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SALES OF BUSINESSES IN INTERNATIONAL CASES: CLEAR OR NOT-SO-CLEAR TITLE?

Sales of Businesses in Insolvency in Italy

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Panel on Sale of Businesses in International Case: Clear or Not-So-Clear Title

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1. THE MULTIPLE PROCEDURES APPROACH

One of the main features of the Italian system is the availability of no less than five different procedures for the sale of the business of an insolvent company:

1.1 Procedures subject to the court's supervision, which do not assume a declaration of insolvency by the competent court

(a) Restructuring Agreements with Creditors ("*Accordi di Ristrutturazione*") pursuant to Article 182-*bis* of the Italian Bankruptcy Law ("IBA");

(b) Pre-insolvency Composition with Creditors ("*Condordato Preventivo*") pursuant to 160-182 of IBA;

1.2 Procedures following a declaration of insolvency by the competent court

(a) Restructuring of large enterprises applicable to enterprises with more than 500 employees and debts of at least €300 million ("Marzano Procedure")[1]. Such regime was introduced in response to large corporate collapses such as Parmalat (2004) and more recently (Aug-Oct, 2008) in order to deal with Alitalia crisis.

(b) Extraordinary administration (*amministrazione straordinaria*) applicable to enterprises with more than 200 employees and debts of more than two thirds of the value of the assets and of the revenues shown on the most recent balance sheet ("Prodi *bis* Procedure")[2];

(c) Bankruptcy Procedure (*fallimento*) under IBA, applicable to any other enterprise not meeting the above thresholds.

In the case of an insolvent company, each of the above procedures may allow the sale of a business (or of a large portion of the business) as a going concern, under significantly different conditions, particularly with regard to choice of purchaser and to the role of both the court and creditors.

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1 The procedure was originally introduced by Law Decree, December 23, 2003, n.347, ratified by Law February 18, 2004, n.39, published in the Italian Official Gazette on December 24, 2003, n. 298. The recent amendments were introduced by Law Decree, August 28, 2008, n. 134, ratified by Law, October 27, 2008, published in the Italian Official Gazette on October 27, 2008.

2 The procedure was originally introduced by Legislative Decree, July 8,1999, n. 270, published in the Italian Official Gazette on August 9,1999, n.185.

1.3 **Brief Introduction to the different procedures**

(a) **Restructuring Agreement**

A company, whether in financial difficulty or insolvent, may enter into a formal restructuring agreement with creditors. The approval of creditors representing 60% (by value) of claims is required, together with an expert's report on the feasibility of the restructuring agreement and, in particular, its ability to satisfy the regular payment of those creditors who are not party to the restructuring agreement. The agreement is published in the Register of Companies and is subject to challenge by creditors and any other interested party for a period of 30 days. If no challenge is made within this time (or if challenges are held not to be well grounded) the competent Court approves (*omologa*) the restructuring.

The restructuring agreement may also provide for a liquidation of the company's assets (including the sale of the business, or of a large portion of the business as a going concern), in accordance with terms and conditions agreed and planned with those creditors which agree to be satisfied with the proceeds of such liquidation, even if not in full.

(b) **Pre-insolvency composition with creditors**

An insolvent company may file a proposal for a composition plan with the competent Court The plan may provide for debt restructuring and satisfaction of creditors' claims by any means, including the transfer of shares, transfer of assets or assumption of liabilities towards creditors or a company controlled by creditors. In general debtors propose to satisfy unsecured creditors with a significantly small percentage (often less than 20% of the amount due)

The plan may provide for a division of creditors into classes according to their legal status and the similarity of their economic claims and different treatment of creditors from different classes.

The plan is approved if the majority of unsecured creditors votes in favour of the proposal, and it becomes enforceable with the final approval (*Omologazione*) by the Court. When there is more than one class of creditors, the proposal must be approved both by the vote of the majority of the unsecured creditors by value and by the majority of the classes. Secured and/or preferred creditors are not expected to vote, when the plan (as should normally be the case) provides for their satisfaction in full. If the plan provides for a "haircut" for the secured/preferred creditors, their approval is also required. If the required majority is not achieved, the court declares the debtor insolvent and a Bankruptcy Procedure is initiated (unless the insolvent company has the size to be admitted to a Prodi *bis* Procedure)

Pre-insolvency composition is very often used to liquidate the company's assets, especially as a going concern (or as one or more business units) and the relevant proceeds are used to satisfy the creditors under the terms and conditions indicated in the plan approved as indicated above. Unless one or more pre-packaged sales are submitted to the creditors' approval, as part of the plan, one or more liquidators are appointed by the court, which also appoints a creditors' committee formed of three or five creditors, involved in the supervision of the liquidation procedure.

(c) **Bankruptcy Procedure**

If an insolvent company does not meet the requirements to be admitted either to the Marzano Procedure or to the Prodi *bis* Procedure, it is subject to bankruptcy. Bankruptcy is declared by the Court, upon request of the company or of a creditor.

Even the Public Prosecutor is entitled to request the declaration of bankruptcy of an insolvent company

When Bankruptcy is declared, the Court appoints a delegated judge (*giudice delegato*), a trustee (*curatore*), and a creditors' committee (*comitato dei creditori*).

Bankruptcy is a liquidation rather than a restructuring procedure. Assets may be sold on a piece by piece or on a going concern basis. Nevertheless, IBA indicates that sale of the business as a going concern should be considered a preferable option. Temporary continuation of the business may therefore be authorized by the Court, when an interruption would be detrimental to the value of the business or of its assets. In such a case, the business may be managed by the Trustee or by a third party under a lease of business agreement, authorized by the delegated judge and by the creditor committee.

(d) **Prodi *bis* Procedure**

Since 1999, large companies have been able to apply for extraordinary administration, a procedure established under so-called Prodi *bis* Law to facilitate the rescue of large companies with at least 200 employees and liabilities exceeding two-thirds of asset and revenue value. The procedure follows the declaration of insolvency declared by the competent Court, upon request of the company, of a creditor or of the Public Prosecutor. One or three commissioners are then appointed by the Minister of Industry (now Minister of Economic Development) to manage the procedure.

One unique feature of the extraordinary administration is that a group of companies may be considered as a single insolvent enterprise. The procedure may be extended to any other insolvent company of the same group, even if it does not meet the minimum requirements, and the same commissioner/s is/are appointed to manage the procedures extended to such group companies, in order to coordinate the rescue or the liquidation of the different businesses belonging to the different companies of the group.

The procedure is aimed at either restructuring the business or selling the business (as a whole or in portions) as a going concern. If rescue and/or sale of the business are not available options, the procedure is converted into a Bankruptcy, to proceed with the sale of assets on a piecemeal basis.

(e) **Marzano Procedure**

The so-called Marzano Law created a stand alone extraordinary administration procedure (with its origins in Prodi *bis* Procedure) for companies (or groups of companies) with at least 500 employees and €300 million indebtedness. The Marzano Law, enacted in response to the Parmalat collapse has been recently modified in order to deal with Alitalia's crisis. The procedure is also aimed at rescuing the company or at selling the relevant businesses as going concern.

The procedure starts with an application to the Ministry of Industry by the insolvent company, which simultaneously files a request for declaration of insolvency to the competent court. Between one and three commissioners are appointed to manage the business and to prepare a restructuring or liquidation plan. Similarly to the Prodi *bis* Procedure, if a rescue or a sale of the business is not possible, the procedure is converted into a Bankruptcy,

As a result of the Alitalia crisis, amendments were made to the Marzano Law introducing the concept of "large enterprises operating in the sector of essential public services", to which special rules now apply.

2. SALE OF A BUSINESS OF AN INSOLVENT COMPANY IN EACH OF THE AVAILABLE PROCEDURES

(a) Restructuring Agreements (*Accordi di Ristrutturazione*)

A sale of business of an insolvent company may occur in the context of a Restructuring Agreement, executed by company's creditors representing at least 60% of the company's indebtedness ("**adhering creditors**"), provided that the company is able to satisfy in full, and when due, the creditors that do not adhere to the agreement ("**non-adhering creditors**").

This solution will be preferable whenever there is a small number of major creditors that agree to consider a solvent out of court liquidation as a better option to maximize the value of the company's assets. It is an entirely consensual procedure, where the Restructuring Agreement and the court's approval are necessary to avoid the sale being considered an unlawful disposal of assets of an insolvent company and the purchase being revoked, in any subsequent Bankruptcy.

The Restructuring Agreement may provide that, following the perfection of the sale of the business, the adhering creditors will be satisfied in accordance with the terms and conditions set forth in the agreement. Typically, in such a case, the agreement will include a stand still obligation, pursuant to which the adhering creditors undertake not to enforce their rights for a period deemed necessary to allow the company to complete the sale.

Adhering creditors may agree to be satisfied in different ways and no obligation to equal treatment of creditors in similar legal or economical position applies. As a consequence, some creditors may accept a significant "haircut" of their claims, immediately releasing both the company and the purchaser of the business, while others may consent to release the company if the purchaser of the business assumes the relevant obligations, although under terms and conditions more favourable than those originally agreed with the company.

An independent expert must confirm the feasibility of the Restructuring Agreement and the ability of the company to satisfy in full, and when due, the non-adhering creditors. Once executed by the adhering creditors and supported by the expert's opinion, the Restructuring Agreement must been submitted to the competent court for approval.

Sale of the business may be structured in any way deemed appropriate by the company and by the adhering creditors. The law allows a pre-packaged sale to an already selected purchaser, subject to the execution of the Restructuring Agreement and to the approval of the Restructuring Agreement by the court. Nevertheless, the Restructuring Agreement may also provide that search for, and selection of, a purchaser will take place after the approval of the Restructuring Agreement by Court, in accordance with certain agreed procedures.

In any event, the court will not be requested to approve the sale and its evaluation in approving the Restructuring Agreement will not encompass any assessment of the attractiveness of the pre-packaged sale or of the procedures for the sale agreed with the adhering creditors. Court's attention will be rather focused on the "feasibility" of the Restructuring Agreement and therefore on the risk of failure of the sale process.

The sale of the business is, *per se*, negotiated and completed with the same forms and procedure of an ordinary sale of business of a solvent company. Purchaser will assume the very same risks and liabilities typical of this kind of transaction in Italy. In particular:

(i) the purchaser will be jointly and severally liable with the seller for any liability (other than tax liabilities and debts vis-à-vis the employees) resulting from the mandatory accounting books of the company, while the joint and several liability with regard to tax and employment liabilities is assumed without any limitation;

(ii) purchaser's liability for tax matters may be mitigated by obtaining a so-called tax certificate from the Italian Tax Authorities, which allows the purchaser to be fully released from any tax claim which is not indicated in the certificate;

(iii) purchaser's liability for employment matters may be mitigated only by means of individual settlements and releases executed by the relevant employees, in the form provided by the employment law.

Risks related to existing encumbrances, third party claims, lack of title on material assets are the same as in any ordinary sale of business as a going concern. In addition an insolvent company will always be inclined to sell the business on a "as is, where is" basis and, in any event, representation and warranties will be of very little worth. Accurate due diligence is therefore the only instrument available for a purchaser to mitigate such risks.

(b) **Pre-insolvency Composition with Creditors (*Concordato Preventivo*)**

The sale of the business as a going concern may be included in the plan submitted to the creditors' approval in the context of a Pre-insolvency Composition with Creditors ("**PCC**").

In particular, the plan often includes a pre-packaged sale to an identified purchaser, which has submitted a binding offer, already negotiated in all its terms and conditions with the representatives of the insolvent company. Perfection of the sale will be subject to the approval by the required majority of the creditors and to the homologation by the court of the proposed plan. In such a case, execution of the sale and purchase agreement and completion of the sale of business will be authorized by the court.

While the more common structure of pre-packaged sale provides that the purchase price will be paid in cash, that there is no assumption of liabilities by the purchaser and that the relevant proceeds will be used to satisfy the creditors, under the terms and conditions indicated in the plan proposed by the company, it is possible for a purchaser to propose the assumption of certain debts or liabilities, as part of the purchase price, and to offer satisfaction in kind (like shares or other securities issued by the entity purchasing the business, or other forms of payment in kind); nevertheless, the principle of equal treatment of creditors of the same classes must be satisfied.

In the case of a pre-packaged sale, the company independently and freely searches for and selects the purchaser, and negotiates the relevant terms and conditions (including the purchase price) of the sale, before submitting the plan to the creditors. Nevertheless, the court, upon admitting the plan to be submitted to creditors' approval, appoints a commissioner who is required to prepare a report to be also submitted to the creditors, before their vote on the company's proposal. The commissioner's report contains also indication concerning the attractiveness of the company's proposal and therefore, when the plan includes a pre-packaged sale of the business, the commissioner's opinion regarding the fairness of the agreed purchase price. While the commissioner's opinion cannot veto the approval of the plan by the majority of the creditors, it can have a great effect on the creditors' vote. It is therefore advisable for an independent expert opinion on the fair value of the business to be filed by the company, together with the plan, to support the proposed pre-packaged sale.

A few months are often required to complete the procedure and to achieve the creditors' approval and the homologation of the PCC. During this period the company might in theory operate, under the supervision of the court and of the commissioner. Nevertheless, operating the business pending a procedure of PCC may be particularly difficult and often detrimental to the goodwill and to the value of the intangible assets. This is the reason why, in case of a pre-packaged sale, the company and the prospective purchaser enter often in a lease of business agreement in order to allow the prospective purchaser to operate the business, pending the creditors' approval.

Purchasers of a business in the context of a PCC are not jointly and severally liable for the company's liabilities, may enter into agreements with union to limit the number of employees transferred together with the business and are not jointly and severally liable in relation to the tax matters.

The Court, when authorizing the execution and completion of the sale of the business, also orders the cancellation of the registration of preferential rights and restrictions, preventive attachments and other encumbrances in favour of company's creditors.

By contrast, the purchaser remains exposed to the risk of third party claims concerning right and title over the assets transferred as part of the business and does not have, in substance, any protection with regard to the defects or lack of quality of the assets sold. Accurate due diligence is the sole remedy to mitigate such risks. Due diligence may be conducted by the prospective purchaser before the filing of the plan of PCC or pending the creditors' approval. The possibility to operate the business as a lessee, pending the creditors' approval, may offer a unique opportunity to complete and deepen the due diligence exercise.

Appeals brought by the dissenting creditors against the homologation of the PCC do not affect the validity of the sale of the business, authorized by the Court.

The plan prepared by the company may also propose the assignment of the company's assets to the creditors, which may be liquidated in order to satisfy the creditors in a percentage estimated in the plan. In such a case, if the plan is approved and the PCC homologated by the Court, one or more liquidators and a creditors' committee are appointed. In such a case, the sale of the business, as a going concern, if possible, is conducted and executed in accordance with the rules provided for in case of Bankruptcy Procedure.

(c) **Bankruptcy Procedure**

Trustees are responsible for the sale of the business as a going concern, in the context of a Bankruptcy procedure.

A trustee is required to prepare a liquidation plan to be submitted to the creditors committee for approval.

In the liquidation plan the trustee sets out the liquidation strategy, in particular in relation to the decision to liquidate the assets on a piecemeal basis, or selling the business as a going concern. The plan also sets out the methods which may be utilised, and deadlines, for the sale of the assets (or of the business, as the case may be).

A sale of the business may follow only if the liquidation plan is approved by the creditors' committee and in accordance with methods and deadlines indicated in the plan.

While the recent reform has attributed to the trustee a greater degree of flexibility in determining the most efficient procedure for the sale of a business, nevertheless the following constraints apply:

(i) Fair value of the business, as determined by independent experts, must be taken into account;

(ii) Sufficient advertising to solicit attention and adequate offers must precede the selection of the purchasers:

(iii) The purchaser's selection must be the result of a competitive tender or sale process.

IBA does not contain any provision explicitly authorising the trustee to allow the bidders (or, in general, the potential purchaser) to conduct due diligence over the business. On the other hand, there is no prohibition in this regard and a reasonable due diligence process should be considered totally consistent with aims of an efficient sale process.

Execution of the sale, if methods and indications set forth in the liquidation plan approved by the creditors committee and legal requirements summarized above have been applied, is authorized by the delegated judge.

As a consequence of the obligation to conduct the selection of the purchaser through a competitive process, following the approval of a liquidation plan, pre-packaged sales of the business, in the context of a Bankruptcy Procedure, are not allowed.

Since the completion of the various phases required to complete a sale of business may take more than a few months and very often time is of essence to avoid the detriment of the value of the business, if not properly operated, a trustee may be authorized by the court or by the delegated judge to operate the business or to enter into as lease of business agreement, allowing a third party to operate the business, while the trustee is preparing the liquidation plan and the sale process.

The lessee must be also selected through a competitive process. Lease of business agreements must include certain mandatory conditions and may grant the lessee a pre-emption right in case of sale of the business.

Similarly to the sale in the context of a PCC, the purchaser does not normally assume any existing obligation and is released from any existing liability. As part of the mandatory consultation process, preceding the sale of any business, the purchaser may agree with the unions to transfer only a part of the existing workforce.

The purchaser may nevertheless offer to assume part of the debts, as part of the purchase price, but only if the ranking of claims is not altered.

The delegated judge, when authorizing the sale, orders the cancellation of the registration of preferential rights and of restrictions, preventive attachments and other encumbrances in favour of company's creditors.

Due diligence is, instead, the sole available instrument to mitigate the risk of third party claims concerning right and title over the assets transferred as part of the business, as well as defects or lack of quality in the assets sold.

(d) **Prodi *bis* Procedure**

The rules regarding the sale of business as going concern in a Prodi *bis* Procedure are very similar to those set forth by IBA in relation to the Bankruptcy Procedure, as summarized above.

The main differences may be identified as follows:

(i) The plan for the sale of the business is approved by the Ministry of Industry;

(ii) The purchaser is obliged to continue operating the business and to preserve the agreed levels of employment for at least two years after the sale;

(iii) The selection of purchasers, following the issue of the invitation to make an offer, which must be solicited with adequate advertising and by way of a competitive tender or sale process, is not based only on the criteria of highest purchase price, but also taking into account the reliability of the offeror and his/her plan for the continuation of the business, with particular reference to the guarantees offered as regards the preservation of the level of employment;

(iv) It is the Minister of Industry who authorises execution of the sale and orders the cancellation of registered preference rights and encumbrances.

In addition, the Minister of Industry may authorise a third party to propose a composition with the creditors (*Concordato*). In such a case, the third party will offer to take over the company's business and all the company's assets and claims in exchange for satisfying the unsecured creditors with a percentage of their claims, while secured and preferred creditors should be in principle satisfied in full (although a percentage may also be offered to the secured or preferred creditors, whenever they may not expect to be satisfied in full on the basis of the fair value of the relevant securities). The proposal authorised by the Ministry must be approved by the majority by value of unsecured creditors. In calculating this majority, a failure to vote is regarded as a vote in favour of the plan

A similar option is available also in case of a Bankruptcy Procedure (where the proposal is authorised by the delegated judge), but in the context of a Prodi *bis* Procedure the offer must be aimed at taking over the entire business as a going concern and to guarantee the continuation of the business, while in a Bankruptcy Procedure the composition may be aimed at acquiring non-operating assets and/or claims.

The offer to the creditors may include satisfaction in kind of their claims, such as the possibility for the creditors to subscribe securities issued by the legal vehicle which, as a result of the approval of the composition with creditors, takes over the business.

The Law does not provide any indication concerning methods for solicitation of third party offers of a composition with creditors or rules regarding competitive offers simultaneously submitted to the Minister for authorization. It is nevertheless provided that, in authorising the offer, the Minister must take into account its attractiveness and its consistence with the aim of preserving the operation of the business.

(e) **Marzano Procedure**

Marzano Procedure has its origins in the Prodi *bis* Procedure and, therefore, rules concerning the sale of the business are very similar to those set out in the Prodi *bis* Law.

The main differences may be summarised as follows:

(i) Composition with creditors may be an option proposed by the commissioner in the plan prepared and submitted for approval to the Minister of Industry;

(ii) The composition with creditors proposed in the commissioner's plan may encompass assets and businesses pertaining to different companies of the same group to which the Marzano Procedure has been applied, and may therefore take the form of a single proposal addressed simultaneously to the creditors of such different companies;

(iii) In the same context, composition proposed by the commissioner may provide for the formation of a special purpose vehicle, to which the assets of the company (or companies) may be assigned and whose shares will be attributed to the creditors in satisfaction of their claims (in the form of a debt to equity swap);

(iv) Where the Marzano Procedure is applied to large enterprises operating in the sector of essential public services, the commissioner may, immediately and without recourse to a competitive sale process, identify and select a purchaser, whose credibility might guarantee the continuation of the relevant operation in the medium term and a quick take over, to avoid any interruption in the relevant public service; in such a case the purchase price must be at least equal to the market value as determined by a leading independent financial institution, identified by the Minister of Industry.