

INTERNATIONAL AND COMPARATIVE CORPORATE INSOLVENCY LAW

Parmalat: Comity or Tragedy

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Cultural Considerations

Workout Cultures

Workout Cultures

	US	Italy
Rescue Culture	✓	✓ (recent)
Dedicated Court and Judges	✓	
Lender Sophistication	High	Low
Government Influence	Low	High
Stigma of Insolvency		✓
Application of Precedent	✓	
Use of Advisors	✓	✓
Payment of Creditors' Advisors Fees	✓	Varies

Italy

Overview of Insolvency Laws



- **Significant Reforms between 2003 - 2006**
- **Several types of insolvency procedures**
- **Composition with Creditors and Extraordinary Administration provide for reorganization**
- **Extraordinary Administration unique among European laws because allows for restructuring of a corporate group**
- **Restructuring of a large company can be a highly political process**
- **Limited creditor committee involvement**
- **Director liability possible where new debts are incurred while insolvent**

Parmalat – Case Study



■ Origins

- Small, family-owned dairy business started in Parma, Italy in the 1960s
- Developed long-life milk, expanded into other products (juices, baked goods, water) and expanded geographically
- 1990 listed on the Milan Stock Exchange
- By 2003, global food empire with operations in 30 countries, and employed > 35,000 people

■ Big Trouble in Little Parma

- 2003 financial analysts question Parmalat's high levels of debt, while showing showing significant (\$5bn) cash on its balance sheet
- December 2003 couldn't come up with \$150mm note payment
- December 24, 2003 Parmalat commences Extraordinary Administration proceedings in Italy
- Enrico Bondi appointed as Extraordinary Commissioner

Parmalat – Case Study



- **Unraveling the Financial Scandal**
 - **Complicated system of bond and derivative transactions to transfer amounts between different subsidiaries (or to Tanzi family)**
 - **Masked fraud from auditors since the late 1980s.**
 - **\$5bn in cash supposedly held at subsidiary (Bonlat) in a Bank of America account – account was forged by Parmalat!**
 - **\$10bn hole in balance sheet**
 - **Bondi commences numerous suits and clawback actions against financial institutions/auditors who may have been involved in the fraud**

Parmalat – Case Study



- **Parmalat's Insolvency Case**
 - Existing Italian insolvency law grossly inadequate to deal with large company restructuring
 - New laws and procedures implemented and modified on an ad hoc basis
 - Scale of Parmalat crisis had Italian political implications that often outweighed other considerations
 - No legal or cultural precedent for significant involvement by creditors
 - No meaningful access to information
 - Extraordinary Commissioner given dictatorial powers

Parmalat – Case Study



- **Italy always has been a difficult and opaque jurisdiction for restructurings**
 - **Multiple bilateral bank facilities, rather than single syndicated facility**
 - **Very lengthy process**
 - **Little experience with international note/bond issuances**
 - **No culture of paying creditors' professionals fees**
 - **Politics always an issue**
- **Hope was that Parmalat would be different due to international visibility and exposure**
 - **Inadequate laws and court system**
- **Parmalat was different in some ways, especially speed, but overall the Italian system is still inadequate by international standards**
 - **Emphasized role of Minister & Administrator rather than court**
 - **Substantial documentation required to file claims with Italian court**
 - **Original “blue ink” notes and guarantees had to be submitted to Italian court**
 - **No meaningful creditor input**

Parmalat – Case Study



Parmalat Claims Filing Fiasco

- Administrator raised numerous objections to mainly “plain vanilla” notes and guarantees governed by US law:
 - initials on pages look “different” than signatory’s normal initials
 - illegible and uncertified signatures
 - notes signed by attorneys-in-fact, but face of notes do not conclusively demonstrate signatory’s qualifications as attorney-in-fact
 - date of signing notes and guarantees not certified according to Italian law
- Poor communication from Italian court and Parmalat regarding restructuring timeline, claims filing procedures, voting procedures and plan distributions
- Some creditors were able to take advantage of an old provision of the Italian civil code (now abolished) permitting them to assert claims against parent company for claims of subsidiaries during period when parent was sole shareholder of subsidiary (another bite at the apple) – still hung up in litigation

Parmalat – Case Study



■ **Parmalat's Restructuring Plan**

- **While US noteholders were steamrolled in US and Italy, Bondi pushed his restructuring plan forward in Italy**
- **Plan proposed swapping EUR 14bn of net debt (EUR 25bn when including guarantee claims and intracompany debt) into equity of reorganized Parmalat**
- **Creditors' claims compromised based on asset/liability ratio of Parmalat contract counterparty**
- **Restructuring Plan approved by creditors in September 2005**
- **Relisted on the Milan Stock Exchange in October 2005**

Parmalat – Case Study



Outcome

- Parmalat completed a debt-to-equity swap and emerged from reorganization in under 2 years, much faster than prior law
- Shape of restructured Parmalat driven more by politics than economics
- International “black eye” for Italian financings, BUT
- After 6-month hiatus, US private placement noteholders invested in Italy again, with no significant risk premium (although some investors refuse in Italy)

Italy

Insolvency Law Reforms



- **Historically, Italian insolvency law favored the rights of debtors over the rights of creditors. However, the 2005 Reforms and 2006 Reforms tilt some of the balance toward creditors**
- **Several insolvency law reforms enacted in March 2005:**
 - **Claw-back provisions: made more creditor friendly by shortening look-back periods, requiring certain criteria to be met before transactions can be voided, and providing certain exemptions**
 - **Composition with Creditors (*concordato preventivo*) proceedings created for Parmalat now extend to all companies (regardless of size), including provisions emphasizing role of administrator over courts**
 - **New procedure for court ratification of restructuring agreements**

Italy

Liquidation



- **Bankruptcy (*fallimento*) is a court controlled proceeding aimed at liquidating an insolvent debtor and distributing the assets to creditors**
- **Company may be deemed insolvent when it is unable to pay debts as they become due**
- **Liquidation petition may be filed by creditors, the company, the public prosecutor or the court on its own motion**
- **Upon court's bankruptcy declaration, business typically ceases and assets are liquidated**
 - **Possible to continue business for short period of time to maximize value for creditors**
- **Judge, nominated to supervise the bankruptcy, appoints a trustee to collect and distribute debtor's assets**
- **2006 Reform: reduced role for the judge and increased role for creditors**
 - **Judge focuses on supervising the proceeding, controlling the trustee, verifying creditors' claims and appointing a creditors' committee**
 - **Trustee will continue to manage the bankruptcy assets, and will need to prepare a liquidation plan, analyze whether to bring claw-back and recovery actions**
 - **Creditors' committee, comprised of three or five "representative" creditors, will be appointed by the Judge and will have to approve main acts of the trustee and may request that the court replace the trustee**

Italy - *Concordato Preventivo*

Composition with Creditors



- To avoid a bankruptcy proceeding, a debtor may propose a composition with its creditors providing for full payment of secured creditors and a partial payment of unsecureds (typically around 40%)
- No requirement of “insolvency”; only a state of “crisis” (not defined)
- Debtors have many more options to restructure debt, including:
 - Assignment of assets to assignor (e.g., creditors, SPV, etc.)
 - Debt-for-equity swaps
- Composition may provide for separate classification of creditors and different treatment to different classes
- Composition requires approval from creditors representing the majority of claims admitted to vote and from the court
- Cramdown possible: court may approve composition over the dissent of one or more classes provided that a majority of classes approve plan and dissenting classes receive no less than under other possible alternatives
- Once ratified by the court, the composition is binding on all creditors; if composition is not approved, debtor declared bankrupt and is liquidated

Italy

Extraordinary Administration



- Reorganization procedure used to save large insolvent companies with more than 200 employees and aggregate debts exceeding two-thirds of its net assets and two-thirds of its revenue for the prior year
- Petition may be filed by the company, a creditor, the public prosecutor or by the court on its own motion
- Company not admitted into extraordinary administration until court declares the company insolvent (i.e., delayed admission)
- Allows several companies within a corporate group (including companies with no Italian dealings) to be administered in a joint procedurally consolidated proceeding
- 1999 legislation emphasized the role of courts over administrative offices
- Court can appoint up to 3 commissioners upon finding reorganization preferable to liquidation
- Court can terminate restructuring efforts if futile and liquidation is appropriate
- Commissioner has 60 days to present a plan

Italy - Extraordinary Administration Marzano Decree (Parmalat amendments)

- ***Marzano Decree* was adopted in response to Parmalat's insolvency to address some flaws in "traditional" extraordinary administration ("EA") proceedings**
- **Applies to insolvent companies with at least 500 employees and debts of at least Euro 300 million**
- ***Marzano Decree* emphasizes the role of the Minister and extraordinary commissioner, rather than the courts (commissioner w/ substantial powers)**
- **Company files a request with the Minister of Productive Activities for admission to EA procedure and simultaneously files insolvency petition with court**
- **If eligibility conditions are met, Minister will immediately admit company into EA and appoint one extraordinary commissioner**
- **Ordinary EA laws apply, unless otherwise provided by *Marzano Decree***
- **Commissioner has 180 days to present (1) plan to Minister and (2) insolvency report, statement of assets and list of creditors to delegate judge**
 - **One 90-day extension available for submission of plan**
- **If Minister does not authorize plan, court shall convert EA procedure to liquidation**

Italy - Extraordinary Administration Marzano Decree (cont.)



- Plan can provide for satisfaction of claims through a *concordata* proposal (integral part of restructuring plan)
 - There can be a consolidated composition proposal for group companies in EA proceedings, but their respective assets and liabilities must be dealt with separately
- 60-day period to challenge (1) creditors on list of creditors, or (2) exclusion from list of creditors
 - At end of 60-day period, judge finalizes list of creditors and classifies claims as admitted, conditionally admitted or excluded
 - Creditors can challenge the classification of their claims as conditional or excluded by commencing lawsuit (costly, lengthy process)
- Holders of admitted and conditional claims can vote; composition approved if passed by a majority of claims admitted to vote
- Cramdown: if majority of classes approve plan and dissenting classes receive no less than they would under other possible alternatives

Italy

Restructuring Agreements



- **March 2005 reforms introduced new procedures for court ratification of restructuring agreements**
- **Company may file petition for court ratification of a restructuring agreement if:**
 - **Creditors holding 60% of the debtor's total liabilities approve the agreement, and**
 - **Expert's report is submitted certifying feasibility of agreement and debtor's ability to pay in full those creditors not a party to the agreement**
- **Restructuring agreement not binding on creditors who are not party to the agreement**
- **Transactions and payments made pursuant to a ratified agreement are not subject to claw back and voidance actions if debtor subsequently declared bankrupt**
 - **Encourages court-sanctioned restructuring agreements because creditors can minimize claw back/voidance concerns if agreement receives blessing of court**
 - **Previously, little incentive to enter into restructuring agreements because of the real possibility of later being subject to claw back and voidance actions**

Italy

Claw-Back Actions



- **March 2005 reforms substantially revised claw-back rules to make them more creditor friendly (look-back periods cut in half)**
- **Trustee may void gratuitous transactions made at any time within the 2 year period before the insolvency law filing.**
- **Unless transferee proves it was not aware of debtor's insolvency at time of transaction, trustee may void the following within 1 year of insolvency declaration: (1) transactions not conducted on arm's-length terms, (2) payments made with consideration other than cash, and (3) security granted for pre-existing debts that were not due and payable at the time of the security grant**
- **If trustee proves that transferee was aware of debtor's insolvency at time of transaction, trustee may void "ordinary course" transactions within 6 months of insolvency declaration**
- **Exemptions from claw back rules: (1) payment of goods and services made in ordinary course of business, (2) transactions authorized by approved *concordata preventivo* or court-sanctioned restructuring agreement, (3) salary payments, and (4) payments to a bank account that do not reduce indebtedness to the bank**