INSOL INTERNATIONAL

When Liquidation is NOT an Option: A Global Study on the Treatment of Local Public Entities in Distress

November 2022

ACADEMIC PAPER

CONTENTS

ISBN: 978-1-907764-33-2

Published November 2022

Local public entities in distress – a critical analysis of the Italian approach

By Rolandino Guidotti*

1. General context of insolvency law

1.1 The Bankruptcy Law

Italian bankruptcy law (in its current form) dates back to 1942. Currently, Italy's bankruptcy law is contained in Royal Decree number 267 of 16 March 1942 (Bankruptcy Law).

The goal of the bankruptcy procedure under Italian law is merely to liquidate a company's assets (bankruptcy is a liquidation and compulsory winding-up procedure). The main objective of bankruptcy is to protect the rights of creditors and to maximise their returns rather than to facilitate individual ordinary enforcement proceedings.

Since 2005, the original provisions of the Bakruptcy Law have been significantly altered to facilitate the restructuring of distressed but viable entities. In particular, the post - 2005 rules improved the procedures known as arrangement or composition with creditors, the structures of which are inspired by the United States Bankruptcy Code's Chapter 11 procedure. Both of these procedures seek to allow business continuity.

Italy's bankruptcy framework, as amended in 2005,[1] 2006,[2] and 2007,[3] thus contains many elements of discontinuity when compared to the earlier, original Bakruptcy Law (from 1942).[4] Furthermore, it is worth discussing the introduction of the arrangement with creditors in the business continuity procedure[5] that took place in 2012,[6] alongside the new rules that mean that debtors can file a petition for an arrangement (a so-called "blank" or "incomplete" petition) whilst reserving the right to lodge a proposal and a plan at a later stage.[7]

In 2015 the Bakruptcy Law was amended to revise the provisions on arrangements with creditors, due to some concerns regarding the abusive use of these mechanisms. That year marked the introduction of new eligibility requirements to utilise arrangements with creditors based on liquidation. Currently, in order to utilise a procedure in accordance

* Associate Professor of Law, University of Bologna – Alma Mater Studiorum (Italy).

1 By Decree no 35 of 14 March 2005, transposed into Law no 80 of 14 May 2015.

2 By Legislative Decree no 5 of 9 January 2006.

3 By Legislative Decree no 169 of 12 September 2007.

4 The term "bankruptcy law" is used with reference to Royal Decree no 267 of 16 March 1942, if not otherwise specified.

5 Bankruptcy Law, art 186(2).

6 Decree no 83 of 22 June 2012, transposed into Law no 134 of 7 August 2012.

7 Bankruptcy Law, art 161(6).

with the Bakruptcy Law, a debtor must guarantee that it can repay 100% of its senior / preferential debts and 20% of its unsecured debts.[8]

At present, ailing companies can choose between a wide variety of procedures to liquidate or turn around their businesses. These include, *inter alia*:

(a) extrajudicial settlements with creditors;[9]

(b) certified restructuring plans;[10]

(c) debt restructuring agreements[11] (under the Italian system, agricultural enterprises may not be subject to the same bankruptcy or other insolvency procedures as those that apply to commercial entrepreneurs.[12] There is however an exception regarding debt restructuring agreements,[13] as agricultural entrepreneurs may access over-indebtedness procedures, dictated by Law number 3 of 27 January 2012, that are applicable to entities that are not subject to bankruptcy);

(d) debt restructuring agreements involving financial entities;[14]

(e) agreements with tax authorities (tax settlements);[15]

(f) arrangements with creditors in both models, based on liquidation and with business continuity;[16]

(g) extraordinary administrations for large undertakings in a state of insolvency;[17]

---

8 Creditors are given the right to submit competing plans and competing bids, and such proposals overlap those already lodged by a debtor. Competing plans and competing bids envisage the possibility of modifying a debtor's proposal, in and this case, competition regarding the arrangement with creditors procedure is facilitated by the possibility of modifying a debtor's proposal. These two instruments (competing plans and competing bids) differ in nature and, after their introduction in 2015, were maintained in the new Business Crisis and Insolvency Code, which entered into force on 15 July 2022. This code contains the rules of the arrangement (composition) with creditors procedure, which is a procedure (the most important one) through which a crisis situation can be overcome. The two instruments (competing plans and competing bids) both increase the complexity of the arrangement with creditors procedure and extend its duration. On this topic, see R Guidotti, "Arrangement with Creditors, Competing Plans and Competing Bids", *International Company and Commercial Law Review* (2021) 32(2) at 80.

9 Bankruptcy Law, art 67, para 3, letter (d).

10 *Ibid*.

11 *Idem*, art 182(2).

12 Civil Code, art 2221.

13 Decree Law no 98 of 6 July 2011, art 23, para 43; transposed by Law no 111 of 15 July 2011.

14 Bankruptcy Law, art 182(7).

15 *Idem*, art 182(3).

16 *Idem*, arts 160 *ff*.

17 Legislative Decree no 270 of 8 July 1999.

(h) bankruptcy; and[18]

(i) enforced judicial liquidations.[19]

Some of these procedures can be considered formal insolvency procedures according to the definition adopted by the European Union (EU).

1.2 The new Business Crisis and Insolvency Code

On 11 October 2017, the Italian Parliament approved Law number 155 (published in the Official Journal of the Italian Republic on 19 October 2017), which delegated the Italian Government as the legislator for a global reform covering business crises and insolvency.[20]

Law number 155/2017 was produced from work by the Rordorf Commission, which was established by the Minister of Justice. The reform is known as the Rorford Reform, as it was named after the President of the Rordorf Commission, Renato Rordorf.

The legislation that delegated the authority to reform Italy's insolvency law to the Government (Law number 155/2017) allows the Government to create new legislation that: (i) gives priority to proposals intended to overcome financial crises and guarantee business continuity, even by means of a different entrepreneur, as long a proposal ensures that creditors' interests are upheld maximally, or (ii) concerns judicial winding-up, which should replace the bankruptcy procedure[21] as a last resort mechanism.

Following the implementation of Law number 155/2017, Legislative Decree number 14 of 12 January 2019 introduced a new Business Crisis and Insolvency Code (the New Code) into Italy's insolvency law framework. It includes a complex reform that is aimed at considering insolvency procedures in terms of a procedure aimed at preserving the value of distressed enterprises, rather than from a liquidation or sanctioning perspective.

Almost all of the new rules came into force on 15 July 2022. Therefore, two different systems concerning business crises will co-exist in Italy for some time. The criterion

---

18 Bankruptcy Law, arts 1 *ff*.

19 *Idem*, arts 194 *ff*.

20 On this topic, see F Pasquariello, "Italian Bankruptcy Code moving Towards a Reform Era", *Il diritto fallimentare e delle società commerciali* (2016) II at 347; and A Benocci, "Reforming Italian Insolvency Law: Bankruptcy vs. Judicial Liquidation", *European Business Law Review*, (2018) 29(2) at 291.

21 The term bankruptcy describes liquidation proceedings, which can be invoked by a large number of creditors, including companies. The reason for using this term rather than liquidation is because it is used under current Italian law with reference to liquidation proceedings. Bankruptcies can be declared by both individuals and companies (or, rather, natural persons, legal persons or other entities that may be subject to bankruptcy whilst carrying out commercial activity). However, it is acknowledged that in most other jurisdictions the term bankruptcy refers to liquidation proceedings involving individuals. The Italian term *fallimento* cannot be directly translated using the English notions of insolvency or insolvency procedure, as *fallimento* is based on different eligibility criteria and specific characteristics.

adopted by the transitional rules envisaged by the New Code[22] is the filing date. All petitions filed after 15 July 2022 will be subject to the New Code; but petitions filed prior to this date will be subject to the Bakruptcy Law, as amended in recent years.

1.3 The negotiated crisis settlement procedure

Decree number 118 of 24 August 2021 – converted into Law number 147 of 21 October 2021 – introduces an entirely new process for distressed enterprises known as the negotiated crisis settlement procedure.[23] This new settlement procedure aligns with EU Directive number 1023/2019.[24] This new regime is suggested as an option for any business that finds itself in a situation of distress, but is able to continue carrying on its business either directly or indirectly.[25] Direct continuity is characterised by entrepreneurs personally continuing to run their businesses, and indirect continuity involves business being managed or their activities being continued by entities other than the debtors themselves.

The negotiated crisis settlement procedure is an extrajudicial procedure that is confidential and may only be initiated voluntary. It aims to allow the recovery of insolvent entities or entities in distress that have "the potential to remain a going concern, including through the sale of [its] business or a branch of it".[26]

A debtor may request the appointment of an independent expert – a third party selected by an *ad hoc* committee organised by the local Chamber of Commerce. An independent expert is asked to examine any restructuring plan submitted by the company to which they are appointed and facilitate the relationship between that company, its creditors, and any other interested parties. Once a suitable solution for overcoming a debtor's crisis has been identified, the parties may, alternatively, enter into a contract or follow one of the proceedings regulated by the law.

If the expert considers that there are no actual prospects for recovery, he may, at any time, promptly notify the relevant Chamber of Commerce and put an end to the negotiated crisis settlement process.

---

22 New Code, art 390.

23 R Guidotti, "La crisi d'impresa nell'era Draghi: la composizione negoziata e il concordato semplificato", *ristrutturazioniaziendali.ilcaso.it* (8 September 2021) available here.

24 In this regard, see G McCormack, *The European Restructuring Directive* (Edward Elgar Publishing, Cheltenham, 2021); and C G Paulus and R Dammann (eds), *European Preventive Restructuring – Article by Article Commentary* (Beck / Hart / Nomos, Munich, 2021).

25 See R Guidotti, "La composizione negoziata e la direttiva Insolvency: prime note", *dirittodellacrisi.it* (2 February 2022) available here; S Bonfatti and R Guidotti (eds), *Il ruolo dell'esperto nella composizione negoziata per la soluzione della crisi dell'impresa* (Giappichelli Editore, Turin, 2022); and M Irrera, S A Cerrato and F Pasquariello (eds), *La crisi d'impresa e le nuove misure di risanamento* (Zanichelli Editore, Bologna, 2022).

26 See the Explanatory Report to the Decree.

The rules came into force on 15 November 2021 and apply to all businesses or companies registered by a chamber of commerce in Italy.

1.4 Over-indebtedness procedures

In Italy, the over-indebtedness procedures, dictated by Law number 3 of 27 January 2012, which apply to entities not subject to bankruptcy, were recently modified by Law number 176 of 18 December 2020.[27] It should be noted that this law does not apply to local public entities (LPEs) in distress, neither directly nor indirectly, in the absence of rules that permit its application to LPEs.

2. Local public entities

2.1 General definition

In the Italian legal system, there is no unitary definition of public entity, and there are no definitive regulatory parameters through which to establish one. The idea of achieving a clear definition may be somewhat utopian, given that the public sphere has developed extremely varied organisational models in recent years.[28]

This aspect is further complicated by the trend in recent decades toward merging legal forms. This may explain why, on the one hand, public entities use many private law instruments whilst, on the other hand, private entities are increasingly becoming public.[29]

The only certainty in the definition of public entities concerns LPEs, which are clearly identified by an express regulatory provision. Article 2 of Legislative Decree number 267 of 18 August 2000 (TUEL)[30] defines the scope of LPEs, establishing that, for the purposes of the decree, "municipalities", "metropolitan cities", "mountain communities", "island communities" and "unions of municipalities" are to be classified as local entities. The above rule is a specification of article 114 of the Constitution of the Italian Republic[31] according to which:

---

27 M Ranieli, "Requisito soggettivo per l'accesso alle procedure e presupposti di ammissione", in M Irrera, S A Cerrato and F Pasquariello (eds), *La nuova disciplina del sovraindebitamento* (Zanicheeli Editore, Bologna, 2021) at 38, and 47-48.

28 See V Cerulli Irelli, ""Ente pubblico": problemi di identificazione e disciplina applicabile", in *Scritti in onore di Alberto Predieri I*, (Giuffré, Milan, 1996) at 504; G Rossi, "Ente pubblico", in *Enc Giur Treccani XII*, (Treccani Editore, Rome, 1989) at 19; and L E Fiorani, "Società "pubbliche" e fallimento", *Giur comm* (2012) I at 536.

29 S Cimini, "L'attualità della nozione di ente pubblico", *federalismi.it* (2015) 24 at 6; F Fimmanò and M Coppola, "Sovraindebitamento ed enti pubblici. Spunti di riflessione", *Diritto fallimentare e delle società commerciali* (2018) 87; and F T Banfi, *Lezioni di diritto pubblico dell'economia* (Giappichelli Editore, Turin, 2016) at 189 *ff*.

30 *Testo Unico delle leggi sull'ordinamento degli enti locali* (also known in Italy by its abbreviation, TUEL).

31 "Consortia in which local bodies participate" may also be classified as local authorities, with the exception of those that manage economic and entrepreneurial activities. See G C De Martin, "Enti pubblici territoriali", in *Digesto - Discipline pubblicistiche* (Giappichelli Editore, Turin, 2011) in this regard.

> "[t]he Republic shall be composed of municipalities, provinces, metropolitan cities, regions and the State. Municipalities, provinces, metropolitan cities and regions shall be autonomous entities having their own statutes, powers and functions in accordance with the principles laid down in the Constitution."[32]

The mission of LPEs, as stated by the law, is to represent the community that it oversees, protect its interests, and promote its development. The greatest difficulties concern non-territorial entities for which there is no direct classification in law.

However, the regions are not technically local entities, as they represent both the regulatory power and the legislative power.

The greatest difficulties in classification arise with regard to non-territorial entities for which no publicity qualification has been stated by the legislator. To address these problems, scholars have developed multiple theories, namely the:[33]

(i) theory of purpose, which involves verifying the pursuit of a purpose of State;

(ii) theory of *imperium,* which involves verifying the existence of authoritative powers conferred on these entities in question by the State;

(iii) service relationship theory, which verifies the existence of a particular organisational relationship with the State;

(iv) control theory, which verifies any control by the State; and

(v) theory of financing, which investigates whether or not funding is provided by the State budget.

In order to distinguish between public and private entities, courts have typically adopted a quantitative criterion to identify the public elements of the rules applicable to the body being assessed.[34]

2.2 The mission of local public entities

LPEs have purposes established by law and, more specifically, by the TUEL.[35] For instance, the purpose of an LPE is to represent its community, protect the community's interests,

[32] Rome shall be the capital of the Republic, and its status shall be regulated by State Law. Also see Civil Code, art 11.
[33] G Rossi, *Gli enti pubblici* (Zanichelli Editore, Bologna, 1991) at 259 *ff*.
[34] F Pantaleo Gabrieli, "Indici rivelatori del carattere pubblico degli enti", *Foro it* (1940) II at 184.
[35] TUEL, art 3.

and promote the community's development. These entities have their own functions and those conferred on it by the State or regional law.

The TUEL permits the establishment of a consortium between LPEs, also known as municipalities.[36] In this regard it is of interest to examine a judgment of the Turin Court of Appeal,[37] where the court confirmed the principle that a consortium may be subjected to extraordinary administration proceedings for large undertakings in a state of insolvency[38] insofar as it is a commercial entrepreneur. However, the adoption of a procedure must not cause the adopting body's structure to be altered from a private association model, and the activity actually carried out by the entity must predominantly take place on the free market.

3. Dealing with local public entities in distress – the legal framework

3.1 Principles and framework

The rules relevant to the insolvencies of LPEs are contained in the TUEL, which (transposing the rules contained in the previous Legislative Decree number 504 of 1992) envisages *ad hoc* recovery procedures for LPEs.[39]

A range of remedies has been established based on the severity of the situation affecting an entity's economic and financial management.

TUEL regulates entities in financial difficulty.[40] Financial distress[41] can only be declared by a distressed local authority. This opposes the condition of "guided failure", which can be ascertained by the regional section of the Court of Auditors and by a prefect. Should an LPE declare itself in a situation of financial distress, a municipal public entity will take the initiative with a resolution adopted by the Council of the LPE.[42]

Pursuant to TUEL,[43] a state of financial distress occurs if (i) an entity cannot guarantee the fulfilment of its necessary functions and services, or (ii) the liquid and collectable credits claimed by third parties from the entity cannot be paid in the ordinary course of business. It should be noted that in order to declare a municipality to be in financial distress, these two conditions may be independent of each other, as there is no need for them to exist simultaneously.[44]

---

36 *Idem*, art 31.
37 Turin Court of Appeal, 15 February 2010, in *Società* (2010) 643.
38 See para 1.1 above in this regard.
39 These procedures were not envisaged by the original Royal Decree no 383 of 1934 (*Testo Unico della legge comunale e provinciale*)
40 TUEL, art 244.
41 *Dissesto* in Italian.
42 TUEL, art 246.
43 *Idem*, art 244(1).
44 Rome Administrative Court no 32825 of 14 October 2010.

It should be noted that TUEL dictates that the rules on the rehabilitation of local entities apply only to municipalities and provinces.[45]

Note that the notion of insolvency[46] applicable to traditional bankruptcy proceedings is almost identical to financial distress. The chief difference between the two notions relates to the requirement of it being impossible for an entity to carry out its essential functions and services in order to be considered in financial distress. Additionally, the first part of the definition of financial distress[47] is different to insolvency, as the requirement of not being able to fulfil essential functions and services does not apply to general enterprises.

This highlights, on the one hand, the indispensable functions and services performed by LPEs and, on the other, the specific aspects of these entities in undergoing insolvency proceedings. This is not merely limited to the payment of creditors, like other debtors, but involves guaranteeing the continuity of its services and functions.[48]

3.2 Financial distress *versus* bankruptcy

It must be clarified that the financial distress procedure[49] is not a bankruptcy procedure such as bankruptcy[50] and arrangement with creditors.[51] It is only on a *prima facie* basis that it seems possible to identify therein the principles of bankruptcy proceedings. The financial distress procedure applicable to LPEs is a completely original and different procedure from those outlined in the Bakruptcy Law.

According to article 246 of TUEL, a financial distress resolution is adopted by the Council of an LPE[52] after the causes that led to the failure are evaluated. Such a resolution cannot

45 *Idem*, art 244(2).

46 Bankruptcy Law, art 5 provides that: "[a]n enterprise that finds itself in [a] state of insolvency is declared bankrupt. A state of insolvency occurs through non-fulfilment or through other external facts [that] demonstrate that [a] debtor is no longer capable of duly fulfilling its obligations".

47 TUEL, art 244.

48 Case law provides that school assistance services cannot be considered indispensable for the purposes of declaring the state of collapse referred to in art 244 of TUEL, given that Ministerial Decree 28 May 1993 only considers primary and secondary education services to be indispensable, involving the provision of what is necessary for school attendance to students. Alternatively, the related school assistance services involve providing what is deemed most appropriate to guarantee greater convenience in using the same school despite not being indispensable for educational purposes (Latina Regional Administrative Court, no 239 of 12 February 2005).

49 TUEL, art 244.

50 Bankruptcy Law, art 9. Bankruptcy is declared by courts to be based in the location where an enterprise has its head office.

51 *Idem*, art 161. An application for admission to the arrangement with creditors procedure is submitted in the form of a petition signed by a debtor to a court based in the location in which the enterprise has its head office.

52 *Consiglio dell'ente locale*.

be revoked,[53] and a detailed report by the economic and financial auditing body that analyses the causes that determined the distress must be attached to it.

The entities involved in a recovery procedure are the extraordinary liquidation body[54] and the institutional bodies of a distressed entity.[55] Each of them has clearly identified tasks, duties, and obligations in the procedure. The extraordinary liquidation body settles existing debts by using the insolvency assets[56] by the means permitted by law. The institutional bodies of a distressed entity guarantee the stabilisation of a debtor's financial conditions by removing the structural causes that led to its distress. Subsequently, the extraordinary liquidation body restructures the institutional body, which continues to carry out the tasks and functions it is obliged to perform by law.

An extraordinary liquidation body may attempt to settle a distressed entity's debts by liquidating the entity's assets that are subject to the insovlency procedure, and acquiring and managing an entity's available finances to attempt a recovery.[57]

The financial distress procedure applicable to local entities shares many characteristics with "traditional" insolvency procedures. For both, a debtor or its representative will have to ascertain the creditors' claims and liquidate the assets to pay the creditors. Additionally, for both, an automatic stay on enforcement actions will be enforced to promote a collective procedure.

The plan for paying liabilities becomes enforceable upon being filed at the Ministry of the Interior. When filing a plan, the extraordinary liquidation body requests authorisation to obtain a loan in the amount necessary to finance the liabilities.[58] Within 30 days from a loan disbursement, the extraordinary liquidation body makes advance payments in equal proportion for all of the liabilities included in a plan. A plan assumes that all creditors will be paid in full, even if those payments are deferred over time.[59]

3.3 Financial crisis

With regard to the possibility of rescuing local entities and thus restructuring their debt, there are "crisis" procedures that do not always anticipate an entity's insolvency, but sometimes preclude it. It would, therefore, be incorrect to consider that there is no

---

53 In contrast to Bankruptcy Law, art 18, which provides that an appeal against the bankruptcy order may be made by the debtor and by any interested party in a petition to be filed at the Court of Appeal within a period of 30 days.

54 *Organo straordinario di liquidazione*.

55 *Organi istituzionali dell'ente*.

56 *Massa passiva*.

57 TUEL, art 252(4).

58 *Idem*, art 256.

59 On this topic, see *ex pluribus*, L D'Orazio and L Monteferrante (eds), *Procedure concorsuali e diritto pubblico. Insolvenza, imprese pubbliche, contratti pubblici, titoli autorizzatori* (Giuffré, Milan, 2017) at 184 *ff*.

connection and no common pre-alarm situation between the two situations: the less serious "crisis" and the more serious distress situation.

TUEL provides the technical notion of local authorities in conditions of "crisis".[60] These procedures of "pre-distress" are essentially the (i) "guided crisis" (*dissesto guidato*) referred to in Legislative Decree number 149 of 2011, and (ii) multi-year financial rebalancing procedure (*procedura di riequilibrio finanziario pluriennale*) according to Decree Law number 174 of 2012, which was converted into Law number 213 of 2012.[61]

The most important innovation is the simplified procedure under TUEL,[62] which introduced a process similar to that of the arrangement with creditors. During this simplified procedure, the extraordinary liquidation body has the power to settle an entity's credit claims by offering a payment of between 40% and 60% of the entire debt.

3.4 Functions and aims of the legislative frameworks

The procedures that may be utilised by distressed LPEs have been developed to allow protection to the creditors of the entities that use them. They are also crucial for guaranteeing business continuity despite an entity facing a financial crisis, as the imbalances in economic and financial conditions that caused the crisis must not lead to the forced closure of the entity's business.

A declaration of distress[63] leads to a fracture between the past and the future. However, it does allow LPEs to continue free from debt, though also devoid of credits and assets (if they have been sold for liquidation purposes). All of this is explained by considering the utility of protecting local entities, together with the fact that they cannot cease to exist as they are not indispensable, unlike standard companies.

Finally, it should be noted that the discussed legislation aims to allow entities to overcome insolvency issues. In order to fulfil its aim, the legislation is able to influence the rights of creditors (albeit with some limitations), which creditors, following the declaration of insolvency, will be unable to lodge individual enforcement actions to make judicially-ascertained claims.

In short, it can be said that the legislation and the consequent necessary recovery procedure aimed at financial normalisation pursue the dual purpose of:

(i) guaranteeing the general interest in continuing the functions of the entity utilising the procedure, ensuring that essential services are still provided; and

60 TUEL, arts 242 and 243.
61 *Idem*, arts 243(2)-(4).
62 *Idem*, art 258.
63 *Idem*, art 246.

(ii) protecting creditors by satisfying their claims in compliance with the principle of *par condicio creditorum*, subject to the prohibition on individual enforcement actions.[64]

3.5 Automatic stay

TUEL regulates the consequences of a declaration of distress.[65] From the date of a declaration of distress and until a report made in alignment with TUEL (the management report of the extraordinary liquidation body) is approved,[66] no executive actions can be taken or continued against a declaring entity for debts falling under the remit of the extraordinary liquidation body.

This prohibition has been the subject of some fundamental decisions of the European Court of Human Rights[67] concerning the problem of non-payment (or, more specifically, the excessive delay in payment of debts by local authorities in a state of financial distress). In the cases mentioned in the footnotes, the applicants claimed that the state of financial instability declared by the local entity (the municipality of Benevento) in 1993 prevented the execution of their claims ascertained by a final judgment which claims were, therefore, characterised as certain, liquid and collectable. The European Court of Human Rights ruled that the right to a fair trial is compromised if the legal system of a EU member state allows that a final and enforceable judgment cannot be executed to the detriment of an unsuccessful party, as the execution of a conviction ruling pronounced by a court is an integral part of the judicial process.[68]

3.6 Powers of creditors and jurisdiction

As discussed above, the extraordinary liquidation body carries out the financial distress procedure of LPEs. Creditors are not separated into classes, as the procedure aims to facilitate the full payment of an entity's liabilities.[69] This means that creditors do not need to vote on a restructuring plan, as they are not impaired by the procedure. A cramdown mechanism may only be utilised in a simplified procedure.[70]

---

64 This dual purpose, which is inherent in the rules on the financial recovery of municipalities and provinces, has been recognised since the 1990s in a judgment by the Constitutional Court (no 155 of 21 April 1994). Also see Constitutional Court no 269 of 17 July 1998. The Judge highlighted that the ultimate aim of the entire procedure is to return the institution to a position in which it is able to fulfil its institutional functions in a situation of financial equilibrium.

65 TUEL, art 248.

66 *Idem*, art 256.

67 See the "twin" cases of the European Court of Human Rights, *De Luca v Italy* (app no 43870/2004) and *Pennino v Italy* (app no 43892/2004) of 24 September 2013, with comment by L Mercati, "Il dissesto degli enti locali dinanzi alla Corte europea dei diritti umani", *Giur it* (2014) at 373.

68 The European Court of Human Rights specifically stated that the financial needs of the public administration could not justify a serious compromise of the right to have its claims recognised if they derive from a final judgment. In fact, the requirements of a fair trial concern both the assessment phase and the execution phase.

69 TUEL, art 256(5).

70 *Idem*, art 258.

As discussed, the bodies involved in a financial distress procedure are essentially administrative and not jurisdictional. A court is not in charge of the proceedings for LPEs in distress. In particular, the appointment of an extraordinary liquidation body is ordered by a decree of the President of the Republic at the proposal of the Ministry of the Interior. Despite an entity's rescue, the parties responsible for its distress can still be held accountable for damages to the Treasury. Any disputes regarding the interpretation and practical application of the provisions of the TUEL are referred to administrative courts.

3.7 Parties

With regard to the distress procedure affecting LPEs, the extraordinary liquidation body appointed by decree of the President of the Republic will present a repayment plan for approval by the Ministry of the Interior, through which the situation that created the bankruptcy can be removed.

With regard to "crisis" procedures, it should be noted that a resolution to appeal the multi-year financial rebalancing procedure must be sent, within a short period from the date of execution, to the competent regional section of the Court of Auditors and to the Ministry of the Interior.

Within 10 days from the date of the resolution indicated by TUEL,[71] a multi-year financial rebalancing plan must be sent to a competent regional control section of the Court of Auditors and the commission identified in article 155. Within 60 days from submission, this commission will carry out the necessary preliminary investigation based on the guidelines approved by the special section of the Court of Auditors.

Within 30 days from receiving the necessary documentation, the regional control section of the Court of Auditors decides whether to approve or reject a plan by assessing its appropriateness for financial rebalancing purposes. If a plan is approved, the Court of Auditors supervises its execution. A decision to accept or deny approval of a multi-year financial rebalancing plan is communicated to the Ministry of the Interior.

LPEs are prohibited from taking new mortgages after their financial distress has been resolved, except those intended to cover ordinary expenses.[72] It is evident that, in this situation, the only way to guarantee for an entity to truly balance its budget is by adopting measures regarding personnel and local taxes, which are considered extremely penalising. In fact, this aspect means that institutions often only declare bankruptcy when, following the enforcement actions of creditors seizing sums of cash, they can no longer pay salaries to their employees.

---

71 *Idem*, art 243(2), para 5.
72 *Idem*, art 249.

3.8 Publicly-owned companies

For the sake of completeness, it should be noted that the nature of publicly-owned companies in the Italian legal system has long been discussed. The debate has focused on the fact that these companies can be classified as public bodies and thus benefit from a consequent exemption from bankruptcy proceedings. This problem appears to have been resolved by the New Code, which has also extended its subjective scope of application to public companies, thus clarifying that public bodies cannot benefit from the aforementioned exemption. It should be considered that Royal Decree of 18 June 1931 (TUSP)[73] had previously also declared that publicly-owned companies should be subject to bankruptcy proceedings and arrangements with creditors.[74]

4. Dealing with local public entities in distress

4.1 Significant cases of local public entities in distress

The focus now turns to the case concerning the municipality of Catania.

In 2013, the municipality of Catania resorted to using a financial rebalancing procedure, but it was unsuccessful. Consequently, the municipality required that the local authority declares its financial distress.

The municipality of Catania adhered to the multi-year economic-financial rebalancing plan made in 2013 by resolution of the Court of Auditors.[75] This plan had been assessed positively by the Court of Auditors, but was subsequently modified by the Council of the municipality on several occasions.[76] The plan proved to be ineffective, not only in light of the results achieved directly but also by virtue of the substantial legislative changes that occurred between the initial formulation of the plan and its conclusion in late 2018.

Catania has not been the only municipality to experience financial distress in recent times. Another notable case is the municipality of Alessandria. This can be studied in depth by

---

73 *Testo Unico delle Leggi di Pubblica Sicurezza*, art 14 (also known in Italy by its abbreviation, TUSP).

74 See in this regard a recent ruling by the Court of Cassation: Cass no 13160 of 30 June 2020, which ratified that a capital company that is wholly or partly owned by public bodies is always subject to bankruptcy pursuant to the Bankruptcy Law, art 1(1). Should a public entity hold a company's shares, it will only have rights in connection with its position as a shareholder, and it will not be allowed to influence the functioning of a company using its public powers.

75 No 269 of 2013.

76 In the rebalancing plan approved by the municipality of Catania, its main objectives (ie, the main causes of imbalance to be resolved through the plan) were to remedy (i) the municipality's persistent difficulty in collecting its own income, (ii) its tendency to rely on treasury advances, which revealed the structural inability of the entity to cover its normal payments, (iii) the maintenance of a large number of burdensome receivables over five years old that were of doubtful due date and had a crucial impact on its financial results, (iv) issues regarding its municipal shareholdings and financial relationships with them, and (v) the improper use of services on behalf of third parties for cases not envisaged by the regulations and accounting principles for local authorities.

analysing the judgments and orders issued by the regional section of the Court of Auditors for Piedmont.[77] These orders and judgments describe in detail the process of the procedure and clearly identify the financial conditions that can result from such procedure. The judgment of the Court of Auditors is very complex and articulated but section VI thereof is particularly relevant for this research.[78] In this section, the Court of Auditors defines "financial distress" as the situation in which either the LPE is no longer able to guarantee the performance of its essential functions and services, or when there are liquid and payable claims that the LPE is not able to pay within the ordinary course of business.

The procedures outlined in this chapter have been used by many more municipalities, including Caserta and Naples. This shows that, despite the administrative support provided by these procedures, more should be done to strengthen the system of early warning and the accountability of local managers.

[77] Court of Auditors, *Regional Audit Section of Piedmont, resolution no 260 of 12 June 2012*, available here.
[78] *Idem*, p 63 *ff*.