

# Creditors trump trusts

**Professor Stefano Loconte** reviews a recent Italian Supreme Court judgment which held that a trust used in liquidation proceedings will be declared invalid if it is used to circumvent creditor-protection legislation

An Italian company (LLP) became bankrupt and the legal representative set up a self-declared trust in which all the company assets were segregated as part of the liquidation, in order to satisfy creditor claims. The Supreme Court, after reviewing the case, stated that the trust in question could not be used in liquidation proceedings because its aim appeared to be to circumvent compulsory creditor-protection procedures under Italian bankruptcy legislation.<sup>1</sup> The Supreme Court explained that the trustee – through the segregation of company assets in the trust – was managing the liquidation of the assets (i.e. it was able to appoint the liquidator, receiver, administrator, etc) and was therefore not bound by bankruptcy law, as it was required to be.

However, the most important issue decided by the Court is that it is not possible to recognise the juridical effects of a trust used in liquidation proceedings if the trust was set up after the company's declaration of insolvency (*dichiarazione di fallimento*).

## TRUSTS USABLE DURING LIQUIDATION

Another aspect of the Supreme Court's judgment related to the different types of trust that can be used during liquidation proceedings. These are:

- A trust used as a substitute for liquidation proceedings to sell company assets, pay creditors, share remaining goods with the shareholders and dissolve the company.
- A trust used as an alternative method of resolving corporate crises (i.e. *trust endo-concorsuale*).
- A trust used as a substitute for insolvency proceedings to prevent the entrepreneur having to sell company assets (i.e. *trust anti-concorsuale*).

In the case of trusts used as a substitute for liquidation proceedings, the trust, in the past, could have been deemed void when it was used to manage corporate crises as it would grant to the parties more autonomy than the alternative legal mechanisms existing under Italian law. However, Italy's legal system has recently undergone reform and now allows this method of managing corporate crises, and consequently this type of trust.

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**PROFESSOR STEFANO LOCONTE TEP**  
IS MANAGING PARTNER  
OF LOCONTE & PARTNERS  
AND SECRETARY  
OF STEP ITALY



The Supreme Court also stated that, in the other two cases, it is necessary to evaluate the effects of the use of the trust in order to establish its legitimacy. A legal instrument – even one incorporated into national law by the ratification of international agreements such as the Hague Trust Convention of 1985 – cannot be used for purposes that domestic law prohibits.

With regard to a trust used in insolvency proceedings, the Supreme Court agreed with the guidance of the lower courts, which stated that a trust is invalid under article 1418 of the *Civil Code* when it is used to segregate the entire assets of the company for liquidation and in doing so violates creditor-protection measures.

The courts' rulings are not, however, too strict. In many cases, the lower courts recognise the validity of a trust used for liquidation purposes, except where:

- the company was already in a state of collapse; or
- there was no clause that, in the event of insolvency, provided for the consignment of goods to the receiver; or, above all,
- the same individuals had the roles of settlor, trustee and guardian without a third party who would have guaranteed impartiality and decisions in the interests of the creditors.

The Hague Trust Convention was ratified by Italy in 1989. Article 18 of the Convention states: 'The provisions of the Convention may be disregarded when their application would be manifestly incompatible with public policy' – i.e. a trust may be revoked if it pursues purposes contrary to Italian law. A trust used to segregate company assets for liquidation in violation of creditor-protection regulations is therefore void. ●

## STEP

## GLOBAL CONGRESS



'Trusts in some civil-law jurisdictions' will be the topic of a stimulating discussion by Dr Max Ganado, Dr Ákos Menyhei TEP, Diana Palomba TEP and Marilyn Piccini Roy at STEP Global Congress on **7 November 2014** at the **Mandarin Oriental** in Miami. Find out more at [www.stepglobalcongress.com](http://www.stepglobalcongress.com)

<sup>1</sup> Judgment No.10105/14