Distressed M&A (Italy)

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A Practice Note giving an overview of the main features of merger and acquisition transactions involving distressed businesses or distressed sellers (or both), including purchasing schemes and key issues to be addressed, and contractual documents.

Advisers

This Note addresses distressed merger and acquisition (M&A) transactions conducted inside or outside processes governed by the Italian insolvency laws. Due to recent changes in legislation, *Legislative Decree no 14/2019* in force (Italian Insolvency Code), governs processes initiated after 15 July 2022. Processes already pending at 15 July 2022 are still governed by *Royal Decree no 267/1942* (Italian Bankruptcy Act).

The Note describes what is meant by distressed M&A on the Italian market and addresses issues including:

- Possible purchasing schemes.
- Key issues to consider in a distressed M&A transaction.
- Contractual documents envisaged depending on the different purchasing schemes.

Taxation, employment and pension laws are outside the scope of this Note.

Unless stated otherwise in this Note any reference to shares (of a public limited company (SPA)) includes reference to the quotas (of a private limited company (SRL)).

Also, unless otherwise specified, any reference to the Italian Insolvency Code shall imply also the same situation under the Italian Bankruptcy Act to the extent the latter continues to apply. Similarly, any reference to judicial liquidation (*liquidazione giudiziale*) under the Italian Insolvency Code includes also bankruptcy (*fallimento*) under the Italian Bankruptcy Act, unless otherwise specified and to the extent the latter is in place.

What is Meant by Distressed M&A?

Reference to distressed M&A in the Italian legal market is generally understood to include M&A transactions where the seller or target assets (or both) are in financial distress. In the Italian legal system, it is generally understood that financial distress may fall into any of the following categories:

- Financial difficulties (also pre-crisis (*pre-crisi*)) not representing a pre-insolvency or insolvency situation. For example, the company concerned may be in early discussions with its lenders based on its view of its own cash needs going forward or has initiated a supervised composition process.
- A "crisis", which is defined by the Italian Insolvency Code as the condition of economic and financial distress that makes insolvency likely due to the insufficiency of forecasted cash flow to meet the debtor's obligations over the following 12 months. Normally, it is for the company, with the help of its advisers, to carry out a self-assessment of its own financial situation and to decide whether it should try and recover the business by accessing any of the pre-insolvency processes governed by the Italian Insolvency Code.
- Insolvency situations falling within the insolvency processes governed by the Italian Insolvency Code.

Italian company law provides that the internal control systems of a company should include tools to ensure that the company can timely identify a situation of crisis allowing its directors to promptly take the appropriate steps (including resort to the pre-insolvency mechanisms set out under the Italian Insolvency Code) to preserve the business continuity of the company. For more information on the duties of the directors of an SPA in connection with the set-up of an adequate internal control system (that

is, an adequate organisational, administrative and accounting system) and the duty to detect promptly situations of financial distress of the company and take appropriate actions, see *Practice Note, Directors' Duties in an SPA (Italy): Companies in Financial Distress (crisi) and Directors' Duties*.

Distressed Target Company, Distressed Seller or Both?

The challenges involved in a distressed acquisition vary considerably depending on whether the buyer is seeking to acquire:

- The shares in a distressed company (see *Distressed Target Company*).
- An asset belonging to a distressed seller (see *Purchase From a Distressed Seller*).
- A distressed asset from a distressed seller (see *Purchase of a Distressed Company from a Distressed Seller*).

The challenges involved in a distressed acquisition are also influenced by the kind of purchasing scheme adopted (see *Purchasing Schemes*).

Distressed Target Company

If a buyer intends to buy a financially troubled company, the buyer's focus will be on:

- Understanding the causes and the extent of the financial distress.
- The preservation of the value, or of as much value as possible, of the target during the acquisition process and any restructuring process.
- The payment of a price that reflects the real equity value of the target, which may in fact be negative.

These requirements will ideally involve a thorough due diligence aimed at:

- Identifying the causes of the distress.
- Ensuring that the consequences of the distress are fairly reflected in the company's accounts.
- Understanding if the business of the company can (or is likely to) be damaged by its lenders or by other stakeholders' reactions to the financial troubles, either in terms of exercise of contractual rights or in terms of how they may commercially react to the situation of financial difficulties. For example, an important client may decide to purchase from another supplier, or a joint-venture partner may decline to continue to financially support the joint enterprise until the company’s returns to a sound financial footing.

Experience shows that financial difficulties may prompt directors (particularly when they are also shareholders) and managers to incur risks in an attempt to improve the company's performance, or the appearance of its performance. In the context of the due diligence particular care should therefore be devoted to verify that the target company did not engage in violations of the law or accounting principles, for example, by bribing a client to obtain or retain business, or by overstating the book value of an asset (see *Directors' Duties*).

Before embarking on a costly and time-consuming acquisition exercise a buyer will also want to take steps to minimise business disruption. These steps may include reassuring suppliers and clients, engaging in a dialogue with the trade unions and local authorities or providing bridge financing.

Fair Price Determination
The determination of a fair price for the target company or business typically sees a conflict among three main parties:

- Shareholders, keen to retain some value from their participation in the target. Even when the equity value is zero the buyer may be willing to acknowledge that the equity has some value to ensure the support of the shareholders and the management for the envisaged transaction.
- Financial creditors (to the extent their consent is needed, for example, through a waiver for a breach of covenant or in the context of a restructuring process), trying to obtain as high a recovery ratio as possible.
- The buyer who will want to buy the company with a capital structure that ensures its future viability (which often implies a haircut for creditors). These interests are clearly conflicting and, in some instances, may only be satisfactorily resolved in the context of an in-court process (both pre-insolvency (see *Acquisition Through a Pre-Insolvency Process Governed by the Italian Insolvency Code*) and insolvency (see *Acquisition Through an Insolvency Process Governed by the Italian Insolvency Code*)).

Purchase from a Distressed Seller

If a buyer is purchasing a non-distressed asset from a financially troubled company, the buyer's concerns will mainly be the possibility that the seller becomes insolvent and is declared subject to judicial liquidation. The declaration of judicial liquidation of the seller carries the risk that the purchase is voided because it can be clawed-back or amounts to a preferential transfer or even a fraudulent transfer (defrauding the creditors of the seller).

Italian law sets out claw-back and avoidance actions aimed at ensuring the equality of distribution among similarly situated creditors. These actions represent a serious risk and, if brought (even when ultimately unsuccessful) can jeopardise the buyer's ability to re-sell the asset for a significant period of time. For more information on claw-back actions involving transactions carried out by an insolvent debtor during a certain period before it is declared subject to judicial liquidation, see *Country Q&A, Restructuring and Insolvency in Italy: Overview: Setting Aside Transactions*.

Buyers should therefore either satisfy themselves that the seller is not declared subject to judicial liquidation for the whole duration of the period in which claw-back actions could be exercised (so-called hardening period) or conduct the transaction under the Italian Insolvency Code (see *Acquisition Through a Pre-Insolvency Process Governed by the Italian Insolvency Code*), which may entail going through an auction process under court supervision.

Buyers should also be mindful that any warranty they obtain – which could be very limited (if at all granted) especially if the asset is purchased in an auction process – from a financially troubled seller may become of very limited value if the seller becomes subject to judicial liquidation. This is because the seller is unlikely to be able to meet any financial claim made under the warranty, either at all or in full due to having insufficient assets or being in a formal insolvency process that may put unsecured warranty claims at the back of the line for payment. To address the risk a buyer could consider a warranty and indemnity insurance which in any case may not cover all risk areas of the transaction (see *Warranty, Indemnity and Insurance*).

Purchase of a Distressed Company from a Distressed Seller

The situation in which a distressed target company is purchased from a financially troubled parent company is one that compounds all the risks highlighted above (see *Distressed Target Company* and *Purchase From a Distressed Seller*).

Deal Structure: Share Deal or Asset Deal?

Normally a distressed M&A transaction can be structured as either a share sale or an asset sale. The advantages and disadvantages of both a share sale and an asset sale will need to be considered for each particular transaction (see *Practice Note, Acquisition Structures: Comparing Asset Purchases and Share Purchases (Italy)*).

A seller is likely to prefer a share sale, where the shares in the target company are sold and therefore all of the assets and liabilities of the target company transfer with the shares, subject to any change of control provisions in the relevant contracts or regulatory authorisations. A share sale will often be easier to implement, as the main formal requirements relate to the procedures for transferring the target company shares.

In a distress scenario, however, the buyer will often prefer an asset sale especially if the distressed company is undergoing an out-of-court composition process (see *Acquisition Through a Pre-Insolvency Process Governed by the Italian Insolvency Code*). This allows the buyer to cherry-pick those assets that it wants to acquire and, to the extent permitted under Italian law, to leave behind pre-existing liabilities with the seller. An asset sale requires careful identification of the assets being transferred and is more complex, as there may be specific formal requirements depending on the nature of those assets, such as real estate registrations, intellectual property registrations, and consents to assign or novate individual contracts.

If conducting an asset sale, buyers should be aware that certain liabilities may transfer automatically under relevant laws (see *Practice Note, Acquisition Structures: Comparing Asset Purchases and Share Purchases (Italy): Asset Purchases: Automatic Transfer of Liabilities*).

Key Issues for a Distressed Acquisition Transaction

Governmental Approvals: Competition and FDI Regimes

As with any M&A process, merger control and foreign direct investment (FDI) approvals will need to be carefully considered on any distressed M&A transaction.

More generally, it will be important for parties to undertake a careful evaluation to identify any risk of delay to a transaction. This is particularly relevant to a distressed M&A transaction, where speed is often key.

For more information on the regime for foreign direct investment in strategic assets and activities in Italy, see *Practice Note, Regulation of Foreign Investment in Italy*.

For more information on the key competition issues to consider on a private acquisition falling within the Italian merger control regime, see *Practice Note, Competition: Private Acquisitions and Joint Ventures (Italy)*.

Due Diligence

The due diligence is one of the most sensitive matters in distressed M&A and is often carried out under time pressure.

The due diligence in a distressed M&A scenario has the same scope and purpose as a normal due diligence exercise carried out in a non-distressed situation, supplemented by possible time or process constraints if the sale occurs in the context of an out-of-court composition process or a court-supervised pre-insolvency or insolvency process and the need to pay special attention to the risks involved depending on whether the acquisition is of a distressed target company or from a distressed seller or both (see *Distressed Target Company, Distressed Seller or Both?*).

For more information on the purpose, scope and practical aspects of a legal due diligence investigation on the purchase of a business in Italy by way of share purchase or asset purchase, see *Practice Note, Due Diligence for Private Acquisitions (Italy)*.

Stay

Unlike the Italian Bankruptcy Act, the Italian Insolvency Code does not provide for an automatic stay in the pre-insolvency procedures and the supervised composition process. Debtors, however, can ask the tribunal to grant protective measures, preventing creditors from initiating or continuing enforcement actions. If said measures are refused or have expired during the negotiation phase, the creditors will be entitled to start or resume enforcement actions, which would negatively affect the interest of the buyer to complete the transaction. It is, therefore, important for a buyer to understand in advance whether the negotiations can be completed in a protected environment and to pursue completion before the protective measures expire.

Employees Considerations

In a sale of a company's shares, the employment contracts transfer with the shares along with all the other assets and liabilities of the company (see *Deal Structure: Share Deal or Asset Deal?*).

In a sale of a business as going concern or business unit, the general principle of Italian labour law is that the employment contracts of the employees assigned to the target business or business unit transfer automatically to the buyer, without interruption. All of the employment terms and conditions enjoyed by the transferred employees under both their individual employment contracts and collective bargaining agreements (at a national, local and company level) are transferred and the buyer must adhere to the provisions of such collective agreements until their expiry (Article 2112, *Civil Code* (Codice Civile)).

The above applies also to the sale of a distressed business or a distressed company.

Directors' Duties

Under Italian company law directors must discharge their duties in the interest of the company, in accordance with the law and the articles of association.

If the company is solvent and is therefore able to meet all of its obligations, from a practical standpoint, directors will largely be taking into consideration the interests of shareholders. Conversely, if the company is approaching insolvency, directors will have to take into account the need to protect the interests of other stakeholders and in particular those of the creditors of the company.

Directors must at all times make sure that they act diligently and in an informed manner and should be particularly mindful of possible conflicts of interest. For more information on the duties of directors of an SPA, see *Practice Note, Directors' Duties in an SPA (Italy)*.

Legal Regime

While normal M&A transactions are conducted within a framework consisting of company and contract law (with the addition of whatever special legislation may become relevant in the context of a particular transaction, such as intellectual property, employment, tax, environmental law), transactions involving distressed companies or assets are, in addition, often driven by laws regulating insolvency or pre-insolvency processes and greatly influenced by criminal law risks.

Warranty, Indemnity and Insurance

Generally, outside of pre-insolvency and insolvency proceedings, the standard basic representations and warranties (R&W) are granted (such as authority, capacity, title and ownership, in addition to certain standard representations and warranties, typically, on labour, tax or regulatory matters extent). This depends on the negotiation with the seller as well as the necessity to close the transaction swiftly.

In the context of pre-insolvency and insolvency proceedings the ability of a seller to provide R&W is often very limited. Also, the economic safeguard offered by R&W granted by a distressed seller is bound to be very limited.

Buyers should pay particular attention to due diligence and consider the possibility of using W&I insurance, which in any case may not cover all the risk areas of the transaction.

For more information on the use of W&I insurance policies for buyers and sellers in private M&A transactions in Italy, see *Practice Note, Warranty and Indemnity Insurance: Acquisitions (Italy)*.

Multiple Stakeholders

In normal M&A transactions a buyer deals almost exclusively with the shareholder of the target company or the seller of the assets, with occasional interactions with other key stakeholders, such as strategic clients and suppliers, or lenders. In distressed transactions, the deal will be greatly influenced by players who are either not involved in traditional M&A transactions or acquire a greatly enhanced role when there is a distressed element. While actors and their weight can vary depending on circumstances, the following typically play a role, and often a major one:

- **Statutory auditors.** The corporate governance of Italian companies is normally characterised by the presence of a board of statutory auditors. This board, typically consisting of three individuals, often chartered accountants, is tasked with supervising directors' compliance with the law and the company's articles of association and has sweeping powers, including the power to report violations to the courts.
- **External auditors.** For a financially troubled company the role of external auditors is particularly relevant when they have to opine on whether the annual accounts meet the going concern standard or not.
- **Courts and participants in in-court processes.** Transactions affecting a distressed company or its assets can occur either out of court or in the context of an in-court process. Whenever there is an in-court process the role of the court will be very substantial and the applicable rules will significantly impact the dynamics, the timing and the content of the transaction. For example, in-court processes often see the participation of other players, in particular of judicial commissioners and independent experts.
- **Independent expert in an out-of-court supervised composition process.** The independent expert is appointed by a committee of the local Chamber of Commerce (*Camera di Commercio*) to facilitate the negotiations between the debtor, its creditors and any interested parties (including the buyer of the assets) in order to find a solution to overcome the financial imbalance.
- **Trade unions.** Italian law is generally protective of workers' rights and there are specific rules regarding consultation with trade unions when a business (or business unit) as going concern is transferred. Unsurprisingly, workers are particularly concerned when their employer is in financial trouble and engages in a transaction that may result in a change of control of the company or the relevant asset, for example, a factory. Industrial action can delay or disrupt transactions, can worry suppliers and clients and can draw the attention of local or national authorities, politicians and the media.
- **Suppliers.** To protect the value of the target company or the asset, keeping the business going is of paramount importance. Suppliers who become aware of the distressed situation of their client will be understandably concerned

and may stop or reduce deliveries or insist on different payment terms. Suppliers will also be creditors in the restructuring process and their vote may be influential on the outcome of the proposed transaction.

- **Clients.** Clients and customers will also be concerned by the troubled financial situation of the company they buy goods or services from and may be tempted to look for alternative business partners. Keeping them happy during what is often a protracted process is always a significant challenge and the buyer of a distressed company should be mindful of this constituency's requirements.
- **Lenders.** Providers of financing play multiple roles in a typical distressed transaction. They are creditors and their vote or consent is often the most important in any restructuring process. In case of default they may have the ability to exercise contractual rights (for example, the enforcement of guarantees) that would frustrate the proposed transaction. Because of contractual covenants they may veto certain transactions even outside an event of default. They provide liquidity or credit support that could be instrumental to the preservation of the value of the company. And they could provide bridge loans or new money that may be necessary to allow the company to survive through a restructuring process and overcome its financial difficulties.
- **Governmental agencies.** Public bodies may also become players, whether they actually have a role in authorising the proposed transaction (such as merger control, veto powers on foreign investments, transfer of concessions or licences), because they are creditors or clients, or because they have a social interest such as preserving employment or minimising negative impacts on local suppliers.

Price Structure of a Distressed M&A Transaction

Outside an insolvency proceeding, the most common price structure in distressed M&A is the price adjustment clause as it secures the signing to closing period by allowing the adjustment of the price based generally on net debt and working capital ratio as at the closing date.

Other clauses are common, such as earn-out clauses or locked box mechanisms. However, in the framework of pre-insolvency or insolvency proceedings the ability to use such mechanisms is often curtailed by factual circumstances or the need to adhere to processes determined by the law or the court.

For information on earn-out clauses and locked box mechanisms in private M&A transactions on the Italian market, see *Practice Note, Earn-Out, Locked Box, and Retention: Private Acquisitions (Italy)*

Purchasing Schemes

In general, an acquisition involving a distressed seller or a distressed target (or both) will fall into one of the following three categories:

- Acquisitions outside a process governed by the Italian Insolvency Code (see *Acquisition Outside a Process Governed by the Italian Insolvency Code*).
- Acquisition through a pre-insolvency process governed by the Italian Insolvency Code (see *Acquisition Through a Pre-Insolvency Process Governed by the Italian Insolvency Code*).
- Acquisition through an insolvency process governed by the Italian Insolvency Code, or the statutes governing the insolvency of large companies, the so-called *amministrazione straordinaria* (see *Acquisition Through an Insolvency Process Governed by the Italian Insolvency Code*).

The buyer and the seller can, to some extent and after having evaluated pros and cons of each option, choose between a transfer outside a process governed by the Italian Insolvency Code Act and a transfer through a pre-insolvency process governed by the Italian Insolvency Code (see *Acquisition Outside a Process Governed by the Italian Insolvency Code* and *Acquisition Through a Pre-Insolvency Process Governed by the Italian Insolvency Code*).

When the company is undergoing a judicial liquidation supervised by the court there is no other option for a buyer who wishes to proceed with the acquisition than carrying out the transaction through the insolvency processes governed by the Italian Insolvency Code or by the rules on the extraordinary administration of bankrupt companies under *Legislative Decree no 270/1999* and *Law Decree no 347/2003*.

Once the parties have decided to access a pre-insolvency or an insolvency process governed by the Italian Insolvency Code, the agreements signed (including any assets purchase agreement) in the context of such processes are protected against any claw-back or risk to be declared null and void by the court.

Acquisition Outside a Process Governed by the Italian Insolvency Code

If the acquisition is conducted outside a statutory pre-insolvency or insolvency process, the buyer will need to satisfy itself that:

- In the case of a financially troubled seller, the financial health of the seller is good enough to make the claw-back risk non-existent or negligible (on claw-back actions, see *Purchase From a Distressed Seller*). This requires a very careful assessment of the seller's viability at the moment of the transaction and for the duration of the period in which the transaction could be rendered void.
- In the case of a distressed target, the capital structure of the target has been restructured in a way that makes the transaction viable. This typically requires a negotiation with the target's financial creditors and may require an equity injection by the buyer.

For the M&A aspects of an acquisition outside a process governed by the Italian Insolvency Code, see *Documentation for an Acquisition Outside an Italian Insolvency Code Process*.

Acquisition Through a Pre-Insolvency Process Governed by the Italian Insolvency Code

The Italian Insolvency Code sets out the following six pre-insolvency processes aimed at restructuring the debt of a distressed company. All of these processes provide protection from claw-back actions. Two of these processes are conducted out of court, and two are in-court. These processes can be used to facilitate a distressed M&A transaction.

- Supervised composition process (*composizione negoziata*). This is an out of court process (see *Supervised Composition Process*) which, subject to certain conditions, may be followed by a newly introduced restructuring proceedings called simplified composition with creditors for the liquidation of the assets (*concordato semplificato per la liquidazione del patrimonio*) (see *Simplified Composition*).
- Reorganisation plan (*piano attestato di risanamento*). This is an out of court process (see *Reorganisation Plan*).
- Court-ratified debt restructuring agreement (*accordo di ristrutturazione dei debiti*). This is an in-court process (see *Court-ratified debt restructuring Agreement*).
- Judicial composition with the creditors proceeding (*concordato preventivo*). This is an in-court process (see *Judicial Composition with Creditors Proceeding*).

- Certified restructuring plan (*piano di ristrutturazione soggetto a omologazione*). This is an in-court restructuring proceeding (see *Certified Restructuring Plan*).

Supervised Composition Process

Companies in a state of financial or economic imbalance, which is likely to escalate into crisis or insolvency, may access the supervised composition process (*composizione negoziata*) under Article 12 of the Italian Insolvency Code: a debtor-in-possession and out-of- court procedure available if the restructuring of the business is reasonably feasible.

An independent expert is appointed by the local Chamber of Commerce to facilitate the negotiations between the debtor, its creditors and any interested parties to find a solution to overcome the financial imbalance.

The following applies:

- The supervised composition process is not a strict pre-insolvency procedure: it is the only procedure under the Italian Insolvency Act which does not require the existence of a crisis but only a distressed situation (pre-crisis), which can potentially lead to a crisis.
- The supervised composition process is appropriate if the company believes that the situation of distress can be overcome by negotiating with the creditors or renegotiating the existing agreements or disposing of its business or business units.
- In case of disposal of the company business or business unit(s), the Italian Insolvency Code grants an advantage to the buyer who will not be liable for the debts of the transferred business recorded in the mandatory accounting books of the seller company, exception made for those relating to the employees. The expert will therefore scrutinise the suitability of the M&A transaction to achieve a positive outcome of the restructuring process.
- Within the supervised composition process existing agreement can be renegotiated in good faith between the parties if the relationship has become excessively burdensome due to circumstances unknown at the moment of their execution.
- Actions performed in the context of the supervised composition process and consistent with the restructuring process of the company cannot be subject to claw-back actions.

Notice of the procedure is filed with the Companies' House (*Registro delle Imprese*). During the process, the debtor may have to provide further information to the public through the Companies' House.

Simplified Composition

The simplified composition under Article 25-sexies of the Italian Insolvency Code is an-in-court pre-insolvency process accessible only by companies that have unsuccessfully gone through a supervised composition process (see *Supervised Composition Process*), if the independent expert certifies – in the final report regarding the supervised composition process – that the negotiations have been conducted in good faith and the proposals made to overcome the crisis are not practicable.

The proposal for a simplified composition provides for the transfer of the assets of the company and a liquidation plan, and creditors may be grouped into classes. The petition must be filed by the company with the competent Court within 60 days from the receipt of the final report of the independent expert and the filing produces substantially the same effects as the filing for a judicial composition with creditors proceeding (see *Judicial Composition with Creditors Proceeding*).

The approval process is shorter, as it entails only the validation (*omologa*) by the Court after having considered that the company's proposal is not detrimental to the creditors compared to a judicial liquidation scenario and ensures some benefit

to each creditor. Creditors are not entitled to vote the proposal but can file an objection to its validation before the relevant court hearing.

A liquidator is appointed by the Court to implement the liquidation plan and deliver an opinion on the liquidation of the assets. If the liquidation plan contemplates an offer to purchase the business, any business unit(s) or assets, the sale must be carried out in a competitive context; the transfer may be performed also before the validation, subject to prior Court approval.

Given the specific duty of the creditors participating at the supervised composition process to negotiate in good faith with the debtor to overcome the distress, the purchase of an asset in the context of a simplified composition process by such a creditor should be considered carefully in order to avoid possible claims that the creditor's negotiation behavior was instrumental to the acquisition transaction.

Reorganisation Plan

A reorganisation plan (*piano attestato di risanamento*) under Article 56 of the Italian Insolvency Code is a negotiated solution whereby the relevant stakeholders (typically, the shareholders, the company and its lenders, but often also third-party investors and key suppliers) reach an agreement on how the troubled financial situation of the company can be solved. The agreement is supported by a certification from an independent expert that the solution identified will in fact result in the company being able to restructure its debt and rebalance its financial situation.

The effect of the independent expert certification is that the transaction sets out in the restructuring plan (such as the sale of an asset) cannot be subject to claw-back action.

In practice, the reorganisation plan mechanism allows for a negotiated solution (that is an acquisition outside a statutory process), with the addition of the transactions included in the reorganisation plan being protected from the risk of a claw-back action.

This mechanism lends itself well to situations where the financial distress of the company is such that the burden of the reorganisation can be borne by the shareholders and the financial creditors, possibly with contributions from third-party investors and selected suppliers, and there is no need to forcibly obtain the consent of other creditors.

The reorganisation plan mechanism is a viable instrument to acquire assets from a distressed seller or take control of a financially troubled company in the context of a negotiated restructuring of its debt.

The process is confidential as it is not subject to disclosure obligations while it is ongoing and therefore it may not create alarm among the company's clients and suppliers.

For more information on the reorganisation plan, see *Country Q&A, Restructuring and insolvency in Italy: overview: Reorganisation plan*.

Court-Ratified Debt Restructuring Agreement

Court-ratified debt restructuring agreements (*accordi di ristrutturazione dei debiti*) are governed by Articles 57-61 of the Italian Insolvency Code (and Article 182-bis of the Italian Bankruptcy Act). They are formed through an in-court process whereby an agreement reached between the debtor and creditors representing at least 60% (standard restructuring agreement) or 30% (facilitated restructuring agreement) by value of all claims (including secured and unsecured) is approved by the court, provided that an independent expert certifies that:

- The financial data of the company are correct.

- The agreement itself allows for the company being able to fully satisfy the claims of the creditors who have not signed the agreement.

In practice, the incentive for a creditor to sign the court-ratified debt restructuring agreement is the risk that, by not agreeing, the company may become insolvent. It often happens that the financial creditors sign, while trade creditors do not sign and are paid in full.

During the in-court process the debtor is subject to court supervision, which is often exercised through the appointment of one or more court-appointed judicial commissioners.

This mechanism has some additional useful features, such as, subject to certain conditions:

- The possibility to request the court protective measures also during the negotiations (that is, before the filing of the petition for the approval of the restructuring agreement).
- The option to seek the court's authorisation for a bridge loan enjoying super-priority over existing claims.
- The ability to forcibly extend the terms of the court-ratified debt restructuring agreement to creditors, other than financial creditors, representing up to 25% by value of the claims of the same category of the signatories of the restructuring agreement. In other words, the court can "cram down" a proportion of dissenting creditors, other than financial creditors, if at least 75% of creditors with claims in the same category have agreed to it and if the agreement provides for the business continuation.
- The “cram down” of dissenting financial creditors is possible if financial creditors hold at least 50% of the debt, and the crammed-down creditors pertain to the same category.
- The possibility to bind all the financial creditors to a standstill agreement signed by at least 75% by value of the financial creditors.

For more information on the court-ratified debt restructuring agreement, see *Country Q&A, Restructuring and insolvency in Italy: overview: Restructuring agreement*.

The court-approved debt restructuring agreement mechanism is an effective way to acquire assets from a distressed seller or take control of a distressed company in the context of a negotiated restructuring of its debt.

Compared to the out-of-court restructuring plan option, it provides the additional layer of protection afforded by an in-court process.

However, the fact that the company is in a pre-insolvency process is public, which may have adverse effects on its relationship with suppliers and clients.

Judicial Composition with Creditors Proceeding

The judicial composition with creditors proceeding (*concordato preventivo*) is governed by Article 84 of the Italian Insolvency Code. This is an in-court process allowing the debtor to make an offer to its creditors which, if approved by a majority of the overall claims and a majority of (if any) the classes of creditors and by the court, becomes binding on all creditors. Classes are formed grouping creditors with homogenous economic and contractual rights. The feasibility of the restructuring plan underlying the offer to the creditors and the correctness of the financial data of the company must be certified by an independent expert. The expert will therefore scrutinise the viability of the M&A transaction that underpins the debtor's restructuring plan.

Before, simultaneously with or after the filing of the petition for the judicial composition with creditors proceeding, the debtor may ask for protection measures against enforcement actions of the creditors towards its assets. During the process, the debtor is subject to court supervision, including through the appointment of one or more judicial commissioners, and certain actions of the company can only take place if previously authorised by the court.

As in the case of the court-ratified debt restructuring agreement, the company can be authorised by the court to obtain a bridge loan enjoying super-priority over other claims. If the recovery ratio for unsecured creditors does not exceed 30% (20% if the debtor had effectively initiated the supervised composition process) creditors holding more than 10% of the claims can put forward alternative offers. If the plan provides for the sale of the business or business(s) unit or assets of the company, the court orders that other offers are solicited. The court can order that the voting rights of shareholders be exercised by a court-appointed officer.

The judicial composition with creditors proceeding provides the framework to negotiate a solution to a company's financial distress, or it can be adopted to implement a solution previously negotiated among the key stakeholders. Of all the pre-insolvency processes it is the one that is more likely to negatively impact the company's business (including because of its public nature) and to involve publicity, as well as significant costs and delays.

Setting aside insolvency processes, judicial the composition with creditors proceeding is an instrument to cram down dissenting creditors, regardless of their nature as financial or trade creditors. A more limited cram down can apply to creditors only in the context of a court-ratified debt restructuring agreement process (see *Court-ratified debt restructuring Agreement*).

In summary, this process is a powerful way to implement a solution to a company's indebtedness and facilitate a change of control; it does not lend itself well to being an effective instrument for the purchase of assets from a distressed company. This is because the purchase would have to happen in the context of an open tender mechanism, thus exposing a potential purchaser to the role of stalking horse.

For more information on the judicial composition proceeding, see *Country Q&A, Restructuring and insolvency in Italy: overview: Composition proceedings*.

Certified Restructuring Plan

The certified restructuring plan (*piano di ristrutturazione soggetto a omologazione*) is governed by Articles 64-bis and ter of the Italian Insolvency Code. It is an in-court proceeding similar to the judicial composition with creditors proceeding (see *Judicial Composition with Creditors Proceeding*), with few significant differences, incuding:

- The order of priority for the payment of the creditors can be derogated but employee claims must be fully paid in cash within 30 days of the validation of the certified restructuring plan.
- The review of the judicial commissioner has a limited scope.
- Creditors are grouped into classes and the approval of the proposal by all classes is required.
- Dissenting creditors may file an opposition before the validation of the plan if they believe that the plan is not convenient but the tribunal can still approve it if the dissenting creditors would be not worse off compared to judicial liquidation process.

Standstill Agreement

In addition to the restructuring processes described above, debtors can enter into standstill agreements with their creditors aimed at governing, on a temporarily basis, the effects of the crisis by postponing payment deadlines, suspending or waiving legal actions, or agreeing any other measure which does not contemplate the restructuring of the indebtedness.

The effects of the standstill agreements can be extended to non-adhering creditors belonging to the same category to which the agreement must be communicated; dissenting creditors may oppose to the agreement before the competent Court.

An independent expert certifies the truthfulness of the accounting information, the suitability of the standstill to temporarily govern the effects of the crisis and that there are concrete possibilities that the non-adhering creditors are "no worse off" than in a scenario of judicial liquidation.

Similar agreements may be used by the debtors to "buy time" in view, for instance, of possible acquisition transaction able to remove the distress without going through a restructuring process, which may not be affordable for specific entities.

Acquisition Through an Insolvency Process Governed by the Italian Insolvency Code

The Italian system sets out different types of insolvency proceedings, depending on the size of the insolvent company. Special processes (which are out of the scope of this Note) govern the insolvency of banking and financial institutions. In addition to the standard insolvency proceeding (*liquidazione giudiziale*) governed by the Italian Insolvency Code. The insolvency of large companies falls into the extraordinary administration proceedings (*amministrazione straordinaria*) governed by the Legislative Decree no 270/1999 and the Law Decree no 347/2003.

There are several differences between the *liquidazione giudiziale* and the *amministrazione straordinaria* proceedings. For the purposes of this Note the most important ones are:

- While the sole purpose of a *liquidazione giudiziale* process is to enhance creditors' recovery, an *amministrazione straordinaria* process will also aim at preserving the debtor as a going concern and at preserving employment.
- The supervision of *amministrazione straordinaria* and the appointment of the administrators (*commissari straordinari*) is largely entrusted to the government rather than a court. This means that there is often a political element in the dynamics of those processes.
- In a *liquidazione giudiziale* process there are specific rules allowing third parties to put forward a restructuring proposal (*concordato fallimentare*), which are absent in *amministrazione straordinaria* processes.

In the context of any insolvency process a buyer of an insolvent company or its assets will, in practice, have limited opportunities to take a proactive role (with the exception of the *concordato fallimentare* option) and will be limited to participating in public tender-type processes.

Liquidazione giudiziale and *amministrazione straordinaria* always lead to a change of control of the distressed company and/or its assets, as there is no value left in its equity (since the company is insolvent). They are strictly regulated processes, with very limited flexibility as to the terms of a potential acquisition.

For more information on the extraordinary administration proceedings, see *Country Q&A, Restructuring and insolvency in Italy: overview: Extraordinary administration*.

For more information on the bankruptcy proceeding, see *Country Q&A, Restructuring and insolvency in Italy: overview: 7. What are the main insolvency procedures in your jurisdiction?*.

Provisions for the Restructuring of Companies Belonging to the Same Group

The Italian Insolvency Code allows multiple companies in crisis or insolvency belonging to the same group (each having its center of main interest in Italy) to use pre-insolvency and insolvency proceedings to deal with the financial distress at group level.

In case of an M&A transaction in the context of group procedures certain additional elements need to be kept into consideration on both sides:

- From the seller's perspective, the transaction may encounter additional complexities stemming from the need of coordination with the restructuring plan of other group companies.
- From the buyer's perspective, the negotiation process (where available) may be slower and encounter additional constraints.

Contractual Documents

The different purchasing schemes (see *Purchasing Schemes*) generate widely different types of contractual documentation and contractual terms. Some will necessitate contractual documents similar to the ones used in a normal M&A transaction. In other proceedings, the documents governing the transaction will bear a very scarce resemblance to those of an ordinary M&A transaction, as explained below.

Documentation for an Acquisition Outside an Italian Insolvency Code Process

For acquisitions outside a pre-insolvency or insolvency process governed by the Italian Insolvency Code or through a reorganisation plan mechanism (see *Reorganisation Plan*), the contractual documents will generally be similar to those of an ordinary M&A transaction, with particular features aimed at keeping the company in good standing (such as clauses on representations and warranties, indemnity, discharge of outgoing directors and obligations). Similarly for an M&A transaction in the context of a supervised composition mechanism (see *Supervised Composition Process*) although in this case the existence of the independent expert in the negotiation process represents an element that may influence the efficiency of the process (both ways) and the content of the documents.

Often, the transaction will contemplate parallel negotiations with the target's lenders resulting in contracts not typically associated with a M&A transaction, such as agreements for the restructuring of the pre-existing debt, new loan facilities and standstill agreements.

The same documents will be present if the acquisition occurs through a reorganisation plan, but the transaction will also necessitate the plan itself, and the certification of its viability by the independent expert (see *Reorganisation Plan*).

Also, often there will be contracts with professionals not involved in an ordinary M&A transaction, such as a chief restructuring officer, consultants conducting an independent business review and, when present, the independent expert.

Documentation for an Acquisition Through a Pre-insolvency Process

When the selected acquisition scheme is an in-court pre-insolvency process, the M&A and other documents described above will become ancillary to (as the case may be) the restructuring agreement or the composition proposal. Also, some documents or contractual clauses typical of M&A transactions (such as exclusivity, material adverse change or break-up fees) are often

not an option, given the reluctance of the board of directors of the distressed company (and when relevant, the court) to accept anything that reduces options, increases costs or introduces excessive conditionality to the implementation of the transaction.

Next to the contractual documentation there will be documents typical of in-court processes such as court petitions, briefs for the court, minutes of hearings and court decisions.

Documentation for an Acquisition Through an Insolvency Process

In insolvency processes, the contractual documents are generally prepared by the seller without the input or with limited input from the potential buyers, and some elements of typical M&A transactions, such as representations and warranties, are either non-existent or limited to very narrow circumstances.

Advisers

The acquisition of a troubled company, or of assets from a distressed company, is significantly more complex than an ordinary M&A transaction. Those complexities require the involvement of advisers not present in an M&A transaction and with skills that go beyond those needed for standard M&A.

Examples of professionals normally not involved in typical M&A transactions include the independent expert (with different roles in the supervised composition and the pre-insolvency procedures), the chief restructuring officer, turnaround specialists (often covering the role of chief restructuring officer) and the consultants tasked with the independent business review.

Advisers typically used in M&A transactions (financial advisers, lawyers, tax advisers, accounting firms) need to be selected carefully, as they need to have the additional skills and experience required to successfully handle a distressed transaction.

Lawyers will need to complement their M&A skills with insolvency law, corporate governance and directors' liability, criminal law, banking law, and for in-court processes will need to work closely with their litigation colleagues.

END OF DOCUMENT

RESOURCE HISTORY

Resource Updated to Reflect Entry into Force of the Italian Insolvency Code (April 2023).

The Practice Note has been updated to take into account the entry into force of several provisions of the Italian Insolvency Code adopted by means of the Legislative Decree no 14/2019 which apply to processes initiated after 15 July 2022.

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