



Giving a second chance to honest entrepreneurs by discharging debt: EU Commission Directive Proposal

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1. Second chance in the EU Proposal

A proposal for a Directive on “preventing restructuring frameworks, second chance and measures to increase the efficiency of restructuring insolvency and discharge procedures” was presented on 22nd November 2016 by the European Commission and is now expected to be approved ⁽¹⁾.

Firstly, the new framework will focus on early warning, promoting the earliest access to a solution for financial crisis: it’s generally accepted that encouraging an early start of any proceeding is necessary, at the first setback ⁽²⁾. Shareholders and business owners in general have to overcome their hesitations in approaching judicial proceedings, even considering their infamous effects in relationships with Banks, suppliers, competitors and stakehold-

ers in general. This risk is heavier in an Italian economic framework, where this trend is not limited to small enterprises. In fact, in Italy even medium and big enterprises show a familiar imprinting, involving shareholders in the management of the business. Therefore, they are unlikely to waive the right and apply for judicial proceeding, unless insolvency is not actual.

The second achievement of the above mentioned reform improves the possibility of releasing honest debtors and entrepreneurs who apply for a judicial proceeding ⁽³⁾. Some conditions must be fulfilled. The entrepreneur must have, at least partially, paid his debts proportionally to his assets and act correctly and in good faith. Once the conditions are met and no moral hazard is proved, outstanding debts are automatically delated (art. 20).

The period of time after which over-indebted entrepreneurs may be fully discharged from their debts shall be no longer than three years starting from: “the date on which the judicial or administrative authority decided on the application to open such a procedure, in the case of a procedure ending with the liquidation of an over-indebted entrepreneur’s assets; or the date on which implementation of the repayment plan started, in the case of a procedure which includes a repayment plan. Member States shall ensure that on expiry of the discharge period, over-indebted entrepreneurs are discharged of their debts without the need to re-apply to a judicial or administrative authority” (4).

Once the debt has been released, the entrepreneur is no longer subject to any limitations and is ready for a “ fresh start” .

2. *Second chance in Italian Regulatory framework*

Italian framework regulates a post-bankruptcy order case of discharge ⁽⁵⁾ for natural bodies and general company’s partners.

Furthermore, over-indebtedness proceedings are reserved to agricultural activities, small businesses, intellectual activities, start ups⁽⁶⁾ and consumers, pursuant to Law 3/2012, which allows the debtor to gain a complete discharge. ⁽⁷⁾

Presently, Italian bankruptcy code is moving towards a great period of reform, determined by the crisis, which is heavily impacting the whole European economy and by new social needs which are gradually emerging. A Commission was appointed by Italian Minister of Justice, led by its President Renato Rordorf and her proposal was approved in Camera dei Deputati last Spring ⁽⁸⁾; now it is likely to be also approved by Senato in the short term.

According to this project, in case of the absolute impossibility of paying the debt in the present or in the future, this can be released - but only once- ⁽⁹⁾.

On the other hand, financier’s behaviour has to be evaluated in compliance with Responsible lending policy and consumer protection criteria. In fact, professional institutions are supposed to manage an appropriate rating system and to give full information to the consumer. Therefore, the new proposal set up by incoming reform allows no opposition to irresponsible financiers which will have limitations in judicial proceedings.

In case of minor commercial insolvencies the release from the debt will be accessible, unless

creditors challenge it and file an opposition. Instead, in case of major insolvency, a debtor application is requested, whether he is a natural person, a general company or a limited company: company requirements shall be checked by looking at her manager's attitude. The application shall be filed even before the end of the proceeding, after three years from the first admission, so that proceeding length will not affect the result.

Although nowadays requirements for the release seem more complicated, these will be simplified in the future for both entrepreneurs and consumers. Under no circumstances can the discharge be allowed in case of foul play or fraud. Furthermore, a filter must be applied to write off debts even for honest debtors, in order to avoid an overwhelming use of this right: for instance, following the new Law, professionals and consumers won't be able to exercise this clause more than twice, and not unless five years have passed since the first request.

3. *Second chance: trick or treat?*

Evidence shows that honest bankruptcies (i.e., due to late payments, and other objective reasons, not involving fraud) are by far the majority, and reach 96% of bankruptcy cases⁽¹⁰⁾.

Eu Commission Recommendation 2014/135, which advanced the Directive proposal, stresses the importance of giving entrepreneurs a *second chance*, since "second starters are more successful and survive longer than average start-ups. Thus, a failure in entrepreneurship should not result in a life sentence prohibiting any future entrepreneurial ac-

tivity but should be seen as an opportunity for learning and improving"⁽¹¹⁾.

Actually, the choice to improve a fresh start when possible is gaining more and more support. When it is worth readmitting a natural person or a company in the economy, he can start again to produce - or to consume - actively. In this way, he gets rid of the previous debt burden, without carrying it forever and obtains an "economic rehabilitation" ⁽¹²⁾.

This stands out not because of a generic sort of social forgiveness, but according to a legal achievement. This is important also for an economical general benefit: first of all, denying the opportunity of a second chance may increase the phenomena of usury as well as entrepreneurs being driven to the black economy.

Finally, as the proposal of Directive says: "it is estimated that offering a true second chance to honest entrepreneurs to restart business activities would create 3 million jobs across Europe" ⁽¹³⁾.

There is no longer doubt that crisis does not always depend on fraud, but it may come from an unlucky series of events related to business risk; crisis may even be a negative moment arising in a vast business venture ⁽¹⁴⁾ as a result of low sales or insolvency of major clients and suppliers. For this reason, entrepreneurs should not be stigmatized when their honest business fails.

On the other hand, prudence is recommended in weakening debt-liability principles: to pay off debts is an ethic rule, not only a legal matter. Negative consequences, such as increasing costs in accessing finance in case of non priority claims, might be issued.

This is because financiers are likely to cover their major risks in advance.

Given that the rule of law might be questioned, this might lead to a discouragement in

trading and bargains. Therefore, we can't help fearing a lack of trust if creditors all over Europe lose faith in a chance of recovery.

¹ See COM/2016/0723 (final).

² See Commission Recommendation of 12nd March 2014/135/UE, whereas 16): "A restructuring framework should enable debtors to address their financial difficulties at an early stage, when their insolvency could be prevented and the continuation of their business assured. However, in order to avoid any potential risks of the procedure being misused, the financial difficulties of the debtor must be likely to lead to its insolvency and the restructuring plan must be capable of preventing the insolvency of the debtor and ensuring the viability of the business". See also whereas 17): "To promote efficiency and reduce delays and costs, national preventive restructuring frameworks should include flexible procedures limiting court formalities to where they are necessary and proportionate in order to safeguard the interests of creditors and other interested parties likely to be affected. For example, to avoid unnecessary costs and reflect the early nature of the procedure, debtors should in principle be left in control of their assets and the appointment of a mediator or a supervisor should not be compulsory, but made on a case-by-case basis".

³ Article 19. "Access to discharge 1. Member States shall ensure that over-indebted entrepreneurs may be fully discharged of their debts in accordance with this Directive. 2. Member States in which a full discharge of debt is conditional on a partial repayment of debt by the entrepreneur shall ensure that the related repayment obligation is based on the individual situation of the entrepreneur and is notably proportionate to his or her disposable income over the discharge period".

⁴ Article 20, Directive Proposal

⁵ See Article 142, Italian Bankruptcy Code

⁶ According to Decree 18th October 2012, n. 179, converted into Law 17th December 2012, n. 221.

⁷ Article 14 *terdecies*, Law 27th January 2012, n.3.

⁸ D.di I. 3671bis, <http://www.camera.it/leg17/995>

⁹ Art.9 DLL 3671bis: "*Sovraindebitamento*. 1. Nell'esercizio della delega di cui all'articolo 1, per la disciplina della procedura di composizione delle crisi da sovraindebitamento di cui alla legge 27 gennaio 2012, n. 3, il Governo procede al riordino e alla semplificazione della disciplina in materia attenendosi ai seguenti principi e criteri direttivi: (...) c) consentire al debitore meritevole, che non sia in grado di offrire ai creditori alcuna utilità, diretta o indiretta, nemmeno futura, di accedere all'esdebitazione solo per una volta, fatto salvo l'obbligo di pagamento del debito entro tre anni, laddove sopravvengano utilità".

¹⁰ Report on the results of public consultation on The Entrepreneurship 2020 Action Plan, European Commission.

¹¹ See "*Entrepreneurship 2020 action plan*" COM(2012) 795 (in <http://eur-lex.europa.eu/>)

¹² According to the Report on the Treatment of the Insolvency of Natural Persons (Working Group on the Treatment of the Insolvency of Natural Persons,

http://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport_01_11_13.pdf)

characteristics of the discharge are: "Rehabilitation can be said to include three elements. First, the debtor has to be freed from excessive debt. The benefits of the discharge have been extensively discussed from the point of view of the debtors, creditors and the society in section I.9, above. Second, the debtor should be treated on an equal basis with non-debtors after receiving relief (the principle of non-discrimination). Third, the debtor should be able to avoid becoming excessively indebted again in the future, which may require some attempt to change debtors' attitudes concerning proper credit use".

¹³ Annual Report of European SMEs 2015/2016, p. 54.

¹⁴ See also European Commission Press 12th December 2012, (http://europa.eu/rapid/press-release_IP-12-1354_it.htm): "Giving honest businesses a second chance: Commission proposes modern insolvency rules. Vice-President Antonio Tajani, Commission or Industry and Entrepreneurship added that insolvencies are a fact of life in a dynamic, modern economy. Around half of enterprises survive less than five years, and around 200 000 firms go bankrupt in the EU each

year. This means that some 600 companies in Europe go bust every day. A quarter of these bankruptcies have a cross-border element. But evidence suggests that failed entrepreneurs learn from their mistakes and are generally more successful the second time around. Up to 18% of all entrepreneurs who go on to be successful have failed in their first venture. It is therefore essential to have modern laws and efficient procedures in place to help businesses, which have sufficient economic substance, overcome financial difficulties and to get a “second chance”.