measure.

This is a fertile terrain for reform. But should this reform be imposed by the European Union, or simply facilitated? The following sections debate this issue.

### **Why Artisans Are (Still) Prioritized: Considerations for Not Repealing Statutory Priorities in Italy**

The results of the empirical study shed more light on the inadequacy of the current priority mechanism adopted by Italian insolvency law, in particular with reference to artisan entrepreneurs. As such, it is no surprise that various scholars, as well as international and regional organizations, have long advocated for the reduction or abolition of statutory priority ranking in insolvency due to their inefficiency. However, recent reforms and Parliamentary debates, would demonstrate there is little political appetite for abolishing or curtailing these priorities in insolvency law. This section tries to explain the possible reasons, at least with reference to the priority treatment of artisans, and subsequently hints at why full harmonization of insolvency practice at the EU level might be a bad idea.

The first aspect to be investigated is the relation between statutory laws enacted by the Parliament and Italy’s fundamental law, the Constitution.

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<sup>78</sup> John Willcock, ‘First the Brexit Vote - now the Italian Banks’ (July 2016) 198 *Global Turnaround*, at 6; Banca d’Italia, *Financial Stability Report 1/2016* (29 April 2016) - available at: <[https://www.bancaditalia.it/pubblicazioni/rapporto-stabilita/2016-1/en-FSR-1-2016.pdf?language\\_id=1](https://www.bancaditalia.it/pubblicazioni/rapporto-stabilita/2016-1/en-FSR-1-2016.pdf?language_id=1)> [last viewed 29 July 2016].

While the priority ranking in insolvency for artisans was introduced only by means of law no. 426/1975, the Italian Constitution mentions artisans in two different articles (even if in one case only indirectly). These mentions are particularly surprising given it is a relatively short piece of legislation with only 139 articles, which are very broad in scope.

Article 35(1) clarifies that “*The Republic protects work in all its forms and practices*”. Artisanal practice is included in this notion of “work”, as clarified by the case law.<sup>79</sup> Furthermore, pursuant to article 45(2) “*The Law safeguards and promotes artisanal work*” (emphasis added).<sup>80</sup>

These articles are not sufficient to claim that the statutory priority for artisan entrepreneurs enjoys a “constitutional” protection. Nevertheless, it is undeniable that the legislation which has introduced this mechanism into the Civil Code has aimed to transplant mandate specified by article 45(2) of the Constitution.

Furthermore, the choice to introduce this priority ranking by means of an amendment to the existing Civil Code should not be underestimated. The Civil Code, despite its lack of hierarchical prominence over other statutes, is remarkably more prestigious than any other statutory mechanism.

Finally, the Constitutional Court has proven very resilient in allowing the legislator to amend the “rights” of Italian citizens. For instance, it took the government three attempts<sup>81</sup> to establish a “solidarity contribution” on retirement benefits exceeding the threshold of € 90,000 per month. If the Constitutional Court considered that the priority ranking of artisan entrepreneurs is needed to safeguard and promote artisanal work, its repeal might prove problematic. In truth, this is a remote and unlikely hypothesis, but there are precedents and a legal basis for it being advocated in a courtroom.

The second aspect to be considered is the relevance role that micro-enterprises and, in particular, artisan enterprises play in the current economy. In the case of artisans, there are also political considerations closely linked to sustaining the economic relevance of this category of entrepreneur.

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<sup>79</sup> Adriano Patti, *I Privilegi* (2003, Giuffrè, Milano), at 201. The belief that priority treatments granted by means of art. 2751 *bis* of the Civil Code represent the enforcement of the constitutional principle according to which ‘work in every forms and practices’ needs to be protected, is supported by the prevailing jurisprudence (see the judgment no. 1/2000 rendered by the Constitutional Court).

<sup>80</sup> This is the translation in English of the Italian text made by the author of the present note. Article 45 in particular entrusts the legislator to define the statutory measures to not only protect, but also promote the development of artisanal work. This attention to this typology of enterprise has, for some authors, resulted in “*iper-regulation*” – P.F. Lotito, ‘Commentary to Art. 35 of the Italian Constitution’ in R. Bifulco et al (eds), *La Costituzione Italiana* (2007, Strenna Utet, Milano) at 927.

<sup>81</sup> The first attempt (law no. 111/2011) was quashed by the ruling no. 116/2013 in the case B.G. et al c. Inps et al. (*Giurisprudenza Costituzionale*, 2013, 3, 1886). The second attempt (art. 1(1), law no. 214/2011) was successfully challenged in C.G. et al c. Pres. Cons., C. Cost, no. 70/2015, in *Foro Amministrativo* 2015, 4, 1004.

According to the most recent available data<sup>82</sup> (that refer to the situation *as per* 31 December 2013), micro-enterprises (i.e. with less than 10 people employed) represent 95.3% of active enterprises, 47.45% of number of persons employed, and constitute 25.85% of total turnover generated by companies in the country. Among these micro-enterprises, there are 2.4 million employing only one person, which contribute a third of the global turnover generated by this class.

Small and medium enterprises (i.e. 10-249 people employed) provide work to 32.88% of the total labour force and account for 43.18% to turnover, while larger enterprises (i.e. 250+ employees) grant a workplace to 19.7% of the workforce, and account for almost 31.0% of the global turnover.

Size Classes	No. of Enterprises	%	No. of Persons Employed	%	Turnover (ml €)	%
0-9	4,094,444	95.27	7,518,178	47.45	762,497	25.85
10-19	127,998	2.97	1,679,039	10.6	316,186	10.72
20-49	50,760	1.19	1,510,447	9.53	343,315	11.64
<b>Total (1)</b>	<b>4,273,202</b>	<b>99.43</b>	<b>10,707,664</b>	<b>67.58</b>	<b>1,421,998</b>	<b>48.21</b>
50-249	20,897	0.49	2,021,059	12.75	614,279	20.82
250+	3,383	0.08	3,116,677	19.67	913,555	30.97
<b>Total (1+2)</b>	<b>4,297,482</b>	<b>100</b>	<b>15,845,400</b>	<b>100</b>	<b>2,949,832</b>	<b>100</b>

In summation, companies up to 49 employees - which are, for the largest part, potentially eligible under current legislation to be classified as “artisan enterprises” - represent 99.43% of Italian companies, despite employing “only” 67.58% of the workforce and contributing less than half of global business turnover.

These represent quite remarkable numbers, while not dissimilar to those experienced in other jurisdictions.<sup>83</sup> Nevertheless, it is the role that these companies play in the society and their constitutional prominence, which push the Italian legislator to continue to recognize their priority within insolvency law.

Given the potential issues posed by uncontrolled variables, it is difficult to accept the results of this study at face value. This is because is not possible to measure *every variable* capable of hindering a change in the current practice. However, the results

<sup>82</sup> *Report on the Structure and Competitiveness of the Industrial and Services Enterprises*, available at: <<http://www.istat.it/en/archive/175960>> [last viewed 20 July 2016].

<sup>83</sup> According to the Department for Business, Innovation & Skills’ study on *Business Population Estimates for the UK and Regions 2015*, small businesses accounted for 99.3% of all private sector businesses at the start of 2015, and 99.9% were small or medium sized (MSMEs). Available at: <[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/467443/bpe\\_2015\\_statistical\\_release.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/467443/bpe_2015_statistical_release.pdf)> [last viewed 20 July 2016]. Similar data was collected by EUROSTAT with reference to other countries within the European Union - available at: <<http://ec.europa.eu/eurostat/web/structural-business-statistics/structural-business-statistics/sme>> [last viewed: 20 July 2016].

should not be uncritically rejected merely for a lack of precise correspondence with the law-in-action.

While legislative reform within “*certain areas of insolvency law where harmonization is worthwhile and achievable*”<sup>84</sup> can be welcomed, any proposal should also carefully consider shortcomings and limitations in order not to foster over-reaching expectations.<sup>85</sup> A European, top-down Regulation may fall short of achieving this balance.

The Commission and the Directorate-General for Justice launched a consultation on the best approaches to improve the *status quo*.<sup>86</sup> Respondents highlighted at least three possible options,<sup>87</sup> with the preferred choice varying depending on the main respondent group.<sup>88</sup> It was not surprising to observe that MSs and banks advocated for a more cautious approach, arguing that reform of national insolvency frameworks should be a more long-term project.

The evidence collected in this study, along with the observations in the following sections, suggest that full harmonization of certain substantive provisions (e.g. ranking of creditors) may do more harm than good, especially if conceived in a vacuum. The same Directorate-General Justice & Consumers of the European Commission recognizes that full harmonization

“is ambitious given the interplay with other national policy objectives, values and national traditions. *If feasible* (emphasis added), it would inevitably be a project for the long term”.<sup>89</sup>

While the time may not be ripe for full harmonization of insolvency practices (and creditors’ ranking systems), a minimum harmonization Directive may represent an appropriate instrument to foster the establishment of an efficient internal market, and adequately incentivize national legislators to level out their insolvency systems.

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<sup>84</sup> EP Resolution PT\_TA (2011) 0484, *sub C*.

<sup>85</sup> In particular, it might prove challenging to conceive of a harmonized insolvency system capable of, *inter alia*, “*maximiz[ing] the total value [of the distressed firm] to creditors, employees, owners and the economy as a whole*” – EC COM(2014) 1500, *sub (1)*.

<sup>86</sup> Green Paper on a Capital Markets Union COM (2015) 63, in particular question 29.

<sup>87</sup> Directorate-General Justice & Consumers of the European Commission, *Inception Impact Assessment*, available at: <[http://ec.europa.eu/justice/civil/files/insolvency/impact\\_assessment\\_en.pdf](http://ec.europa.eu/justice/civil/files/insolvency/impact_assessment_en.pdf)> [last viewed 29 July 2016], at 6. As mentioned above in note 16, options include: (a) a minimum harmonisation Directive focusing on specific aspects of insolvency; (b) a full harmonization instrument covering the main insolvency procedures in detail, and (c) a 29<sup>th</sup> regime sitting alongside national insolvency regimes into which creditors could opt.

<sup>88</sup> Respondents in favour of option (a) included: banks, pension funds and other financial intermediaries; MSs. Respondents in favour of option (b) included: central banks and capital markets regulators, as well as labour unions. Meanwhile option (c) was advocated by one central bank. Business associations showed more divided opinions both on the impact of differing national insolvency regimes and on the form of possible actions to tackle those differences, while representatives of the MSMEs appreciate improvements in the efficiency and effectiveness of IPs and the courts. Feedback Statement on the Green Paper “Building a Capital Markets Union” (Question 29), SWD(2015) 184 final, at 59.

<sup>89</sup> Directorate-General Justice & Consumers of the European Commission, above note 87, at 6.

The following section explains why a Directive may be preferable to a 29<sup>th</sup> elective insolvency regime, and explores in greater details the possible content of this legislative instrument, and the benefits expected by its implementation.

### **A Way Forward**

While the previous section outlined the reasons against the implementation of a full harmonization Regulation, the EU legislator may well opt for the enactment of a non-binding substantive set of rules, following the UNCITRAL Model Law on Cross-Border Insolvency pattern. This section, however, demonstrates why it is preferable, at least at this stage, for the EU legislator not to depart from the well-established practice of the incremental and minimum harmonization approach.

On the one hand, establishing a 29<sup>th</sup> comprehensive and eligible insolvency regime would require extensive and lengthy work from the European administrative bodies, with the involvement of experts from several jurisdictions. Moreover, given its elective nature, it may also result in scarce application unless MSs can incentivize their businesses to opt-in.<sup>90</sup> Furthermore, during the consultation of the Green Paper “Building a Capital Markets Union” only one respondent advocated this method. Finally, should the MS fail to implement the mechanism in the time prescribed, the provision could end up not be used in cases between private parties (incidental horizontal effects).<sup>91</sup>

On the other, despite the unsatisfactory remarks of the EU Commissioner for Justice,<sup>92</sup> recent regional and international<sup>93</sup> documents have succeeded in putting pressure on the Italian government to set up a study commission<sup>94</sup> aimed at conceiving a systemic reform of its substantive insolvency law. Similar results have been achieved in other MSs. This proves that soft-law measures - or, at least,

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<sup>90</sup> An alternative solution may consist in the automatic application of the system unless a company opts out. However, such a solution would hardly be accepted by MSs, and would impinge the rights of existing creditors.

<sup>91</sup> This doctrine was created in cases such as *CIA Security International SA v Signalson SA* (Case C-194/94) [1996] ECR I-2201, and *Unilever Italia SpA v Central Food SpA* (Case C-443/98) [2000] ECR I-7535, where the ECJ - while not departing from the *Marshall/Dori* rulings - concluded that Directives can, even in actions between private parties, exclude the enforcement of inconsistent national law.

<sup>92</sup> Above note 24.

<sup>93</sup> The Commission’s paperwork expressly refers to the UNCITRAL Model Law on Cross-Border Insolvency (1997), its Guide to Enactment and Interpretation (2013), as well as to the UNCITRAL Legislative Guides on Insolvency Law (2004, 2010 and 2013).

<sup>94</sup> The Commission was set up by means of a Decree of the Ministry of Justice, dated 28 January 2015. It is commonly known as “Rordorf Commission” by the name of its president, a judge in the Italian Supreme Court. The official name of the Commission is “*Commissione per elaborare proposte di interventi di riforma, ricognizione e riordino della disciplina delle procedure concorsuali*”. More details available at: <[http://www.fallimentiesocieta.it/sites/default/files/Riforma\\_DirFall.pdf](http://www.fallimentiesocieta.it/sites/default/files/Riforma_DirFall.pdf)> [last viewed 26 July 2016].



measures binding merely with reference to their purposes, such as Directives - may equally well promote substantive changes within the current legislation.<sup>95</sup>

This section consequently advocates for complimenting the 2014 Recommendation with a draft Directive. It suggests the inclusion of specific goals in its recital, and it analyses the supportive role that the CJEU could play to promote reform in Italy (and, similarly, in other MSs). It also describes how Italian legislation should (and could) change to meet the recommended aims.

#### *The “Carrot”: Soft-Law Measures*

Italian authorities have undertaken successive reforms of the insolvency and enforcement framework in recent years.<sup>96</sup> What has always been lacking in these attempts is a “global view”: there have only been piecemeal and fragmentary amendments to the existing statutory framework, which dates back to the Second World War.<sup>97</sup> However, these reforms have primarily been driven by non-binding recommendations.

More recently however, on 10<sup>th</sup> February 2016 the Council of Ministers adopted a draft statutory instrument to reform the Italian insolvency framework from the grounds up. A detailed analysis of the content of this proposal, which has already been amended during the Parliamentary debate in the Justice Commission,<sup>98</sup> would fall outside the scope of this study. Nevertheless, it is appropriate to say that this proposal, if enacted, would represent the first, global and systemic attempt to reform of insolvency law since the enactment of the current legislation.

It is proper to qualify this as merely a proposal for delegated legislation. Only once the draft instrument is approved by the Parliament, and published in the *Official Gazette*, the Government and the Ministry of Justice will have the authority to amend the current legislation. The Government will then have another twelve months to issue one or more law decrees, which have to conform to the requirements and directions set out in the statutory instrument passed by the Parliament. It is their enactment that will determine a change in the applicable law.

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<sup>95</sup> According to the report attached to the draft legislation proposal currently debated in the Parliament, the “zero option” - that is leaving things as they are, without amending the existing legislation - is unfeasible, due to the “strong recommendations” made at the EU and international level.

<sup>96</sup> For a summary, see José Garrido, *IMF Working Paper on Insolvency and Enforcement Reforms in Italy*, WP/16/134, at 7 - available at: <<https://www.imf.org/external/pubs/ft/wp/2016/wp16134.pdf>> [last viewed 29 July 2016]. The Author notes that “[t]he frequent and sudden modifications of the law have, however, come at a cost of undermining legal certainty”, at 8.

<sup>97</sup> Royal Decree no. 262/1942 and Civil Code (1942).

<sup>98</sup> At the moment, there are two versions of the original proposal for delegated legislation: (i) (C-3671 *bis* - available at: <[http://www.camera.it/\\_dati/leg17/lavori/stampati/pdf/17PDL0041360.pdf](http://www.camera.it/_dati/leg17/lavori/stampati/pdf/17PDL0041360.pdf)> [last viewed 26 July 2016]) which deals with the main body of the reform; (ii) (C-3671 *ter* - available at: <[http://www.camera.it/\\_dati/leg17/lavori/stampati/pdf/17PDL0041370.pdf](http://www.camera.it/_dati/leg17/lavori/stampati/pdf/17PDL0041370.pdf)> [last viewed 26 July 2017]) which amends the discipline of a rescue procedure for large corporations only.

However, the delegation is binding only with reference to the content of the reform. In other words, the Government is not forced to issue those law decrees, and the delegation may expire without any amendment being introduced - which in itself, is not a remote possibility. Furthermore, if the delegated legislation is approved by mid-2017, it is unlikely that the law decrees could be issued before mid-2018 - the exact period in which the next general elections are set to take place.

Despite being in the preliminary stages of debate, this proposal is worth close consideration. In fact, this call for reform has been justified not only by “conventional” reasons, such as: the need to reduce inconsistencies between old and more recent provisions; reduce administrative burdens, or streamline judicial practice. In the explanatory documents attached to the draft bill, the Italian Ministry of Justice had also justified the measure with reference to the urgency of implementing a system of best practices and recommendations emerged at the international and regional/European level.

With reference to the creditors’ priorities within insolvency law, the technical report attached to the draft proposal recognises that the discipline is extremely indented, obsolete and antiquated. Both the government (by means of the report of the Ministry of Justice) and the members of the Commission have advocated for the need for a complete overhaul of the discipline.<sup>99</sup> However, the bold call for reform included in the technical report is contradicted by the rather limited scope of the amendment proposals, which are focused mainly on pledges (or “*privilegio retentivo*” in Italian) and other related institutes, e.g. “*patto commissorio*”.<sup>100</sup>

#### *The “Stick”: CJEU Jurisprudence and EU Draft Directive*

Up to now the proposal for delegated legislation represents one of the most remarkable accomplishments stemming from the EU and international calls for reform. However, additional elements may also reinforce the persuasiveness of existing recommendations. For instance, at the EU level, the Court of Justice of the European Union (hereinafter, CJEU) may act as a powerful arrow in the EU’s bow. In fact, cross-border cases in the European Union are regulated under the Insolvency

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<sup>99</sup> C-3671 bis - available at: <[http://www.camera.it/\\_dati/leg17/lavori/stampati/pdf/17PDL0041360.pdf](http://www.camera.it/_dati/leg17/lavori/stampati/pdf/17PDL0041360.pdf)> at 17 [last viewed 26 July 2016].

<sup>100</sup> The “*patto commissorio*” is an agreement in which the creditor is guaranteed against the non-fulfilment of a debt obligation by the collateral security of goods owned by the debtor. Should the debtor fail in its (pecuniary) obligation, the creditor would become the sole owner of the mortgaged or pledged good. The nullity of such an agreement (and of any agreement which results in similar outcomes) is stated in articles 1963 and 2744 of the Civil Code. The Rordorf Commission advocated for recognizing the validity of these agreements, upon the implementation of certain safeguards. However, back in 2016, the Italian legislator eased the limits on the so-called “*Martian pact*” - a contractual provision named after the classic Roman lawyer *Martian* and substantially similar to the “*patto commissorio*”. It allows the creditor to seize the collateral or force a sale, on the provision that he/she compensated the debtor for any excess value of the collateral once the loan is satisfied (art. 2 law no. 119/2016, which determines the transferral of the rights *in rem* on an immovable property when the missed payment of three or more monthly instalments lasts for nine months or more).

Regulation<sup>101</sup> (soon to be replaced by the Recast Regulation)<sup>102</sup> with the authority to adjudicate cases arising from the application of these legislative instruments held by the CJEU.

Under the (modified) universalist approach, which underlies both these legislative instruments, cross-border cases are handled within only one jurisdiction (i.e. where the centre of main interest of the debtor is located); the *lex forum* (procedural and substantive) is applied to all creditors, irrespective of their nationality. However, whenever assets are located in more than one jurisdiction, local creditors may ask to open secondary proceedings,<sup>103</sup> in which the *lex loci forum*<sup>104</sup> is applied (but only with reference to the assets located in that jurisdiction). This strategy is highly attractive for local prioritized creditors, where they do not enjoy the same level of priority in the COMI MS, provided that there are sufficient unencumbered assets in the secondary jurisdiction.<sup>105</sup>

The Recast Regulation provides some mechanisms to restrict the opening of secondary proceedings,<sup>106</sup> and one of the pillars of the Treaties is that claimants should be treated equally, irrespective of their nationality.<sup>107</sup> Accordingly, given the opportunity, it is likely the CJEU would dismiss and render inapplicable any national law ascribing priority status to national litigants. Indeed, this is precisely what the current Italian insolvency law does, since the priority ranking is granted only if the artisan is listed in a separate section of the Italian Companies' House.<sup>108</sup>

Such a ruling would put additional pressure on the Italian legislator to reform the existing rules on creditors' priority ranking within insolvency legislation.

Another arrow in EU's bow is the legislative instrument that the Commission is due to pass by the end of 2016. Should it be a Directive with the goal of achieving minimum standards across MSs' insolvency laws, such an instrument would fit perfectly within the context described above.

In my opinion, the Recital of this legislative instrument should stress the need to “*remove obstacles in national legislations to the functioning of efficient cross-border practices in insolvency law*”. Accordingly, the CJEU could appraise whether the existing legislation meets the requirements of proportionality, adequacy and

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<sup>101</sup> Regulation (EU) 1346/2000.

<sup>102</sup> Regulation (EU) 2015/848, which will enter into force in July 2017.

<sup>103</sup> Art. 34 of Regulation (EU) 2015/848.

<sup>104</sup> Art. 35 of Regulation (EU) 2015/848.

<sup>105</sup> Sometimes, courts and IPs of the main proceeding “recognize” priorities of secondary jurisdictions to avoid the costs and delays that would occur from them. See *Re Collins and Aikman* [2006] EWHC 1343.

<sup>106</sup> Art. 38(2) and 36 of Regulation (EU) 2015/848.

<sup>107</sup> This is the so called ‘freedom of establishment’, art. 49 to 52 TFEU.

<sup>108</sup> Art. 5 of Law no. 443/1985.

effective judicial protection, as is conceived<sup>109</sup> for the purpose of evaluating the appropriateness of state responses to breaches of EU law.

If these changes happen in the near future, the reform of these statutory priorities within Italian insolvency law, and possibly the systemic harmonization of insolvency practice, may become a reality.

*“Italian law 2.0”*

What would Italian insolvency law look like, if the sticks and the carrot described above occur in the near future?

This paper restricts this speculative exercise to the creditors’ ranking in insolvency. It starts from the assumption that, whenever beneficiaries are sufficiently restricted in number - which is not the case of ‘artisan entrepreneurs’ as described by law no. 443/1985 - the legislator may have to consider establishing a priority ranking in insolvency law. Otherwise alternative mechanisms would need to be considered.

Any new rule on the subject should omit any reference to national procedural requirements for the benefit to be granted, such as the company being listed in a special section of the Companies’ House register. Furthermore, it is also necessary to come up with a statute that singles out only those highly non-adjusting creditors that might be severely affected by the debtor’s lack of repayment.

If the Italian legislator wanted to restrict the priority treatment to those small<sup>110</sup> artisans who find themselves in a situation substantially similar to that of unskilled salaried workers, it could rephrase art. 2751 *bis* (5) of the Civil Code<sup>111</sup> as follows:

*“Hanno privilegio generale sui mobili i crediti riguardanti: [...] (5) i crediti dell’artigiano (...) che esercita un’attività professionale con il lavoro proprio e dei componenti della famiglia, per i corrispettivi dei servizi prestati e della vendita dei manufatti.”*

“A general privilege on movable property is granted to credits relating to [...] claims of an artisan (...) who engages professionally in an activity organized mainly with his/her own work and that of the members of their families, for the compensation of services rendered and the sale of manufactured products.”

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<sup>109</sup> See *EC v Kingdom of the Netherlands* (Case C-508/10) [2012] 2 C.M.L.R. 48, where the Court held that by levying excessive and disproportionate administrative charges on third-country nationals and their family members seeking residence permits under Directive 2003/109, the Netherlands had failed to fulfil its obligations under that Directive. See also *Sagulo, Brenca and Bakhouché* (Case C-8/77) [1977] ECR 1495, where the Court ruled that, while states were entitled to impose reasonable penalties for infringements of administrative requirements governing EU residence permits for migrant workers, the penalties must not be *disproportionate* to the offence in question, and must not constitute an obstacle to freedom of movement.

<sup>110</sup> According to the European standards set out in the EU Recommendation 2003/361.

<sup>111</sup> The Rordorf Commission advocated for grouping the insolvency discipline into only one piece of legislation, outside the Civil Code. Nevertheless, this provision can easily be accommodated within this yet-to-be-drafted bill.

This study also demonstrated that, whenever a priority rule is introduced, it should be sufficiently flexible to allow both judiciary and practitioners to exercise adequate discretion in its implementation. The more detailed the criteria set out in the law, the more mechanic its application, the less likely the goal is achieved.

As a result, the Italian legislator may explore the opportunity of introducing in its insolvency framework a provision similar to 11 U.S. Code §.105(a), according that:

*“L’autorità giudiziaria competente può adottare ogni ordinanza, decreto o sentenza che appaia necessario o appropriato per implementare le disposizioni [della presente legge].”<sup>112</sup>*

“The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions [of this law].”

Since similar solutions have been enacted in other countries,<sup>113</sup> the Italian government may explore adopting the same approach with its domestic insolvency law. However, this approach to reform presents some shortcomings, which are detailed and debated in the following section.

### **The Limits of the Study, and their Impact on the Recommendations of this Article**

As it happens with similar empirical studies, this report and its conclusions are open to criticism.

A few limitations of the data set should be noted. These include the geographical distribution of the cases, and the timeframe of the study. Another characteristic is that it is focused only on liquidation cases (“*fallimenti*”). Reported recovery rate to artisans are even lower in alternative rescue procedures, such as pre-bankruptcy agreements (“*concordato preventivo*”),<sup>114</sup> given that rescue procedures may not (and usually do not) end with a distribution to creditors. More importantly for data-collection purposes, statistics for these proceedings were not collected on Fall.co or on other digital platforms at the time of the study.

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<sup>112</sup> This is the translation in Italian of the English text made by the author of the present note.

<sup>113</sup> Pursuant to Art. 132 (1) of the South Korean Debtor Rehabilitation and Bankruptcy Act 2005, in a rehabilitation procedure, “[w]hen a small- and medium-sized businessman who is a transaction partner of the debtor is feared to face hardship in the continuation of his/her business unless he/she receives the payment of a small-sum claim that he/she holds, the court may grant permission to pay back the whole or part of such small-sum claim to him/her upon receiving an application filed by any custodian, any preservative custodian or the debtor even before it decides to authorize a confirmation of a rehabilitation plan” - official English translation provided by the South Korean Ministry of Government Legislation. Available at: <<http://www.moleg.go.kr/english/korLawEng?pstSeq=52645>> [last viewed 21 June 2016].

<sup>114</sup> See ‘Analisi dell’Impatto della Regolamentazione (AIR)’, in a proposal for delegated legislation C-3671 *ter* - available at: <[http://www.camera.it/\\_dati/leg17/lavori/stampati/pdf/17PDL0041370.pdf](http://www.camera.it/_dati/leg17/lavori/stampati/pdf/17PDL0041370.pdf)> [last viewed 26 July 2017], at 40.

Another limit is the size of the sample. Data was gathered for only 1,193 liquidation proceedings *closed* over a period of 18 months, compared to the 14,269 companies that *filed* for liquidation in 2013 alone.<sup>115</sup> As such, it represents only a marginal portion of the liquidation procedures closed in Italy in the considered timeframe.

Finally, it was not possible to cross-reference the digital documents uploaded on Fall.co with the archived papers.<sup>116</sup> Liquidation booklets are archived in separate buildings from the main courthouse, sometimes not even in the same city or region. Consultation of these documents is therefore highly problematic and time-consuming. It would also require the constant assistance of a member of the archive, during a period in which courthouses are seriously undermanned.

Nevertheless, the lack of cross-referencing should not be as problematic as it seems. Many of the documents consulted on Fall.co are computer scans of papers and reports signed by the judge responsible for the case. Therefore, it is unlikely that any of the official documents uploaded have been replaced without any reference being posted on the database. On the other hand, the consultation of paper archives would have allowed for data to be gathered on those proceedings where there was no or insufficient information was available on Fall.co.

Although some of the attacks are well aimed, on the whole they miss the target, since there is no evidence that radically different results could be observed under alternative scenarios.

As for the notional conclusions, this paper has already acknowledged the lack of theoretical justification for statutory priorities in insolvency law, especially with reference to MSMEs. The purpose of this note has been to adopt a pragmatic approach to existing problems, rather than theoretically debating the advantages of certain solutions over sub-optimal ones.

Furthermore, harmonization practices - and not priority ranking for creditors - were the subject of this paper. With regard to that, it might be argued that it is methodologically flawed to draw EU-wide conclusions from an analysis of national practices. However, it seems to me that, while players and interests may vary from country to country, the mechanics of politics are similar throughout the world, not simply in Europe. In other words, the onus is on those who disagree with the conclusions of this study to demonstrate that any of the alternative solutions envisaged by the EU (full harmonization Regulation or an autonomous set of rules) would work better in current times and under present circumstances in other MSs.

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<sup>115</sup> Unfortunately, these figures are no longer provided by the National Institute of Statistics, but only by privately-owned companies. See: <<https://www.cribis.com/news/fallimenti-in-italia-2013-anno-record-54-al-giorno-2-ogni-ora/>> [last viewed 16 June 2016].

<sup>116</sup> In accordance with Italian law, paper documents duly signed and notified to all the parties are the only ones with legal value.

While it may be argued that the results achieved with the 2014 Recommendation are relatively minor, significant changes do not happen overnight, and two years is a relatively short time in politics.

A policy of implemental and pragmatic changes within national legislations has always characterized the EU harmonization process, and has resulted in remarkable achievements. Despite its limitations, incremental integration has brought us thus far; so is it right to overlook these achievements?

### **Conclusion**

This study highlighted some of the fundamental challenges that the European legislator faces in its approximation efforts, particularly when the subject of this effort is creditors' ranking in insolvency law.

On the one hand, there are various efficiency arguments advocating for the substantive harmonization of insolvency law at EU level, alongside large theoretical support for abolishing statutory priorities within insolvency law. While on the other, there are opposing considerations (i.e. respect of fundamental, constitutional provisions, as well as deference to prevalent domestic business culture) that call for the adoption of a more pragmatic approach.

Reforms at national level may be 'directed' by the European Commission without the need for embracing a top-down and all-encompassing harmonization approach. The CJEU could then act as a last resort mechanism, should soft-law recommendations and hard-law Directives be ignored. In other words, should the carrot prove ineffective, there is always the stick.

As a result, this paper suggests that, in current times, the 'minimum standard approach' represents the optimal way of proceeding to harmonize insolvency practice in the European Union.