

Parmalat: A Lesson for the Future?

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The last known location of several billion US dollars is Uglan House, P.O Box 309 in the Cayman Islands.

Beginning at Collecchio near Parma in Italy, the seat of La Coloniale, the company through which Calisto Tanzi controlled Parmalat, the chronicle of these monies travels five thousand miles, reaching the palm-encircled resort of Georgetown, Grand Cayman Island, in the Caribbean, where the 'investment fund' Epicurum, was domiciled. According to the information available, US\$ 6.9 billion have gone missing.

There are two networks of offshore companies. The first can be traced back to the Parmalat group, and the second is headed by Fausto Tonna, who has been the financial director of the Parmalat group for fifteen years. During this period, the Collecchio group has experienced an incredible increase in turnover, going from ITL 7 billion (equivalent to EUR 3.5 million) to EUR 7.5 billion. One would have thought that Tanzi would have needed to have access to colossal capital to sustain such development and maintain control; however, the controlling company, La Coloniale, has always maintained a modest capital of approximately EUR 190 million.

The transformation to multinational group must therefore have come about through different means – loan financing. According to the recent assessment by the analysis team of Enrico Bondi, who is currently drawing up a restructuring plan for the stricken company, the group's debt to date would probably exceed EUR 14.3 billion and the total value of bonds on the market would amount to about EUR 7.2 billion.

The principal problem relates to the assets of the group, which seem to have almost completely disappeared in an amazing worldwide network of some 260 companies. These companies may have been used to hide questionable financial operations, infra-group acquisitions and cessions in relation to Parmalat's budgetary requirements, using 'back-to-back' operations, showing non-existent assets in the accounts and then having them 'disappear' far from the control

of the Bank of Italy. This type of financing is similar to the US concept of escrow financing.

Briefly, the operation of escrow consists of a company (Company A) obtaining credit from a bank and then depositing it in a foreign bank as a pledge. The foreign bank, holding the money as a guarantee, then sets up a trust in favour of one of the group's offshore companies. The credit originally obtained will only appear in the balance sheet of Company A, creating an apparent liquidity that could be used to guarantee, for example, new bond issues. This can be made even more straightforward with the aid of well-known financial institutions, as occurred in the Parmalat situation with the Bank of America and Citigroup.

Tanzi controlled the Parmalat group through the family's holding company, La Coloniale. The Tanzi family is the majority shareholder of La Coloniale through the limited liability company Utilitas srl, in turn owned by Acqua S.A. domiciled in Luxembourg and controlled by the Luxembourg management company group and by LM Consulting Company, in the Virgin Islands.

Parmalat SpA, controlled by Parmalat Finanziaria, owns Soparfi, a financial institution with its registered office at Place del La Contests 5, in Luxembourg. From an examination of the *Registre de commerce et des sociétés* of Luxembourg, it is clear that this company was the principal channel for the infra-group sales. From the documents, it appears that Parmalat Holding Malta Ltd, a Soparfi subsidiary having its registered office in Malta, controls not only Parmalat Trading Company, but also Parmalat Capital Finance, an offshore company domiciled in Malta with its registered office in Georgetown, Grand Cayman.

Established in 2002, Parmalat Capital Finance Ltd has performed only two operations: first it purchased a Cayman company, Bonlat Financing Corporation, at a price of US\$ 2; and second it transformed Bonlat into an asset container by transferring US\$ 6.9 billion to Bonlat, shown in the Parmalat group's balance sheet as 'loan capital'. Bonlat then invested the whole sum in a currency swap with the Epicurum fund.

Notes

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The idea was to enter markets in which Parmalat was absent or weak. The intention would appear to be for the Collecchio group to supply trademarks and technology in exchange for royalties. The managers of Epicurum were to collect these royalties until they amounted to US\$ 7 billion, but the operation collapsed and the fund is now in liquidation.

Epicurum invested the US\$ 6.9 billion obtained from Parmalat Capital Finance Ltd in a Luxembourg company, The Third Millennium, which was founded by Fausto Tonna, and which owns the company Raceme s.r.l. which in turn controls RTM Holding Malta and Sailor Ltd, both registered at Ugland House, P.O. Box 309, Cayman Islands.

In the chain of rolling heads is the Italian member firm of accountants Grant Thornton International, namely Grant Thornton SpA, accused of collaborating and falsifying its audit of some of the group's subsidiaries.

Controls and Defaults

It is important to mention at this point how the Italian accounting controls on stock companies listed on the stock exchange are structured. There are two levels of control – public and private. The first, public, is regulated by various authorities, and the second, private, involves auditing companies.

The powers of control over the financial market are essentially reserved to the Minister of Finance, the Bank of Italy and to CONSOB (Securities and Exchange Commission), and, in the case of regulated markets, to the individual market surveillance organizations. The Minister is entrusted with regulatory powers for the establishment of principled and professional standards for majority shareholders, for company management in investment funds, for SICAV (variable capital investment companies) and stockbrokers. The Minister also has powers to establish systems for the protection of investors and endorsement powers over market surveillance organizations (extraordinary administration and forced administrative liquidation).

The Bank of Italy on the other hand has exclusive control over stock issues exceeding determined quantitative thresholds, and also has regulatory and supervisory powers over management funds, SICAVs, stockbrokers and over banks in relation to the development of investment services. Some of these supervisory powers coincide with those granted to CONSOB.

Although the boundary between the powers of these two agencies has been established – the Bank of Italy has power to control the risks and asset stability, while CONSOB deals with issues of operational transparency and correctness – there is a lack of more defined and specific co-ordination between the two, leading to expensive duplication of activities.

Unlike the Bank of Italy, CONSOB does not have supervisory powers in relation to access to financial markets. However, it does exercise exclusive supervision over market surveillance organizations (complementary to the self-regulatory systems operated by those market surveillance organizations over their own operations as per Art. 61 of the *Testo Unico della Finanza* (TUF)) and over intermediaries involved in negotiations relating to the issuing of quoted stock. CONSOB also exercises exclusive supervision over requests for public savings under Art. 9 of TUF.

The private auditing companies carry out functions of control and reporting. Firstly they monitor the general accounting and statements of assets and liabilities of the companies they audit, as well as establish whether the regulations relative to the evaluation of company assets have been complied with. Auditing companies have the right to obtain from the managers of the company any documents and information which may be required for the purposes of the audit, and if necessary may carry out inspections.

The reporting functions are carried out vis-à-vis the shareholders (reports on the balance sheets, evaluation of the price of the share issues) the management board, the consumers and the market, as well as to CONSOB itself should the evaluation of the balance sheet be negative or for any reason impossible.

Notwithstanding, or perhaps due to, the existence of all these bodies, there is a lack of any real harmony between them, which leads to the requirement for specific coordination each time any significant investigation is to be made.

Conclusions

Although the independence of the public controlling bodies is subject to regulation, there are no such measures in force in relation to the private controllers, namely the auditing companies – which may in part have led to the Parmalat situation reaching the position it did.

Currently, there is a lively debate in relation to this issue of independence. The auditing companies are still regulated by the provisions of a law promulgated in 1975 which essentially only limits the social objects of private auditors to '*auditing and organizing the accounting of companies*'. There are also several recommendations relating to the supervisory functions of the audit companies which have been issued by CONSOB, but these resolutions are not in any way binding.

However, the Ministry of Justice was charged in 1998, by way of a legislative decree, to issue regulations controlling auditing standards and independence. Such regulations have not to date been issued. Given this void, the demands for independence, both within Italy and the rest of Europe, have been

increasingly vociferous, particularly after the financial scandals that have occupied the local and international economic pages since the failure of Enron.

Within Europe, the principles set out in the Sarbanes–Oxley Act 2002 as to the independence of auditing companies have been approved in the Recommendation by the European Commission dated 16 May 2002: ‘Statutory Auditors’ Independence in the EU: A Set of Fundamental Principles’ (UJEC no. L191, 19/07/2002).

Given the facts originating from Collecchio, facts that are coming forth in greater detail as each day passes, it is obvious that this deficiency in the Italian legislation needs to be addressed. If it is not, there is a real danger that the undisclosed merry-go-round of corporate capital may occur yet again, leading to future exposure for banks and investors.

The moral of this tale seems to be that new enforceable regulations must be put in place, together with more effective collaboration between the public controlling bodies.