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The Three Targets of Insolvency Mediation: Dispute Resolution, Agreement Facilitation, Corporate Distress Management

by P. Lucarelli and I. Forestieri

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The Three Targets of Insolvency Mediation: Dispute Resolution, Agreement Facilitation, Corporate Distress Management

Paola Lucarelli and Ilaria Forestieri[1]

Abstract

Traditionally, in Italy the resolution of corporate distress was constricted to formal insolvency procedures. Until, recently, the development of a new approach toward insolvency and business failure has allowed legislators, both at a national and European level, to begin to have to pay an increasing attention to the use of out-of-Court debt restructuring mechanisms. These non-judicial proceedings hold many advantages compared to the formal insolvency proceedings. However, in numerous cases, out-of-Court debt restructurings are non-efficient because of several debtor-creditors negotiating issues and concerns. Mediation represents a valuable tool for creating a fair and effective negotiation process among the stakeholders involved in the restructuring process, to solve these potential issues.

The first section of the paper offers an overview of the Italian insolvency tools, which takes in to particular consideration the different characteristics of informal restructurings alongside semi-formal (hybrid) debt restructurings adopted in Italy and in other main European countries. The second section describes the advantages and disadvantages of these restructuring proceedings. The third section focuses on the use of mediation in the insolvency context, to reach three different goals: (a) ***resolution*** *of plan and bankruptcy-related disputes; (b)* ***facilitation*** *of negotiations on a restructuring plan; (c)* ***prevention*** *of insolvency. Finally, the analysis moves from theory to practice explaining the outcomes of an empirical research: in this final part mediation is considered in a non-traditional sense; rather than only a dispute resolution mechanism, mediation is seen as a way to train debtors and creditors to a new Rescue Culture.*

1. The Italian Insolvency Tools in the Light of the European Trend toward Insolvency and Business Failure

During the last ten years, the Italian authorities have engaged in several reforms in attempt of improving the efficiency of national insolvency framework[2]. The result of the many legal changes is a wide set of tools that entrepreneurs can choose in order to resolve a situation of financial difficulties.

Considering the different levels in which Courts are formally involved, insolvency proceedings could be described as following: (*i*) purely contractual agreements (*i.e. informal* proceedings) that are generally governed by contractual rules (*i.e.* the Civil Code); (*ii*) Court-controlled proceedings (*i.e. formal* proceedings); (*iii*) finally, there are a number of proceedings with a limited judicial control (*i.e. semi- formal* or *hybrid* proceedings), where

[1] Professor Paola Lucarelli is the author of paragraphs 4 and 3.III.; Dr. Ilaria Forestieri is the author of paragraphs 1-2-3.I-3.II and 5.

[2] In 2005, the Italian Bankruptcy Law (Royal Decree 19th March 1942, n. 267) was completely overhauled by d. lgs. 9th January 2006, n. 5. The final version of the text was directly influenced by the frequent reforms in 2009, 2012, 2013 and 2015. This can be accessed at: http://www.camera.it/parlam/leggi/deleghe/06005dl.htm.

the contractual arrangements are supported by the Courts' intervention, or by the intervention of other administrative authority[3].

The Italian insolvency system offers several possibilities to entrepreneurs facing financial difficulties to restructure their debt, all of which are conducted – totally or partially – out of Court. In this view, the architecture of the Italian insolvency system has been influenced by the American Chapter 11, U.S. Bankruptcy Code; a source of inspiration for many legislators, both in Europe and beyond. In comparison, a completely different solution was adopted in Germany where the Insolvency Law does not regulate any composition or reorganisation procedure available outside of a formal insolvency process (*Insolvenzordnung*)[4].

This section of the paper aims at describing the main features of different restructuring and pre-insolvency proceedings available in Italy to rescue business' undergoing financial crises[5]. In-Court insolvency procedures, which intend to liquidate the company's asset, such as Bankruptcy, are out of the scope of our analysis, but they will be considered as a term of comparison with the former[6]. The interest for restructuring and pre-insolvency proceedings is related to the development of a new trend toward business failure and insolvency that has already taken place at the European level.

The EU Commission's Recommendation of March 12, 2014 adopted a new approach to business failure and insolvency[7], with the main objective of maximizing value facilitating viable enterprises to achieve faster resolution of the distress. To avoid the cost and time of formal insolvency procedures, the Commission encourages the resolution of corporate distress through an agreement between debtors and creditors. Thus, in order to preserve the private and confidential nature of negotiations, EU legislator excludes the judicial intervention; while, in certain other cases, this intervention is minimal with the Courts taking a supervisory (oversight) role.

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[3] Italian Insolvency Law, as in many jurisdictions, does not consider a distinction between informal, semi-formal and formal insolvency proceedings. That theoretical division, indeed, was proposed by the World Bank Insolvency Initiative, together with UNCITRAL, as a standard on the basis of which scholars and other public authorities have conducted comparative studies about the effectiveness of insolvency proceedings in different countries around the world. *See*, World Bank Group, *Principles for Effective Insolvency and Creditors/Debtor Regimes* (2016), available at: http://pubdocs.worldbank.org/en/919511468425523509/ICR-Principles-Insolvency-Creditor-Debtor-Regimes-2016.pdf. According to the World Bank principles the different solutions for the company's financial difficulties can be represented as a continuum, with informal procedures at one extreme and formal proceedings at the other. This continuum is based on the degree of judicial intervention and the type of formalities prescribed by the national Bankruptcy Law. For the concept of informal and hybrid proceedings, *see,* J.M. GARRIDO, *Out of Court Debt Restructuring. World Bank Studies,* The World Bank, Washington DC, 2012. available at http://elibrary.worldbank.org/doi/abs/10.1596/978-0-8213-8983-6.

[4] InsolvenzOrdnung, according to § 19, 1, InsO, allows debtors in a situation of Overindebtedness to initiate a formal insolvency process. According to§ 19, 2, InsO, Overindebtedness shall exist if the debtor's assets no longer cover his existing obligations to pay, unless it is highly likely, considering the circumstances, that the enterprise will continue to exist.

[5] In this context, the term "rescue" means the preservation of viable business as a going concern, through the use of insolvency tools that enable debtors to restructure their companies. Restructuring is intended both as a debt and business restructuring.

[6] In the context of this paper the term Bankruptcy is used for insolvent companies, while the term Insolvency is used as a colloquial definition of both companies which are financially distressed, and companies in the state of not being able to pay debts.

[7] *See*, European Commission's Recommendation of 12th March 2014, *on a new Approach to Business Failure and Insolvency*, available at: http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf.

In this context and in light of the upcoming reform, a brief description of the main characteristics is required, detailing the pre-insolvency and restructuring proceedings available in Italy[8], and considering their empirical use over the last decade.

The Italian Bankruptcy Law, (IBL-Legge Fallimentare)[9] currently, provides three legal instruments for restructuring, all of which have different characteristics depending on the process, on the degree of Court intervention, and on the applicability of the agreements' contents to creditors who do not participate in negotiations[10].

The choice between the different instruments depends on the type of the company, as on the measures needed to keep the business solvent.

The **Recovery Plan**, "piano di risanamento attestato" (according to art. 67, par. 3, letter *d*), IBL), is an *informal* proceeding that can be started by the debtor, when (s)he is in a temporary crisis, through the submission of a plan certified by a qualified professional for debt recovery and for rebalancing the financial situation. The process for negotiating a Recovery Plan is entirely private and confidential; the contractual agreement is binding only upon the creditors involved in the negotiation and does not need a Court approval.

Debt Restructuring Agreement, "accordo di ristrutturazione dei debiti" (according to art. 182-*bis*, IBL), is a *semi-formal* (*hybrid*) proceeding: because the process for negotiating a Debt Restructuring Agreement preserves its private and confidential nature. The agreement is also binding only upon creditors who have participated in the negotiation. The Court takes a more supervisory role in order to control that the legal requirements are met[11].

The procedure gives the parties considerable freedom in deciding the contents of the agreement, which may consist of simple financial operations such as a rescheduling of payments or debts cancellation; or in a more complex strategy, such as a combination of debt restructuring operations with corporate reorganization measures (*e.g.* assets sale; substantial

[8] For a comprehensive overview of the restructuring instruments currently available under the Italian Insolvency Law: Recovery Plan ("piano di risanamento attestato"); Debt Restructuring Agreement with Creditors ("accordo di ristrutturazione dei debiti"); and Preventive Arrangement with Creditors ("concordato preventivo"), *see*, L. Stanghellini, Linee Guida per il finanziamento alle Imprese in Crisi – 2a Edizione, 2015 (Guidelines on Financing of Distressed Firms – 2nd Edition, 2015), (April 28, 2015). Available at SSRN: https://ssrn.com/abstract=2600678. The Guidelines are the result of a National Research Project conducted by a group of researchers from the University of Florence, which started in 2007 and is still being continued.

[9] Refer to (ft. 1).

[10] When the circumstances that would make the restructuring of the business do not occur (*i.e.*, when the company is facing insolvency) the situation should be solved with fully judicial proceedings such as *Bankruptcy*, fallimento (art. 5, IBL), aiming at liquidating the assets; and for "large" businesses (i.e., 200 employees or more) with a going concern liquidation, *Extraordinary Administration of Large Firms in Crisis*, Amministrazione Straordinaria delle Grandi Imprese in crisi (Law 18th February 2004, n. 39). *See*, G. Meo, *L'amministrazione straordinaria delle grandi imprese in crisi*, in *Trattato di diritto fallimentare e delle altre procedure concorsuali*, IV, Torino, 2014, p. 1139, Zanichelli.

[11] Debt Restructuring Agreement with Financial Intermediaries, (accordo di ristrutturazione dei debiti con intermediari finanziari), pursuant to art. 182-septies of the Italian Bankruptcy Law, allows the debtor to restructure the business in situations where the majority of the involved creditors are banks and financial intermediaries (they must represent the 75 percent of the total amount of credits). This type of restructuring agreement introduces a special regime since it is binding not only for the financial creditors who signed the agreement, but also for those financial creditors who did not sign the agreement, even though they were eligible to participate in the negotiations. The regulation is still being implemented and it is premature to assess its impact.

financing commitments; merger, or acquisition transactions). However, according to art. 182-*bis*, IBL, debtors are compelled to respect certain formalities; with regards to the agreement, it has to be signed by the creditors representing at least 60 percent of the debt exposure; the feasibility of the plan for debt recovery must be confirmed by a qualified professional; the agreement should be approved by a Court; the agreement has to be published in the Companies' Register, along with the relevant documentation (according to art. 161, par. 2, IBL)[12].

Preventive Arrangement with Creditors, "concordato preventivo" (art. 160 et seq., IBL), the proceeding for Preventive Arrangement with Creditors has been significantly amended from 2005 to 2015, especially within Law August 7, 2012, no. 134 whereby the process became the Italian equivalent of US's Chapter 11.

In a nutshell, the procedure allows debtor to seek an arrangement with creditors based upon a restructuring plan certified by a professional. The arrangement is submitted to a certain majority of creditors for approval and consists of a wide range of operations in order to satisfy in whole or in part the creditors; including the sale of assets and the allocation of shares or other financial instruments (the so called "liquidation agreement")[13]. Despite the many legal changes to make the process more flexible and easier than it has been in the past, Preventive Arrangement with Creditors remains a judicial procedure. The Court must examine the petition and, if it concludes it complete and compatible with the applicable rules, it admits the debtor to the procedure for Preventive Arrangement with Creditors whereby the restructuring plan is negotiated, under the control of an appointed judge and a Judicial Commissioner.

1.1. Empirical analysis of the use of out-of-Court Debt Restructuring Proceedings in Italy

In the previous section we have proposed an overview of the national insolvency rules governing the different instruments to restructure viable business in Italy. In this section, data will be provided in order to understand the environment where the pre-insolvency and restructuring instruments are placed and how they work in practice.

If Italian general statistics are more closely examined, the data show that at the pick of the financial crisis (2014), enterprise bankruptcies surpassed 15,000 cases. The introduction of substantial legal changes in 2012 caused a significant increase in the number of Preventive Arrangements with Creditors (especially in the first half of 2013), enterprise reorganizations

[12] In this case, the debt restructuring agreement protects the debtor from creditors' judicial actions to enforce their rights in court (120-day moratorium as an effect of court-confirmed agreements); it also allows the debtor to obtain new financing with advantageous conditions and to make payments, only under well-defined conditions and with the judges' approval.

[13] The Italian legislator intervened once more in 2015 by adopting measures aimed at introducing some more competitive market mechanisms in Arrangement with Creditors procedures. *See*, Decree Law 27th June 2015, n. 83 "Urgent measures on bankruptcy, civil procedure, judicial organization and administration", converted into Law 6th August 2015, n. 132.

declined by 20 % in 2014[14]. On the contrary in 2015, bankruptcies decreased (14,700 procedures, 6.3% less than the previous year)[15].

A different situation is registered for the procedures that tackle the resolution of the corporate distress out-of-Court: (*i*) currently, there is no public data concerning the numbers of signed purely contractual agreements; there is no public data on the efficacy of such agreements. With regards to Debt Restructuring Agreements (Judicially confirmed), (*i*) the data are public, but hard to collect; (*ii*) there is a lack of information about the efficacy of the Debt Restructuring Agreements (since, at the date of this paper, most of them are still in course of implementation).

In light of these apparent system flaws, the University of Florence, in cooperation with other relevant bodies, is head of a project financed by the European Commission which aims to provide a guidance on the application of informal and semi-formal proceedings in three of the main European jurisdictions (Italy, Spain, Germany)[16]. The research's conclusions are based on both quantitative data about the outcomes of relevant informal and semi-formal proceedings in the jurisdictions studied, supported by qualitative information derived from stakeholder questionnaires and targeted stakeholder interviews.

The analysis of the data collected in the period from the comprehensive reform of Italian Bankruptcy Law in 2005 to the year 2016 is still in progress, but it is possible to briefly explain some preliminary considerations about the practical use of pre-insolvency and restructuring procedures in Italy.

(*i*) Purely contractual agreement, with one or more creditors, shows a great flexibility in the negotiations and also allows for saving time and resources. However, the instrument is scarcely used as a result of its many disadvantages[17]. These problems are mainly related to

[14] For the empirical analysis on filing of Preventive Arrangements with Creditors in Italy and with a particular look at the Court of Milan, one of the largest courts in Italy, during the 2005-2014 period, *see*, A. Danovi, P. Riva, M. Azzola, *PAC, (Preventive Arrangement with Creditors): a tool to safeguard the enterprise value,* in *International Journal of Business Research*, Vol. 16, No. 2, 2016.

[15] *See*, A. Danovi, P. Riva, M. Azzola, *PAC, (Preventive Arrangement with Creditors)*, *ibidem*. According to a report issued by Banca d'Italia, "as a whole, the reform has substantially improved the legal framework for early intervention in cases of firms in distress, promoting early action in case of crisis and making restructuring more likely. It should also provide better protection to creditors in case of difficulties of the borrowers, as foreclosure procedures are expected to become speedier and less costly, with forced sales improved by extra-judicial and more market oriented mechanisms". *See*, L. Carpinelli, G. Cascarino, S. Giacomelli, and V. Vacca, 2016, *The Management of Non-performing Loans: a Survey Among the Main Italian Banks*, Occasional Paper No. 311, Bank of Italy. According to the latest *OECD Economic Survey: Italy 2017*, available at: http://www.dt.tesoro.it/export/sites/sitodt/modules/documenti_en/analisi_progammazione/attivita_internaz/Survey_Italy_2017.pdf. During the financial crisis the number of defaults has increased rapidly. The average length of court-led insolvencies is still above 7 years and varies greatly across courts, ranging from 2 to more than 16 years. Moreover, liquidation is still by far the most common form of insolvency, accounting in 2015 and 2016 for more than 90% of new insolvency cases and an even higher share of backlog cases. Also, most insolvencies starting as reorganization procedures (about 90%) end up as liquidation.

[16] The European project, JUST/2014/JCOO/AG/CIVI 4000007627, "Contractualised distress resolution in the shadow of the law: Effective judicial review and oversight of insolvency and pre-insolvency proceedings" is financed by the European Commission. The project is carried out by the University of Florence, in partnership with Humboldt-Universität zu Berlin and Universidad Autónoma de Madrid; supported by the Consejo General del Poder Judicial; E-Lab, University of Bergamo; and Bank of Italy. More information about the project is available at: www.codire.eu.

[17] The complexity of the rules governing insolvency proceedings is another factor that can reduce the rate of success of a recovery strategy. The several amendments of the legal environment incurred in the past years, in Italy, influenced the ex ante behavior of creditors. On the one hand, the creditors who had entered into

the distribution of bargaining power among the parties and the time to negotiate the agreement.

- Contractual agreements are **extremely rigid in their approval procedure, as they require unanimity of creditors;** and the procedure **does not allow to bind minority creditors.**
- Negotiations usually involve one creditor, but in case of multiple creditors a **coordination problem could arise**. It consists of the risk of free-rider behaviour, when certain creditors refuse to cooperate in order to initiate an enforcement action, at the expense of the debtor and of those creditors who are prepared to cooperate[18].
- Contractual agreements are not a valid option when the company is close to become insolvent[19]. However, at an early stage, **it is difficult for creditors to assess the debtor's financial and economic situation,** because of the **absence of adequate information in the negotiation process (information asymmetry)**.
- There are **issues related to the efficacy of out-of-Court agreements**, as in the case of ex-post avoidance actions.

(*ii*) As mentioned before, during the period from 2005 to 2016 an increasing number of Debt Restructuring Agreements have been adopted in Italy to restructure medium-size enterprises, with significant and relatively concentrated debt exposure. On average, the Italian insolvency system denotes about 1800 procedures for Debt Restructuring Agreements filled in the whole Italian Courts during the referred period[20].

The procedure for Debt Restructuring Agreement is attractive for Italian debtors, particularly because companies facing a situation of financial difficulties may implement a wide range of options to restructure the business or refinance the debt, with a limited Court intervention. Furthermore, the procedure for Debt Restructuring Agreement allows the debtors to benefit of a *moratorium* period during which negotiations are protected from the risk of creditors filing for the debtor's insolvency. However, like all the contractual agreements, the procedure for Debt Restructuring Agreement could fail because of the following issues.

- First of all, the **system of majorities** envisaged in the procedure constitutes a disincentive to debtors.

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restructuring operations may be worried that those operations would be found detrimental to the estate or to creditors (preference); on the other, there is the risk for creditors of enhancing debtors in implementing delaying strategies and increasing the corporate distress. On the main advantages and disadvantages of purely contractual solution to corporate distress, *see*, J. Garrido, *Out-of-Court Debt Restructuring*, 17-18.

[18] *See*, C.O., Finkelstein, *Financial Distress as a Non-Cooperative Game: A Proposal for Overcoming Obstacles to Private Workouts*, (1993). *Faculty Scholarship.* Paper 1335, available at: http://scholarship.law.upenn.edu/faculty_scholarship/1335. S. Paterson. (2016) The Paradox of Alignment: Agency Problems and Debt Restructuring. European Business Organization Law Review 17:4, pages 497-521. For a review of the main literature on the economic analysis of insolvency law, *see* L. Stanghellini, *Le crisi di impresa fra diritto ed economia. Le procedure di insolvenza*, Bologna, 2005, 61.

[19] One of the main problem that reduces the rate of success of out-of-Court proceedings is also that often debtors initiate the process at a later stage, when they are close to insolvency. In this way, out-of-Court restructuring proceedings work as an alternative to insolvency proceedings, rather than as a mechanism of early prevention.

[20] Some preliminary conclusions on the rate of success of Debt Restructuring Agreements in Italy are based on a substantial portion of empirical data that was collected in 16 Courts based in North-Italy, during the period from 2005 to 2014. *See*, A. Danovi, V. Conca, L. Riva, *Debt restructuring agreements in Italy. An empirical analysis of filing under article 182-bis of Italian Bankruptcy Law*. English version of the research was presented during the 1st. World Conference on Risk, Banking and Finance in Tokyo, 7-8.01.2015.

- Many parties are involved in the negotiation and it leads to the above mentioned multi-party negotiation issues, as creditors' **information asymmetry** and **coordination problems**.
- An additional problem is the **cost of the procedure** and **the expense for qualified insolvency professionals** to assist debtors during the negotiations.

Although these agreements are open to all kind of creditors, practice shows that they are mainly used by mid and large business. It seems that there are numerous obstacles, especially to small Enterprises' access to pre-insolvency procedure for restructuring. Amongst other obstacles[21] lies the cost of specialized legal assistance – especially when the professional engaged does not possess proper skills and techniques needed to conduct successful negotiations − professional fees could represent just a waste of resources[22].

iii) Currently, Preventive Arrangements with Creditors can be considered the main instrument used by Italian small and medium-sized companies (and occasionally large ones) to manage insolvency by avoiding formal bankruptcy. The recent reforms have substantially improved this strategy; this article will not focus upon all of the amendments of Preventive Arrangements with Creditors, but it is worth mentioning that the procedure has become a useful tool to avoid bankruptcy, mainly for the freedom granted to the debtor. On the one hand, it is up to the debtor to decide time and modalities of the restructuring plan. On the other hand, Courts' and creditor's influence are residual. However, there are the typical negative consequences of in-Court solutions such as time, cost and a certain complexity of the procedural terms to comply with[23].

1.2. The Shortcomings of the Italian Insolvency Framework for out-of-Court Debt Restructuring Proceedings

Considering the Italian experiences, the out-of-Court solutions to business distress are very attractive in theory, but in many cases, they are not as effective as they could be. In this view, the Italian insolvency framework is far from other European economies that have already introduced flexible, informal preventive proceedings, that could be seen as the major step for the development of a **Rescue Culture**[24].

In France, for instance, the established practices of out of court restructuring proceedings, the *ad hoc* mandate, conciliation proceedings (and the closing option safeguard proceedings) aims at facilitating negotiations between the debtor and its main (financial) creditors, with a

[21] One of the main element that could reduce the success of restructuring proceedings is the delay of debtors in identifying the causes of the distress and react accordingly. Especially small entrepreneurs believe that is not worthwhile to engage a specialized legal assistance to help them in negotiating with the creditors a strategy to restructure their business, because they believe that they are capable of settling their problems.

[22] On the problem of the expenses for the initiation of insolvency proceedings, *see*, I. Forestieri, *L'assistenza al debitore*. Spunti di riflessione, in Materiali del corso di perfezionamento "Il nuovo diritto fallimentare". Le soluzioni negoziali della crisi di impresa fra presente e futuro. Vol. I, 2017, 262.

[23] For an overview on the practical use of Preventive Arrangements with Creditors in Italy, *see*. A. Paletta, *Analisi delle condizioni di efficienza economica del concordato preventivo. Working paper OCI. Rapporto di ricerca 2016*. Available at: https://www.osservatorio-oci.org.

[24] On the development of the rescue culture, *see*, Insolvency service, *A Review of Company Rescue and Business Reconstruction Mechanism*, Report by the Review Group (DTI-London), 2000, 12-23. P. Omar, *International Insolvency Law. Themes and Perspectives*. Routledge, London, 2013, passim. See, J.A. Mirimanoff, *Une nouvelle culture: La gestion des conflits*, available at: http://www.gemme.ch/rep_fichier/Une_nouvelle_culture_La_%20gestion_des_conflits.pdf.

view to reaching a consensual restructuring agreement, thus avoiding the opening of ordinary collective insolvency proceedings. The workout process is assisted by the intervention of a third party, *i.e.* a mediator or a conciliator which is seen as a positive signal for encouraging entrepreneurs to disclose their financial difficulties earlier. This assumption was confirmed by the latest *Deloitte Altares* Report on the distressed business in France, which raises that 2,467 preventive and confidential proceedings were opened in 2016, with an increase of 3% when compared to 2015 and of which 65% are *ad hoc* mandate proceedings[25].

The above mentioned data highlighted an improving trend in the French system toward preventive solutions and this is an acknowledgement of what already took place in practice in the UK. In English law, the preventive restructuring framework is composed of two different proceedings: Company Voluntary Arrangements ("CVA") and Scheme of Arrangement[26].

The scheme of arrangement relies on creditors' self-interest in embarking on negotiations and deciding on a plan acceptance. Since 2008, schemes of arrangement have increasingly been applied as method of implementing debt restructurings. One of the main advantages of a scheme of arrangement is that: (*i*) it can be used by insolvent or non-insolvent companies to restructure its debts without the need for unanimity; (*ii*) it can be opened to deal with a restructuring of the debt, a restructuring of the business, a combination of both; or even a liquidation of the entity[27]. These advantages have attracted many European companies to restructure their business in the United Kingdom, as the scheme of arrangement proposed by the Italian *Seat Pagine Gialle S.p.A.* in 2012.

Considering the Italian situation, as set in the previous paragraph, there is a need for a legislative intervention to improve the mechanisms for restructuring viable business without resorting to the judge intervention: in Italy, however, these procedures have a low rate of success due to an inadequate legal framework that should be amended in many ways (*matter of law*).

A more appropriate solution, however, calls for the elaboration of *best practices* to improve the negotiation environment. Those solutions should be based on specific methodologies and

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[25] The study made by Deloitte/Altares is based on a panel of 17 courts, it appears that the number of consensual proceedings has been rising at a fast pace between 2011 and 2014 and the total number of consensual proceedings opened in 2014 has outgrown the crisis level of 2009. *See*, E. Inacio, *French Insolvency statistics: Fluctuat nec mergitur?* Available at: https://www.insol-europe.org/technical-content/national-insolvency-statistics-france.

[26] On the UK market and the rise of Schemes of Arrangements, *see*, A. Cohen, coordinating partner for the European Restructuring and Insolvency Practice, Clifford Chance, *Composition and Pre-insolvency Procedures in Europe – All Change?*. Available at: https://www.cliffordchance.com/briefings/2016/03/composition_and_preinsolvencyproceduresi.html. The study offers an overview of the impact of the new pre-insolvency procedures that have been introduced in the key European jurisdictions: France, Germany, Italy, Spain and the Netherlands. *See*, also *The Commission Insolvency Proposal and its impact on the Protection of Creditors*. Study for the JURI committee (2017), available at: http//europarl.europa.eu/supporting-analyses, passim. Kastrinou A., *Comparative Analysis of the Informal Pre-Insolvency Procedures of the UK and France*, Int. Insolv. Rev., Vol. 25: 99–118, 2016. For the numbers of the United Kingdom (94.594 cases, including companies and personal, in 2015), *see*, *The Insolvency Service, A review of the corporate insolvency framework: a consultation on options for reform*, May 2016, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/495531/Q4_2015_statistics_release_-_web.pdf).

[27] The relevant law is set out in Sections 895-901 of the Companies Act of 2006, *see*, Payne J., *Schemes of Arrangement. Theory, Structure and Operation*, Cambridge University Press, 2014.

negotiation techniques that facilitate better relationships between debtors, creditors and all the stakeholders involved in the process[28].

In this view, the EU Recommendation of March 12, 2014 strongly encourages the use of *Mediation* as a valuable mechanism to increase the efficiency of out of Court restructuring proceedings. The Recommendation considers the restructuring plan very difficult to be agreed and realized, therefore EU underlines the role of two new actors in the area of reconstruction and insolvency: **a supervisor and a mediator** to facilitate the debtor/creditors agreement[29].

The EU Recommendation number 8 and 9 of the European Commission expressly states:

> "*Debtors should be able to enter a process of restructuring their business without the need to formally open court proceedings.*
>
> *The appointment of a mediator or a supervisor by the court should not be compulsory, but rather be made on a case by case basis where it considers such appointment necessary:*
>
> > *(a) in the case of a mediator, in order to assist the debtor and creditors in the successful running of negotiations on a restructuring plan;*
> > *(b) in the case of a supervisor, in order to oversee the activity of the debtor and creditors and take the necessary measures to safeguard the legitimate interests of one or more creditors or another interested party".*

The EU Commission's message is clear; entrepreneurs should react to the distress **as early as possible**. However, not only is *time* is of great importance. Even a swift reaction to the financial distress could fail if debtor and creditors do not have the right culture and skills to negotiate a feasible solution.

In this view, the World Bank Principles for Effective Insolvency and Creditor Rights Systems, also state that:

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[28] Italy is still lacking something similar to the London Approach or another type of conduct code for participants involved in the negotiation process. The London Approach considers the role of the financial supervisor acting as a mediator, or providing access to independent mediators that create the conditions for negotiation among all the parties involved. It was originally designed by the Bank of England in the 1970s, as a non-statutory and informal framework for dealing with temporary support operations mounted by banks and other lenders to a company in financial difficulties. The document is available at: http://www.bankofengland.co.uk/archive/Documents/historicpubs/qb/1993/qb93q1110115.pdf. The rapid change of the credit market, during the last decade, has an impact for the London Approach's survival, *see,* S. Paterson, *Bargaining in Financial Restructuring: Market Norms, Legal Rights and Regulatory Standards*, Journal of Corporate Law Studies, Vol. 14 , Iss. 2,2014.
Best practice lessons can be drawn from international organizations like INSOL International that endorsed mediation as the best solution to address insolvency, restructuring and allied matters that emerge in the course of insolvency proceedings. With respect to out-of-Court agreements, the INSOL principles for multi-creditor negotiations are generally considered as an international best practice, *see INSOL International Statement of Principles for a multi-creditor Workout* (2000), available at. http://www.insol-org.com.

[29] The EU Recommendation 8 and 9 of the European Commission considers the introduction of a mediator to help debtors and creditors in *negotiating* on a restructuring plan. *See, European Commission's Recommendation of 12th March 2014*, (ft. 4). The importance of appointing a mediator is also confirmed in Recital 18 and Article 5 of the Proposal Restructuring Directive (2016) on 2012/30/EU, available at: http://ec.europa.eu/information_society/newsroom/image/document/2016-48/proposal_40046.pdf.

> "*an informal workout process may work better if it enables creditors and debtors to use informal techniques, such as voluntary negotiation or mediation or informal dispute resolution. While a reliable method for timely resolution of intercreditor differences is important, the financial supervisor should play a facilitating role consistent with its regulatory duties as opposed to actively participating in the resolution of inter-creditor differences*"[30].

In this view, there is no doubt that the intervention of a mediator, as a neutral party, would shape expectations of appropriate behaviour. Not only this, it would also help the parties in exchanging information, limiting holdouts problems, and fostering creditor coordination.

Following the new EU's strategy, the Italian Government nominated the "Rordorf Commission" with a broad mandate to introduce substantial legal changes, such as adopting a preventive approach to business rescue. The "Rordorf Commission" was aware of the importance of enhancing negotiations for the resolution of the corporate distress, therefore it proposed the introduction of a preventive procedure – which should be fashioned after the alert procedure available in the French system – to allow debtors in financial difficulties to find an amicable solution with creditors with the help of an experienced third party[31]. The Rordorf Commission's Proposal is interesting because it offers a space to introduce mediation as a preventive tool to avoid insolvency, which is almost ignored by the Italian bankruptcy community. On the contrary, in some European countries including France and Spain, mediation in rescue and insolvency occurs.

If the Italian legislator did not introduce such change, the whole insolvency system would inevitably fail to preserve the values of negotiating party autonomy and company's asset value maximization that out-of-Court proceedings aim at bringing to the insolvency system for the resolution of corporate distress.

1.3. The Practice of Insolvency Mediation in the EU Member States

As mentioned previously, the EU Recommendation introduces the mediator as a new insolvency professional, but does not describe the mediator's role. The European legislator only provides that: (*a*) the mediator functions consist in assisting the parties in reaching a compromise on a restructuring plan; (*b*) a mediator may be appointed ex officio or on request by the debtor or creditors where the parties cannot manage the negotiations by themselves.

The lack of precise information regarding the role and professional qualifications of such an 'insolvency mediator' introduces the need for a comparative study of the practical use of mediation in those few EU Member States that have developed a practice of mediation for the rescue of distressed company, as request by the European Commission Recommendation[32].

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[30] Principle B4, World Bank *Informal Workout Procedures*, *cit*., (ft. 3).

[31] The Rordorf Commission was established by the Minister of Justice on January 28, 2015. The lines suggested by the Rordorf Commission have been submitted to the Italian Parliament as a proposal of a comprehensive reform of the Insolvency Legal Framework in February 2016. The report delivered by the Rordorf Commission is available at: http://www.osservatorio-oci.org/index.php?option=com_phocadownload&view=category&download=1477, 11-13.

[32] For these considerations and for an overview of the use of mediation in matters of insolvency in the EU Member States and in the US, *see,* European Law Institute (ELI), *Report on Rescue of Business in Insolvency Law*, available at: http://www.europeanlawinstitute.eu/fileadmin/user_upload/p_eli/Publications/Instrument_INSOLVENCY.pdf.

As mentioned above, the French Insolvency Law[33] provides a set of flexible proceedings, such as: *Mandat ad hoc*, *Conciliation Procedure, Procedure de Sauvegarde*. These proceedings show different characteristics, but they have nearly the same objective: they consider the intervention of a third to facilitate negotiations between the debtor and its main (financial) creditors, with view of reaching a consensual restructuring agreement, thus avoiding the opening of ordinary collective insolvency proceedings.

In this paper we must limit ourselves to providing just a general impression of how preventive proceedings are organized in France.

Mandat ad hoc is a flexible procedure, which can be initiated by debtor in financial difficulties, though not insolvent, at any time. The President of the Court may appoint a *Mandataire ad hoc* upon the request of the debtor and the duration of the procedure is freely determined by the President having regard to the debtor's application.

Conciliation Procedure is more closely regulated. Such proceeding applies to debtors that are facing financial difficulties lasting longer than 45 days. The President of the Court may appoint a conciliator who is in charge for a period not exceeding five months. The debtor may suggest the name of any person to be appointed and this suggestion is usually followed by the President of the Court. The outcomes of such proceeding are wide: usually, they consist of rescheduling of payments; or reducing debtor's indebtedness; but often the rescue strategy requires more sophisticated operations.

After the debtor has already benefited from the opening of conciliation proceedings, it is not able to file for another consecutive conciliation proceeding for at least three months following the termination of the earlier proceeding. The agreement reached through the conciliation procedure should be approved by the President of the Court to make it enforceable.

In the practice of the French insolvency system debtors tend to start to conduct negotiations within the *mandat ad hoc*'s framework. Then, when an agreement is about to be reached, the debtor requests for the opening of conciliation proceedings in order to benefit from a court approval of the restructuring agreement.

As demonstrated by the already mentioned study made by *Deloitte/Altares*, 82% of companies opening a conciliation proceeding have benefited from such a formal approval ("homologation") of the conciliation agreement by the court since 2010. Conciliation has proven to be very attractive and efficient mainly in case of financial difficulties of mid-sized enterprises. In 2015, 1.000 of such proceedings were opened in France, constituting an

[33] Executive Order n° 2014-326 of 12 March 2014 reforming French insolvency proceedings was published in the Official Journal of the French Republic (Journal officiel de la République Française) on 14 March 2014. For a more detailed description of the preventive insolvency restructuring regimes in France, *see, The Commission Insolvency Proposal and its impact on the Protection of Creditors*. Study for the JURI committee (2017), available at: http//europarl.europa.eu/supporting-analyses, (ft.20); A. Cohen, coordinating partner for the European Restructuring and Insolvency Practice, Clifford Chance, *Composition and Pre-insolvency Procedures in Europe – All Change?* (ft.20).

increase of 72% compared with 2011. Even more interestingly, apparently the success rate of these proceedings was approximately 70%[34].

Sauvegarde Financière Accélérée - SFA is an accelerated financial safeguard proceeding to rapidly implement a restructuring plan without affecting the position of non-financial creditors. With the ordinance of March 12, 2014[35], the French legislator introduced the accelerated safeguard proceeding (*sauvegarde accélérée - SA*) as a new variant for conciliation, which have a different "deterrent effect" on minority creditors. SFA procedure allows to cram-down all creditors, except employees, and not only financial creditors[36]. Since minority creditors are aware that their hold-up value is rather limited, often, in practice they prefer to negotiate some limited advantages within the framework of a consensual conciliation agreement. Consequently, the French legal landscape of preventive restructuring proceedings is still dominated by conciliation proceedings.

In Spain, the legislator has implemented many changes in the insolvency system. From 2009 to 2015 the reforms amended several parts of the Insolvency Law, including those most relevant concerning this paper, directly or indirectly, out of Court solutions[37]. In particular, the Spanish Royal Decree-Law 1/2015, passed on February 27th called the second opportunity Law, introduced some amendments both in the voluntary payment settlement regulation as well as in the mediator role.

Currently, the Spanish law promotes three types of out-of-Court agreements: **Acuerdo de Refinanciación**; **Acuerdo de Refinanciación Homologado** and **Acuerdo Extrajudicial de Pagos**. These three procedures are conducted and implemented without judicial intervention. They also allow a greater protection to debtors as long as certain legal requirements are met: during the negotiation period, no creditors (with some exceptions to public creditors) may file for executions over the company's assets; no creditors may file for bankruptcy; once approved, the agreement is protected from ex-post avoidance actions.

In 2013 the Spanish Insolvency Act has included a new chapter regulating the 'insolvency mediator'. To enhance the rescue of distressed small and medium-sized businesses (SMEs), the Spanish legislator considers the intervention of a *Mediador concursal* as a valuable solution in helping debtors to seek an agreement on payments (Acuerdo Extrajudicial de Pagos**)** with creditors. In this case, the role of this insolvency professional goes beyond the simple task of resolving disputes, the mediator's tasks consists instead of organizing and managing meetings between debtor and creditors, drafting restructuring plans and other supporting activities that have a key role for the success of the procedure[38].

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[34] *See*, the report dated 1 July 2016 of the Haut Comité Juridique de la Place Financière de Paris (HCJP) on insolvency proceedings, p. 7, available at: www.hcjp.fr; E. Inacio, *French Insolvency statistics: Fluctuat nec mergitur?* (ft. 21), passim.

[35], Ord. no 2014-326, ratified by the law no. 2016-1547 of 18 Nov. 2016.

[36] *See*, *French Insolvency Proceedings: La Révolution a Commencé*, Gallagher A.; Rousseau A. American Bankruptcy Institute Journal; Alexandria33.11 (Nov 2014), 20-21,64-65.

[37] For an overview of the out-of-court debt restructurings procedures available in Spain, *see* I. Tirado, *Out of Court Debt Restructuring in Spain. A Modernized Framework,* Working paper, Oxford, (2017), available at: https://www.law.ox.ac.uk/sites/files/oxlaw/tirado_modernised_framework.pdf.

[38] *See*, María del Pilar Galeote Muñoz, *Mediaciòn Concorsual el Acuerdo Extrajudcial de Pagos y el Mediador Concursa*l, Working Papers IE-Law School (2015), available at: SSRN: https://ssrn.com/abstract=2659255. On the development of Insolvency Mediation in Spain, *see*, Martín Molina, P., Díaz-Gálvez, J., Lopo López, M., & Digitalia, Inc. *La ley concursal y la mediación concursal: Un estudio conjunto realizado por especialistas.* Pedro B. Martín Molina, José María del Carre Díaz-Gálvez, María Antonia Lopo López (coordinadores). Madrid: Dykinson (2014).

2. What is really necessary to improve Out-of-Court Restructuring Proceedings?

The previous overview of the different restructuring tools available in Italy underline that out-of-Court restructuring procedures' effectiveness lies in their **informality and flexibility**. Thus, greater flexibility corresponds to a wide negotiating party autonomy. It is worth drawing to attention that a **situation of financial distress inevitably introduces changes in the debtor-creditors relationship which make the interaction between the parties more complicated and difficult.**

This is a normative *paradox* because, at the same time, Italian legislators would align themselves with the priority of the parties' autonomy in negotiation, despite the fact that the **contracting process does not work properly because of the above-mentioned debtor-creditors negotiation issues**[39].

It is important to note that negotiations leading up to a restructuring plan, which is fundamentally an agreement, are unregulated in the sense that parties are free to negotiate to conclude a contract and negotiate about the contents of such a contract. However, the practice has demonstrated that out-of-Court negotiation processes may have a very poor success for many reasons. (*A*) often debtors (especially the small ones) do not have the right business culture and skills to conduct successful negotiations. Individual debtors often fail to resolve their problems because in a moment of financial crisis, they are often not able to behave rationally and as a result act upon these irrational and negative emotions[40]. In addition, the relationship has often 'cooled' as a result of the deteriorated state of affairs. The moment when the business is in imminent financial difficulties is always surrounded by *uncertainty* about how to react to the distress. Everyone becomes crystallized in their own view of the facts: the debtor is concerned with many issues, as the cost of insolvency procedures; the risk of reputational damages; and the fear of losing control of the business. (*B*) As noted in the previous paragraphs, conducting multi-party negotiations may be particularly burdensome for debtors because of the presence of a large number of creditors involved and the differences in their legal and economic positions. Creditors will not always be prepared to cooperate, or they will not be ready to agree with restructuring proposals which substantially change their rights[41].

To improve **the dynamics of debtor-creditor relationships in the negotiation process designed to culminate in a restructuring plan**, it is necessary to look more closely at the nature of the problem; the type of parties involved; their negotiation skills and their

[39] The literature on contractual insolvency is wide, among the main contributors, *see*, A., Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 Yale L.J. 1807 – 157 (1998). *L.M. LoPucki, Contract Bankruptcy – A Reply to Alan Schwartz*, 109 Yale L.J. 317 – 342 (1999). *L. Bebchuk - A New Approach to Corporate Reorganizations*, 101 Harv. L. Rev. 775 (1988).

[40] For a concise review of cognitive biases, it is useful to refer to D. Kahnema, A. Tversky, *Choices, Values and frames,* Cambridge, 2000*; Id. Prospect theory: An analysis of decision under risk*, in *Econometria*, 1979, p. 273 ss. D. Kahneman, *Thinking fast and slow*, New York, 2013. R.H. Thaler, C.R. Sunstein, *Nudge: Improving Decisions about Health, Wealth and Happiness*, London, 2009, p. 7.

[41] Multi-party, multi-issue negotiations are a particularly challenging type of group decision making, because negotiators must integrate complex information, and manage conflicting goals as they work towards an agreement. *See*, M. Olekalns, J. M. Brett, L. R. Weingart, (2003) "Phases, Traditions and Interruptions: Modelling Process in Multi Party Negotiations", International Journal of Conflict Management, Vol. 14 Issue: 3/4, pp.191-211.

behaviour[42]. Whenever an insolvency proceeding is started, among other technical issues, one of the main problems to address is the *quality* of the interaction between all the stakeholders involved in the process. This is considering the fact that there is often a significant emotional reaction from the parties on both sides that gives rise to litigation.

Many disputes may have less to do with legal issues or economic concerns, and more to do with creditors' lack of trust in the debtor's behaviour. Trust is indeed a critical element to the debtor/creditor relationships: without trust the chance that the parties will find a mutually acceptable resolution to their problems is significantly reduced. In some other cases, the relationship may be complicated by the incapacity to communicate an undisclosed issue, such as a personal or amicable relationship, which has culminated in antagonism. The party who is emotionally involved in a dispute can feel frustrated, and will not hear what the debtor has to say; with both sides exchanging less than a few e-mails, the negativity increases over the time.

3. Facilitating the Agreement through Mediation. Beyond the Dispute Resolution Approach

Traditionally mediation in the Insolvency and Bankruptcy contexts has been considered mainly as a dispute resolution mechanism. This tendency is reflected in many academic works that focus predominantly on the benefit that mediation produces in reducing both the time and cost of a judicial intervention[43]. This section of the paper aims at demonstrating that the mediation goals go beyond a timely and less expensive method to resolve disputes. It proposes a modernized approach that considers mediation as a **managing tool for corporate distress**.

Finally, this paper aims at provoking a reflection on the use of mediation as a way to develop a new paradigm of a **Preventive Rescue Culture** that is still lacking in Italy. This paper underlines that in order to facilitate the insolvency management, mediation acts as a *fertilizer* to build the best environment for debtor-creditor negotiations.

3.1. Resolution of the Disputes that May Arise in the Context of Bankruptcy

Obviously, there are many good reasons for a discussion on the role of mediation in formal insolvency proceedings aiming at liquidating the asset. Bankruptcy leads to extremely difficult factual and legal issues and involves a large number of participants[44].

The main problem which complicates the proceeding is often related to distributional issues about how to allocate the debtor's assets among the different classes of creditors. When a formal bankruptcy proceeding is filled, the assets could be not sufficient to give creditors the full amount to which they are entitled; or the debtor and creditors could not agree on the

[42] On the introduction of a new paradigm where mediation has a key role to restore cooperation and mutual trust between parties of a commercial relationship, *see*, P. Lucarelli, L. Ristori, *I contratti commerciali di durata*. Milano, 2016, 30.

[43] *See*, Esher, J. A. (2009), *Alternative Dispute Resolution in U.S. Bankruptcy Practice*, University of Massachusetts Law Review: Vol. 4: Iss. 1, Article 3. Available at: http://scholarship.law.umassd.edu/umlr/vol4/iss1/3. Id., *Recent Use of Mediation for Resolution and Effective Management of Large Case Insolvencies*, International Corporate Rescue 2015-6, 349.

[44] *See*, R.M. Fishman et al, *Types of bankruptcy-related disputes*, in *Bankruptcy Mediation*. American Bankruptcy Institute, 2016, 10-55.

amount that the debtor, who has surplus income, is required to pay to creditors. Moreover, bankruptcy proceedings can be concerned with related disputes such as directors' liability or the debtor's negative behaviour when the debtor (manager of the company) has engaged in operations that increased the distress, or has omitted to keep in order records and books of account - even when the debtor did not sufficiently disclose the business transactions and financial position of the business.

Mediating such disputes could be an effective solution with the goal of not to prevent insolvency or to preserve on-going relationships among the parties, but usually of helping the parties to negotiate a consensual plan for liquidating the debtor's assets. The intervention of a mediator might also help debtors to minimize the many risks related to business failure, such as reputational damages[45].

3.2. Facilitating the Negotiations on a Restructuring Plan and the Resolution of Plan-Related Disputes

The process for the confirmation of a restructuring plan also offers a framework to consider mediation as a powerful tool to manage debtor/creditors' meetings; to coordinate creditors regarding their voting on a restructuring plan; or to manage and resolve a large number of plan-related claims[46].

In short, negotiating a restructuring plan is not a simple two-dimensional litigation in which one side or the other prevails at the end. From a broader perspective, restructuring plans are a multi-party agreement since negotiations involve a large number of parties at the table, in order to decide the best procedural route to solve the distress[47].

As it currently stands, the debtor is always playing the restructuring game against *time*: the decision between restructuring the business or maximizing asset value by a sale often demands a deep discussion in order to discover the facts; disclosing the financial and operating information; reconstructing the whole history of the company. Such activities are the variable that impacts the timing and the success of insolvency procedures, but, as noted previously, plan negotiations could reach an impasse or encounter obstacles due to the difficult interaction among the key parties.

The main point of negotiations is that the debtor convinces the creditors that they will receive higher distributions if they bet on a rescue strategy, rather than on a liquidation. However, creditors may be unwilling to seriously engage on the negotiation table, because they do not

[45]For instance, Bankruptcy mediation is formally part of the judicial system in Canada. In addition of being privately available, Article 105 of the Canadian Bankruptcy and Insolvency general rules (C.R.C., c. 368) prescribes mandatory mediation to resolve two type of disputes: (*a*) Mediation for surplus income, which can be initiated both by the trustee, or one or more creditors, in case of disagreement with the amount of surplus income to be paid by the bankrupt, according to art. 68(8) Canadian Bankruptcy Act; (*b*) and mediation in case of creditors' opposition to bankrupt's discharge, according to art. 170.1(2) Canadian Bankruptcy Act. Canadian bankruptcy regulation is available on the Justice Laws website: http://laws-lois.justice.gc.ca/eng/acts/B-3/index.html.

[46] *See*, D.S. Schaible, E.J. Vonnegut, *The Rise of Plan Mediation: Benefits and Pitfalls. American Bankruptcy Institute Journal*; Aug. 2014; 33; ABI/INFORM Collection, 8. Hon. R. J. Newsome, *Mediating Disputes arising out of troubled Companies. Do it sooner rather than later.* 42 Golden Gate U. L. Rev., 661, 2011-2012.

[47] According to the ELI Report, *Report on Rescue of Business in Insolvency Law*, 92, (ft. 32), "There is little consideration in literature and academia of a 'restructuring plan' as a multi-party contract (as e.g. a workout) compared to bilateral contracts".

trust in the debtor's capability to manage the distress; moreover, creditors may appear skeptical to negotiate with the debtor until any risks such as wrongful operations or fraud accusations are investigated and analyzed.

If the creditors agree that restructuring the business is a feasible solution, then the debtor has to face a second major challenge: restructuring the business implies that the company's assets and repayment resources should be evaluated in order to prove that the restructuring strategy is feasible. In this way, a plan confirmation process costs a tremendous amount of money that is used on discovery, experts, hearings and consequent professional fees.

There is no doubt that mediation for resolving plan related issues can help the parties to achieve satisfactory results quickly and with less angst. This has been confirmed in many US's Chapter 11 cases where mediation has found greater application to facilitate multi-party negotiations and resolve disputes critical for the confirmation of a restructuring plan[48].

The business praxis shows that the intervention of a mediator as a neutral-third party offers an opportunity for the parties to establish a common ground for cooperation in the exchange of the financial and other information necessary for meaningful plan negotiations. Mediation is a private and confidential process whereby debtors can feel comfortable in sharing all the problems that afflict the business with the creditors, without any social stigma of failure.

Furthermore, mediation is a voluntary process where the solution for the case is not imposed to the parties by a third (as in the case of an arbitration award). The mediators' task is only to facilitate the discussion: by asking questions the mediator inspires the parties to express their expectations and hidden feelings and become more receptive about their real interests. Once the parties can communicate effectively, then they become able to focus on the content of the plan that would be tailored considering the peculiarities of each case.

From the creditors' perspective, mediation processes represent a way to collect information about the business financial situation, the state of the payments and any other relevant element that may support creditors' decision. Thus, mediation represents a test of the debtor's situation, and allows creditors to better assess whether it is reasonable to pay for transactions that are only modestly profitable (*e.g.* to receive a reduced amount of the debt; or to accept a periodic repayment) as a way of maximising the asset value.

In this context, the problems that usually arise during the negotiations for a restructuring plan are resolved by the mediator, who is technically prepared and has arguably unrivalled experience in dealing with multi-party negotiation dynamics.

Since a restructuring plan-related mediation involves a large number of participants, it requires mediation moving away from a standardized process, as in the case of mediation with only two parties. Indeed, in the context of multi-party negotiations, mediators should engage in various kinds of techniques to persuade the different parties. For instance, to overcome the resistance of a creditor, an *evaluative* mediator may try to advance negotiations by making suggestions regarding the contents of the plan. Although, mediation scholars and other practitioners have criticized this approach, since it represents an imposition of the mediator's view. In certain cases, the parties may ask an evaluative mediator to provide them

[48] *See*, Peples R., *The Use of Mediation in Chapter 11 cases*, 17 Am. Bankr. Inst. L. Rev. 401, 2009. Feder B.D. and Hahn D., *Mediation in Large Chapter 11 Cases*, available at http://www.abi.org/committee-post/mediation-in-large-chapter-11-cases.

with a solution to their problems, when the confirmation a plan on an expedite schedule is urgently required[49].

On the contrary, a *facilitative* mediator, rather than imposing a solution, prefers to enhance communication between the parties in order to make them be able to agree on a plan which is not imposed by the mediator, or by the majority which has an advantage in the negotiation; but it is the result of a meaningful discussion that mutually benefits all the parties[50]. It is beyond doubt that a mediated restructuring plan can be beneficial for all the reasons discussed above: the mediation process gives the parties the opportunity to build a rescue strategy with a higher degree of adherence to their real interests; additionally, parties can gather a wide range of information to assure performance and to monitor future behaviour. However, mediation for plan confirmation should be considered with care, because it also adds an element of uncertainty to the process. The risk of failure of mediating certain issues could have adverse consequences, in terms of time and cost for a second process before the Court. Giving those issues, it is fundamental that the mediator aid the parties in identifying the disputes or issues that may need to be settled or teed up for determination by the Court[51].

3.3. Prevention of Insolvency

As noted in the first paragraph of this paper, the main source of inefficiency and hence the main problem of out-of-Court proceedings in rescuing viable businesses, lies with the debtor-creditor interaction. Negotiations often take too long and are too costly due to non-efficient relational dynamics. When the company is in (or imminent) financial distress parties are often unwilling or unable to take an objective view of their problems. However, the first couple of months of a (possible) insolvency case are fundamental for the rescue of the business, and it is during this period that the intervention of a mediator would facilitate the prevention of an insolvency case, as recommended by regulators including the European Commission and the "Rordorf Commission".

Since out-of-Court debt restructurings show great flexibility and because of the availability of the process even to non-insolvent companies, they represent a great likelihood for the introduction of good practices based on the mediation model, as a way to prevent insolvency.

The intervention of a neutral party even from an early stage of an insolvency case reduces the burden of turning to a mediator when it may be too late for the parties to reach an amicable resolution of the distress. Furthermore, the mediator, as a neutral, can help the parties to listen respectfully and empathically to one another's statements and personal remarks. The possibility of discharging all negative emotions renders the parties more susceptible to further efforts in finding a solution to their problems. In particular, the mediators able to explain to creditors that they have an interest in finding a consensual solution with the debtor by

[49] On the importance of selecting the right mediator, *see*, L.A. Berkoff, *The importance of the right mediator, American Bankruptcy Institute Journal*; Apr. 2017; 101; ABI/INFORM Collection. P.A. Rubin, *10 Tips for a Successful Mediation*, in *American Bankruptcy Institute Journal;* Nov 2014; 33, 11; ABI/INFORM Collection, 40.

[50] For a comparison between evaluative and facilitative mediation, s*ee*, L.A. Berkoff et al., *Agreeing to Mediate, Selecting the Mediator and Mediation Approaches*, in *Bankruptcy Mediation*. cit., 57; *see* also, L.H. Kornreich, *Achieving a Balance Between Absolute Neutrality and a Participant's Desires in Mediation*, *American Bankruptcy Institute Journal*; May 2017; ABI/INFORM Collection, 71.

[51] The ELI Report expressely states that: "A careful balance should be applied in that an increasing role for mediators will only make sense where there are mediator-suitable disputes". *See*, *European Law Institute (ELI)*, *Report on Rescue of Business in Insolvency Law*, cit. (ft. 32), 132.

describing the potential consequences of insolvency proceedings if an agreement is not found.

At this stage, mediation also helps the parties in preventing (and resolving) future issues regarding plan confirmation or even in a liquidation of the entity. In this case, the intervention of a neutral, specialized third party helps creditors in getting more information about the debtor's financial situation, in order to shift through distressed businesses to identify those that are viable; while non viable companies will be liquidated. Indeed, none of the creditors would think that restructuring the business would be a viable solution when the outcomes of the negotiations suggest that the debtor cannot satisfy the targets of economic performance.

The assumptions mentioned above clarify that mediation should be used as a valuable tool to resolve disputes. However mediation might be used in a *non-traditional* way in insolvency cases, in particular as a way to educate parties on the realities of financial distress and business culture.

Lawyers seem to not yet be prepared for this new concept: they are still too focused on the *disease* while a new research is opening up about the models and techniques useful to safeguard the *health* of business and business relationships.

Indeed, there is an urgent need to capture the jurist's attention to the possible expansion of the point of view from which some phenomena can be observed and the law is produced, from the regulation and remediation functions to the business health promotion. In the case of a business crisis, attention should be paid to the anticipating intervention in order to safeguard the enterprise, and above all to supply crisis management techniques that leverage private autonomy as a source of effective distress resolution.

In many cases, *ex-post* legal measures to corporate distress no longer represent a valid solution. The problem of dissonance between the concrete needs and the legal answers is very deep: some clear reasons, others more hidden, do not seem to be sufficiently considered a valid topic for a scientific discussion. Amongst the first reasons, certainly, is that there is the crisis of enforcement, which then has its origin in the serious dysfunction of the justice system: the law is not applicable in the channels needed to satisfy justice. Among the latter reasons, however, is the belief that the intervention of the judge as the best and exclusive solution for conflicts between individuals[52].

The key feature of the mediation process is the attention to the internal dynamics of the problem, its causes, and the parties' interests. The lack of the mediator's powers to decide the fate of the business crisis or the dispute also encourages the parties' availability to put more information on the table and to make proposals for its solution. It explores the relationship with the possibility of discovering exchange tanks that had not been imagined of existence.

The aim of mediation is therefore different from that of the process and procedures. Through mediation, the parties are able to understand and better manage the crisis or conflicts and its causes, in order to safeguard the businesses' health or the underlying relationships. A *cognitive function* of the crisis and the conflicts.

[52] On the limits of judicial remedies for commercial long-term contracts, *see*, Lucarelli P., Ristori L., *I contratti commerciali di durata*, *cit*., *passim*.

The new paradigm relating to the corporate distress management thus belongs to the self-reflexive professional and entrepreneur. Culture, skills, awareness, relationship and problems management efficiency, trust and collaboration, become the goals of mediation even in the context of corporate crisis management.

4. Mediation in Italy: The Interaction between Law and Practice. Further Reforms to Improve Out-of-Courts Debt Restructuring.

This final section has the scope to provoke thoughts for further explorations on whether the introduction of any mediation elements in the pre-insolvency and restructuring proceedings could improve negotiations between all the stakeholders involved in the procedure.

A new approach to insolvency and business failure, indeed, should consider the implementation of **informal, flexible proceedings**, with the intervention of a specialized third party, fashioned over a mediation process, to help debtors in reaching agreements with creditors before the initiation of formal insolvency procedures.

Obviously, to make those preventive mechanism work in practice it is fundamental to resolve many issues: how a mediation process would be configured in the context of insolvency; who is the subject entitled to initiate the process, the debtor, the creditors or a combination of both; the identity of the mediator, a private individual or the Court or other public authorities. Moreover, it is not clear how creditors with opposing interests should be coordinated during the mediation process. One possible answer is that different creditors should be organized under a representative who has the burden to coordinate the different groups and to represent each creditor class during the mediation. Another question is the enforcement of mediation agreements reached with certain creditors, in case of subsequent bankruptcy. The point is whether those agreements fall under the avoidance rules or the system should introduce an exception to the avoidance rules and under which conditions[53].

As noted before the French model has proven to be efficient, therefore that example should also be considered by the Italian legislator. In the French legal system of mandataire ad hoc and règlement amiable/conciliation, the out-of-court workout is typically initiated by the debtor on a voluntary basis and it often involves the intervention of a third. Considering the Italian situation, however, there are no provisions for the involvement of mediators in restructuring and insolvency procedures.

In Italy, actually, there is a well-developed and broad mediation framework for resolving civil and commercial matters. However, the legislation concerns only certain types of civil and commercial disputes, while it does not apply to corporate and insolvency matters. Mandatory mediation was introduced by the Italian Mediation Bill, d.lgs. no. 28 of 2010, for two reasons: first, a lack of voluntary mediation; second, the growing public interest in Courts closing cases through mediation rather than adjudication. In order to promote mediation as a viable, effective and efficient alternative to court proceedings, the law obliges the parties to start mediation before opting for court proceedings.

[53] In 2015 the Spanish legislator introduced, for the first time, a system of protection of out of court, contractual, non-collective agreements from ex post avoidance actions. The regulation is included in article 71 bis of the Insolvency Law, *see*, I. Tirado, *Out of Court Debt Restructuring in Spain*, *cit*., (ft. 35).

The Italian Mediation Bill, significantly amended by the Italian authorities in 2013, is designed in order to give the Judiciary the power to order the parties to undertake a preliminary tentative of mediation, from the moment disputants step into the court until the cases go to final hearings (art. 5- *bis* Italian Mediation Bill). The judges, using the tool of the case management, have to evaluate when it is the right moment to send the parties to mediation considering a series of key elements such as: (1) the nature of the case; (2) the amount of the claim; (3) the participants; (4) the stage of the procedure. Only if the parties fail to achieve a consensual settlement under the guidance of a mediator are they allowed to step back to the judge, who will resolve the case with a sentence.

The Italian rules concerning court-connected mediation have been instrumental in anchoring mediation in the formal system of civil and commercial litigations, and this conjunction has led to an exponential increase of mediation procedures in Italy.

This assumption is confirmed by the data gathered through a qualitative case study conducted by a group of researchers from the University of Florence, in the period from June 1, 2013, to June 30, 2014[54]. In this period the researchers chose a number of Florentine courts that were active in organizing case-filing mediation, all of whom held different backgrounds other than insolvency or bankruptcy proceedings (the courts selected were active in the fields of civil and commercial matters, for instance, family disputes, financial contracts, insurances, and medical cases).

The data have been gathered in three ways: (*a*) examination of docket sheets and computerized docket records; (*b*) observation of judicial sessions; and (*c*) semi-structured interviews, or occasional talks, with the disputants, lawyers, judges, or mediators. At the end of the research a total of 2,753 docket sheets have been analysed. Using specific case selection filters the researchers considered that 1,122 cases were suitable for mediation. Of that number, the sample considered for the analysis consists of 507 courts' mediation referrals; about 40% of those mediations ended up with an agreement.

From a statistical point of view, that sample can be considered representative only of the practice of mediation within the Civil Court based in Florence, since it does not consider the data on the practice of court-connected mediation in the other Italian Courts[55]. However, due to a lack of previous empirical research in Italy on the topic, we believe that the data can be interesting for both scholars and lawyers. Considering the Florentine Court, the research shows that during the period of implementation of the project, the number of cases where a mediation process was initiated by the parties on their own volition were significantly lower than the number of cases where parties initiated the mediation process because they have been compelled to mediate by the judge.

The findings of the research carried out by the University of Florence within the Commercial and Civil Florentine Courts shed light on the question whether the legal changes that occurred in the fields of civil and commercial disputes would be possible also in the context of insolvency and bankruptcy proceedings.

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[54] *See*, P. Lucarelli, *Mediazione su ordine del giudice a Firenze*, *ibidem*, *passim*.

[55] Future researches will be able to more deeply investigate the causal relationship between the courts' role in case filling mediation and the development of such mechanism in the Italian legal system. The University of Florence is actually involved in a new research project on court-connected mediation started in 2016 and which is still continued.

The practice demonstrates that the judge's intervention is a very effective way to set the stage for the parties to negotiate and to facilitate settlement. Moreover, the court's initiative to send the parties to mediation gives a sense of procedural and substantive fairness amongst the parties; it also resolves the problem of courts' backlog affecting the Italian civil justice system.

In this view, in the nearly future, it is fundamental to address a list of practical issues and many normative questions concerning the implementation of court-connected mediation in the insolvency and bankruptcy context, such as whether judges should be involved in mediation; or addressing practical considerations such as when, how, and in what circumstances parties should be redirected to mediation; along with a discussion about the identification of the criteria for referrals by Courts to mediation.

5. Conclusions

The increasing number of companies dealing with financial difficulties has prompted the European Commission to diversify the tools available to debtors which enable them to restructure viable companies out of Court, with scope of preserving value by avoiding bankruptcy. Following the new European trend, several European countries, including Spain, Italy, France, have introduced different procedures regarding business restructuring or they have amended existing laws to create systems ensuring the survival of viable businesses.

As set out in the first paragraph, out of Court solutions for the corporate distress often face the usual disadvantages of collective action problems. To reduce such problems, the revision of some EU countries' national laws demonstrates a common tendency in introducing a third experienced party, who has the general aim of helping debtors in negotiating with stakeholders (mainly creditors) the rescue of the company.

The new paradigm of business rescue moves the focus from Courts − which traditionally have a control role in formal insolvency procedure − to the actors (namely debtors, creditors and all the parties interested), who are the real players of out of Court debt restructurings. In addition to those actors, an appointed mediator, or a Court appointed supervisor, plays a key role: it ensures the proper functioning of negotiations and the efficient handling of procedures for the benefit of creditors as well as other stakeholder.

The paper considers mediation as an effective tool to resolve insolvency matters. Obviously, mediation itself is not a *panacea*, a way to resolve all the insolvency matters, but there are no doubts that a disruption of the company value can be prevented if all the parties involved in the restructuring process adopt a more problem-solving attitude.

Disputes in the context of insolvency and bankruptcy can be solved more quickly and at lower cost through mediation, so as to preserve the debtor's estate for the benefit of the creditors. Mediation's goals however go beyond the dispute resolution approach to avoid the impoverishment of the company's asset. Mediation serves one more purpose: encouraging the many participants into the restructuring process to develop a responsible approach in resolving corporate distress (*i.e.*, cooperating instead of fighting each other).

To make such changes possible, the Italian government should foster mediation into the system, as a flexible, effective procedure to prevent insolvency following some EU member states' examples. A second major contribution may come from the judiciary: bankruptcy

judges, from their position, may bring an important contribution in selecting the cases that would be suitable for mediation, involving the intercession and assistance of a neutral and impartial third party.

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