Investing in Distressed Italian Companies under the Reformed Italian Bankruptcy Law - a comparison with the US Bankruptcy Code

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INVESTING IN DISTRESSED ITALIAN COMPANIES
UNDER THE REFORMED ITALIAN BANKRUPTCY LAW:
A COMPARISON WITH THE US BANKRUPTCY CODE

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INTRODUCTION

The present article explains the advantages of investing in distressed Italian companies under the reformed Italian Bankruptcy Law (“IBL”)\(^1\). The article compares the US Bankruptcy Code (“USBC”) and the IBL, underling relevant differences of the two legal systems. Since 2007 the IBL has provided efficient mechanisms for distressed companies to avoid their liquidation\(^2\) and to preserve both the going concern value and creditors’ rights. The IBL is declaredly inspired by the USBC and, in particular, by the rules provided by the USBC Chapter 11. The new rationale of the entire Italian bankruptcy system is to give to the debtor more freedom in dealing with its creditors and to reduce the Court’s power. The IBL is now also drawn in order to facilitate investments in distressed companies.

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\(^1\) Royal Decree n.267 of 16\(^{th}\) March 1942, as recently amended.
\(^2\) The main Italian liquidation proceeding is the Fallimento, equivalent to the US Chapter 7 (“Fallimento”).
The investments regarding distressed companies available under the Italian system are, at least, three. The most common of these is the trading of (illiquid) assets, such as claims or credits, belonging to distressed companies. The investor buys and resells depreciated assets usually in a short period, making a profits.

A different type of investment is the financing of distressed companies in the context of an insolvency procedure. This scheme is similar to the USBC Section 364, which provides the financing of the debtor in possession.

The third type of investment here discussed (“Investment”), proposes ways in which an investor (“Investor”) may be able to take control of a distressed target company under more favorable conditions as compared to deals involving healthy target companies. The Investment runs in parallel with the target company’s reorganization plan under the IBL. The present article will respond to four questions: i) What is the investment opportunity? ii) How to carry out the Investment? iii) How to deal with the Investment’s risks? and iv) Why select this opportunity?

I. WHAT IS THE INVESTMENT OPPORTUNITY?

The Investment allows the Investor to take control of a target company in a safe and fast way. This goal is achieved by taking possession of the target company’s branches, segments and assets instrumental to the Investor business (“TA” or “Target Assets”). The difference between the Investment and a traditional healthy deal is the distressed status of the target company. The Investor achieves the control of the Target Assets though two steps: i) a lease agreement (“LA” or “Lease Agreement”) and ii) a sale and purchase agreement (“SPA” or “Sale and Purchase Agreement ”): the object of both the Lease Agreement and the Sale and Purchase Agreement are the Target Assets. The Investment, only if developed in the context of the reorganization plan of the owner of the Target Assets (“Debtor”), offers attractive conditions and advantages.

A. Investment’s context: the Concordato Preventivo

The Investment runs in parallel with one of the bankruptcy proceedings provided by the IBL, the Concordato Preventivo (“CP” or “Concordato Preventivo”)3, which is to be considered the

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3 The Concordato Preventivo is provided by IBL section 160. The IBL provides also the “Accordo di ristrutturazione dei debiti”, under section 182-bis and the “Piano di risanamento” under the section 67, subsection 3, lett.d). These provisions provide out of court remedies similar to the US pre-packaged plans in which the Court’s intervention is only formal, for the “Accordo di ristrutturazione dei debiti”, or even hypothetical, for the “Piano di risanamento”.


foundation of the Investment. The Concordato Preventivo is the most interesting of the IBL’s bankruptcy proceedings because it allows the Debtor to better deal with all the involved parties, providing breathing room immediately available after the filing of the petition. The Concordato Preventivo can be activated by filing a petition to the Court, only by a debtor in situation of Crisis.

No one else has the right to activate the Concordato Preventivo.

The Concordato Preventivo contains a proposal of arrangement with all Debtor’s pre-petition creditors ("Creditors") in which the Debtor must provide, by means of a reorganization plan ("Plan") both: i) the restructuring of the debts and ii) the satisfaction of the Creditors. The Plan should allow the Debtor to i) rewrite the right side of the balance sheet, renegotiating with Creditors the conditions of the debts (mainly amount and terms) and ii) to pay off the renegotiated debts. At the end of the Concordato Preventivo the Debtor is discharged of all pre-petition debts. The IBL allows the Plan to categorize and organize Creditors into classes on the basis of their legal status and homogeneous economic interests and to provide different treatment for different classes. The division into classes must respect two rules: i) the Plan shall offer to Creditors not less than what is hypothetically available to them in a liquidation scenario and, ii) the Plan shall respect the ranking of lawful preferential claims in providing Creditors satisfaction.

The Plan must include two reports, drawn up by Debtor’s appointed appraisers ("Appraisers") attesting to: i) the correctness, accuracy and fairness of all documents attached to the petition including the accounting records and the feasibility of the Plan and, ii) the hypothetical valuation of the Debtor’s assets in a liquidation scenario in order to prove the fulfillment of the two precedent rules. The Plan allows the writing down and the complete discharge of most of the debts owed to the Government for taxes or social security contributions.

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4 The filing of the petition causes the stop of all executive actions on the Debtor’s assets, under the Section 168 of IBL, the US Automatic Stay equivalent. IBL does not include provisions to lift the stay.
5 Crisis includes both the balance-sheet insolvency in which the debtor’s liabilities exceed its assets and the equity or cash flow insolvency in which the debtor cannot meet its obligations as they fall due. The concept includes also a reversible pre-insolvency situation in which the daily debtor’s illiquidity can be solved by the means of a restructuring plan.
6 According to the section 160 of IBL, the Debtor can provide the Creditor’s satisfaction by any lawful means, including transfer of assets, assumption of debts or other extraordinary transactions, including the allocation of shares, quotas, bonds (also convertible into shares), or other financial or debt instruments to the creditors.
7 The rule, comparable to the US Best Interests Test, is also applicable to the secured creditors whose credit’s face value exceeds the value of the respective collateral (undersecured). The Plan must offer to undersecured creditors at least the amount hypothetically available in a liquidation, considering the possible valuation of the collateral. The remaining part of the credit is treated as general unsecured credit.
8 The ranking is provided by the Italian Civil Code. According to the IBL the Plan can offer different percentages of the credit to the Creditors but the percentage satisfaction to each creditor must be higher than the satisfaction of a lower ranked creditor. In this sense the rule is comparable, with differences, to the US Absolute Priority Rule.
9 The Appraisers, even if appointed by the Debtor, remain independent and have an individual liability for inaccuracy of false indications similar to the auditors’ liability.
### B. The Phases of the Concordato Preventivo

Once the petition containing the Plan has been filed, the entire Concordato Preventivo proceeding follows three phases: i) the Post Petition Phase ("PPP" or "Post Petition Phase"), ii) the Post Admission Phase ("PAP" or "Post Admission Phase") and iii) the Post Confirmation Phase ("PCP" or "Post Confirmation Phase"). The following **Figure.1** shows the development of the Concordato Preventivo and the three phases.

![Figure 1](image_url)

<table>
<thead>
<tr>
<th>Post Petition Phase</th>
<th>Post Admission Phase</th>
<th>Post Confirmation Phase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Filing Petition + Plan</td>
<td>Admission Decree + Judicial Commissioner + Debtor</td>
<td>Confirmation Decree + Discharge</td>
</tr>
<tr>
<td>Automatic Stay</td>
<td></td>
<td></td>
</tr>
<tr>
<td>t0</td>
<td>t1</td>
<td>t2</td>
</tr>
<tr>
<td>Court Formal Check</td>
<td>Judicial Commissioner’s Report</td>
<td>Plan’s Execution</td>
</tr>
<tr>
<td>Creditors Meeting</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8 months</td>
<td></td>
<td>Figure.1</td>
</tr>
</tbody>
</table>

In each of the phases the Debtor and the Plan have to deal with the subjects involved in the proceeding to pass their scrutiny. The IBL is strict in defining the different roles, positions, rights and duties of all these subjects and this makes the entire proceeding more predictable than it would have been in the past. The most important change provided by the IBL is the new role of the Court, now allowed to examine the Plan merit only in limited circumstances. The filing of the petition and the start of the Post Petition Phase triggers, as stated above, the suspension of all executive actions against the Debtor’s assets, as it happens under USBC Section 360, that provides the automatic stay.

The first important judicial hurdle to be passed by the Plan is obtaining the Court’s decision to grant the Debtor’s admission to the procedure, by the issuing of admission decree (“Admission Decree”). The latitude of the Court’s control at this stage is limited to a formal check of lawfulness and completeness of the Plan. Unless there is a lack of formal requirements or the clear lack of feasibility of the Plan, the Court generally has no grounds to reject the petition nor the Plan. The Court issues the Admission Decree within 30 days after the filing of the petition. In the Admission
The Court also appoints the Judicial Commissioner ("JC" or "Judicial Commissioner")\textsuperscript{10}. The Judicial Commissioner is in charge of overseeing the daily business management that remains in the hands to the Debtor (similar to the US debtor in possession). Unlike the procedures for liquidation, the Concordato Preventivo does not require the dispossession of the Debtor. The latter is entitled to continue to run the business provided that all the extraordinary transactions are authorized by the Court and the Judicial Commissioner.

The second important judicial hurdle to be passed by the Plan is the report that the Judicial Commissioner has to complete pursuant to section 172 of IBL ("Judicial Commissioner Report"). The purpose of the Judicial Commissioner Report is: i) to review all the assumptions of the Debtor and Appraisers confirming the feasibility of the Plan as previewed; ii) to explain, in plain meaning, the Plan to the Court and Creditors; iii) to point out if, and why, the Plan should be considered more favorable for Creditors than a liquidation scenario. The Judicial Commissioner is often an accountant or an auditor or, in any case, a professional with a strong economic and business background able to understand all the economics of the Plan. The Judicial Commissioner is also expected to explain to the Court if, and how, the continuation of the Debtor’s business after the Admission Decree will be profitable\textsuperscript{11} or harmful for the Creditors\textsuperscript{12}. The Judicial Commissioner has also the power, in case of fraud or lack of feasibility of the Plan, to recommend to the Court that the Concordato Preventivo is converted into a compulsory liquidation. The Judicial Commissioner’s role is narrowly determined by the IBL and this allows its behavior to be largely foreseeable.

The Creditors’ meeting for the vote ("Creditors’ Meeting") is the third, and the most important, step for the Plan. In the scheduled hearing, the Creditors, informed about the Plan by the Judicial Commissioner Report, have the chance to ask for clarifications from the Judicial Commissioner, the Debtor and the Court. After clarifications the Creditors vote the Debtor’s Plan. The Plan is approved if it receives the consent by Creditors owing the simple majority (50% plus 1€) of the total pre-petition Debtor’s unsecured debts and, if there are various classes, also if the majority of the classes agrees to the Plan\textsuperscript{13}.

\textsuperscript{10} The Judicial Commissioner is comparable to the USBC Section 1104 Examiner but, under the IBL, his appointment is mandatory and his function is not limited to investigation oriented purposes.
\textsuperscript{11} Providing a positive difference of the short-term revenues on the short-term costs.
\textsuperscript{12} The issue of the accruing of new debts in the post admission phase is common to all the bankruptcy procedures. In fact, due to the nature of "spese di procedura", the USBC Section 503 administrative expenses equivalent, these costs, to be paid in full on top all the other claims can in concrete erode the estate and damage the Creditors’ (secured and unsecured) rights and expectations.
\textsuperscript{13} The reform has eliminated the double majority check and, due to this, it is no longer necessary to count the number of creditors as referring to the credits amount suffices.
After the Creditors vote, the Court is called to grant the final confirmation of the Plan by issuing the Confirmation Decree. The latitude of the Court’s scrutiny (the fourth and last hurdle to be passed by the Plan) can vary depending on whether objections arise. If no objections are raised, the Court has simply to ratify the Creditors’ decision granting the Confirmation Decree. In case of objections the Court has to issue a judgment on these before issuing the Confirmation Decree. If there are objections the Court has the duty and power to rule also on the merits of the Plan but only on a limited ground. The IBL has restricted the possibility to attack the Plan especially for the Creditors, whose objections are usually more frequent. Usually the Creditors complain about the merit of the Plan arguing that it does not respect the best interest rule. In other words, they have to prove that greater relief would be available if outside of the Plan (such as in a liquidation scenario). In this case the Court is allowed to examine the merit of the Plan and to decide if the plaintiff’s interest are respected or not. In any case, according to a provision similar to the cram down provided by the USBC, the Court has the power to force the dissenting and objecting Creditors to accept the Plan notwithstanding their refusal if the Plan appears as the best solution available.

The Confirmation Decree opens the Post Confirmation Phase and the Plan’s execution. In this context all the obligations included in the Plan have to be fulfilled and the Court issues all the necessary decrees to allow the Plan’s execution. The Debtor is discharged of its all pre-petition debts.

As prescribed by the IBL, the length of the entire proceeding, from the petition’s filing to the Confirmation Decree, takes a maximum of eight months. The Admission Decree is issued, generally, within thirty days after the filing of the petition.

II. HOW TO CARRY OUT THE INVESTMENT?

The main goal of the Investment is to take control of the Debtor’s company in a safe and fast way. The Investment is carried out by acquiring the ownership of the Target Assets though two-steps, the Lease Agreement and the Sale and Purchase Agreement. The two-step scheme is necessary to make the Investment safe and fast.

In relation to the Investment’s safety, on the one hand, the Italian Civil Code provides that the buyer, in case of sale of enterprise (or substantial assets of an enterprise), succeeds the seller in all the previous liabilities. This provision obliges the parties to deal with and regulate, in their

14 The term is not peremptory but generally respected. The Creditors’ objections can require more time but, often, the Concordato Preventivo is completed approximately one year after the filing of petition.
contracts the issues connected to the presence of these liabilities (known or not). Usually, in dealing with a healthy company, these issues are solved providing representations and warranties or indemnifications provisions because the seller appears as a reliable subject and the buyer will be likely able to recover losses. In a default context, on the contrary, the seller company is not a reliable subject and this is able to concretely affect the future chance for the buyer to recover any possible losses from the seller. This is why, in substance, a hypothetical immediate purchase of the Target Assets from the Debtor would expose the Investor to all the previous Debtor’s liabilities without an effective protection.

On the other hand, the IBL provides that, once having completed a procedure such as the Concordato Preventivo, because of the discharge, all the previous Debtor’s debts are cancelled. At this moment the Investor does not risk to be liable any longer for Debtor’s previous debts. Moreover, according to the Italian Civil Code, the rule regarding the transfer of the liabilities from the seller to the buyer is not applicable to lease agreements of the enterprises in which the lessee bears only the liabilities of the lease.

According to the Italian Civil Code and to the IBL the two-steps scheme is able to make the Investment safe in relation to the possible accruing of previous liabilities. The Investor buys the Target Assets only when all the previous Debtor’s liabilities have been cancelled. Once having obtained the Confirmation Decree (and the consequent discharge) the Investor is able to safely acquire the Target Assets by the means of the Sale and Purchase Agreement that, in fact, is triggered by the issuing of the same Confirmation Decree.

In order to quickly take control of the target company without waiting the completion of the Concordato Preventivo and the discharge, the Investment requires the completion of the Lease Agreement. Under the Lease Agreement, triggered by the issuing of the Admission Decree, the Investor can control and use the Target Assets, as if it is the owner, without keeping the Debtor’s liabilities, during the period required for the completion of the Concordato Preventivo.

The key to the Investment’s success is matching the Investor’s business plan needs with the needs of all Concordato Preventivo’s players. In this sense the rents and the price (cash, securities or other) provided by the Investor are the foundation, in terms of upcoming assets, of the Plan. The following Figure.2 shows the parallel run of the Plan and the Concordato Preventivo.
**A. The Investment in the Post Petition Phase**

As mentioned the Debtor’s petition must include the Plan. The shaping of the Plan requires the Debtor and the Investor to deal together in order to match their respective needs and interests before the filing of the petition. This negotiation involves the same schemes and activities of a traditional healthy acquisition transaction, but with substantial differences. One of the most attractive of these differences is the possibility to avoid, in large part, the representations and warranties provisions usually present in a traditional acquisition.\(^\text{15}\)

If the Plan includes the transfer of employees the Investor and Debtor have to obtain the employee trade unions’ consent on the transfer.\(^\text{16}\) As to costs collocation, the Investor bears the pure cost connected to the due diligence as well as other costs carried out for the Plan, while the Debtor’s costs are treated as procedural expenses.

The Plan, to be likely admitted by the Court and subsequently approved by the Creditors, has to ensure the future cash flows of the Concordato Preventivo and the feasibility of the Plan.

In this sense a feasible Plan is a plan able to pay the Creditors as promised. In order to ensure the future payments and respect of the Plan’s conditions, the Plan typically includes an

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\(^{15}\) As said the Sale and Purchase Agreement will be sign once having obtained the discharge of all previous Debtor’s debts. Moreover, dealing in the presence of the Court’s authorization gives advantages including the transfer of the assets free from liens. In this scenario most of the representations and warranties and the indemnifications can be omitted saving costs and time.

\(^{16}\) The Italian Labor Law prescribes, for every contract providing a transfer of employees from an old employer to a new one, a special procedure to be carried out in order to obtain the consent of the trade unions. This procedure requires approximately 30 days.

\(^{17}\) For example the cost related to the incorporation and capitalization of the special purpose vehicle (“SPV”), the costs connected to obtaining a short term credit lines for the running of the business, if necessary, or the costs related to the amendment of the own business plan.
Investor’s binding proposal to conclude both the Lease Agreement and Sale and Purchase Agreement. This makes future cash flows automatic and certain and the Plan, in this sense, feasible. The operating of the automatic stay after the filing of the petition allows the Investor to make the proposals being sure that the Target Assets will remain in the Debtor’s possession for all the Concordato Preventivo.

As mentioned, the Court’s Admission Decree is expected generally within thirty days of the filing of the petition. In evaluating the Debtor’s admission to the Concordato Preventivo, the most important concern of the Court is the possible accruing of substantial costs as procedural expenses. At this stage a Plan, providing both a reduction of the expenses and new fresh capital, has a great chance to obtain an Admission Decree. Such a plan is able to make profitable the Concordato Preventivo that loses costs and keeps earnings, mostly coming from the rents paid by the Investor.

**B. The Investment in the Post Admission Phase**

The Admission Decree triggers the Lease Agreement. It is crucial to recognize that the Plan and the Lease Agreement are strongly correlated. The Admission Decree means that the Court is granting not a generic plan but the Plan founded on the Lease Agreement and on the Sale and Purchase Agreement.

The Lease Agreement triggers the split of the company into two branches that, from this moment, will follow parallel but separate tracks. The profitable part of the Debtor’s assets, often coinciding with the Target Assets, goes to the Investor (or to its controlled SPV) while the other assets not included in the Target Assets (“Other Assets” or “OA”) remain in the Concordato Preventivo to be liquidated. The Target Assets are switched from the Debtor to the Investor that is able to immediately use them. The Lease Agreement rules the contractual relation between the Debtor, as lessor, and the Investor, as lessee. The Investor bears the short-term costs\(^{18}\) connected with the Target Assets including the rents and keeps all the revenues arising from the Target Assets. The profitability of the Investor’s business depends on the business plan and on its capacity to choose in advance, and include in the Target Assets, only the truly strategic assets.

\(^{18}\) Usually short term loans if required, accounts payable, trade credit.
C. The Investment in the Post Confirmation Phase

The Confirmation Decree issued by the Court triggers the Sale and Purchase Agreement included in the Plan accepted by the Creditors and, subsequently, the Court issues the decrees to enact all the Plan’s provisions. The Investor pays the price and becomes owner of the Target Assets.

The Debtor, with the proceeds of the sale of the Target Assets and of the Other Assets, is able to pay all the Creditors according to the Plan. The Debtor achieves the balance between the restructured debts and assets.

Thanks to the revenues and the profitable running during the Lease Agreement, the goodwill and the value of the Investor (‘s SPV) is typically accrued and this is the proper moment for the Investor to raise money by an IPO or by private investors, in equity or debt. The Figure 3 below provides elements of Debtor and Investor Balance Sheets in the different phases of the Concordato Preventivo.

<table>
<thead>
<tr>
<th>Post Petition Phase</th>
<th>Post Admission Phase</th>
<th>Post Confirmation Phase</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DEBTOR</strong></td>
<td><strong>DEBTOR + JC</strong></td>
<td><strong>DEBTOR</strong></td>
</tr>
<tr>
<td>+</td>
<td></td>
<td>+</td>
</tr>
<tr>
<td>Target Assets</td>
<td>Proc. Expenses</td>
<td>LA Rentals</td>
</tr>
<tr>
<td>Other Assets</td>
<td>Short Term Costs</td>
<td>Other Assets</td>
</tr>
<tr>
<td>Pre Petition Debts</td>
<td></td>
<td>Other Assets</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Restructured Debts</td>
</tr>
<tr>
<td><strong>INVESTOR or controlled SPV</strong></td>
<td><strong>INVESTOR or controlled SPV</strong></td>
<td><strong>INVESTOR or controlled SPV</strong></td>
</tr>
<tr>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>DD Costs</td>
<td>Revenues</td>
<td>LA Rentals</td>
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<tr>
<td>SPV COST</td>
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<tr>
<td>Goodwill</td>
<td></td>
<td>New Eq / Debt</td>
</tr>
</tbody>
</table>

III. HOW TO DEAL WITH THE INVESTMENT’S RISKS?

Each of the Concordato Preventivo’s phases presents factors of risks able, in theory, to block the Investment. The risks arise both from the IBL’s provisions and from the behavior of the players involved in the Concordato Preventivo. A classical approach considers all the risks connected to a bankruptcy proceeding as generally not predictable. The cause of this can be the cultural gap between economic and legal professionals. The first are accustomed to risk-analysis schemes while the second are generally reluctant to forecast possible different outcomes of a future uncertain event.

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19 The Plan could require the appointment of a liquidator, only in the presence of a complex liquidation.
An efficient approach to the Investment’s risks can be adopted by: i) figuring out in advance the possible risk factors, ii) knowing the rules of the different players, iii) forecasting the predictable outputs and iv) providing exits from the Investment to mitigate possible losses.

In fact, the risk of the Creditors’ vote on the Plan is not so different from the risk of a refusal by a counterpart in a negotiation; equally the Court refusal to issue the Admission Decree is not so different from a Government agencies’ refusal to issue a permit or authorization.

The IBL’s new strict rules and practice allows the Investor: i) to mostly predict the player’s behavior and the risks related to the Concordato Preventivo and ii) to mitigate the related possible losses by contractual provisions. The risk of the Investment’s failure changes during the Concordato Preventivo and reaches its highest point in the Post Admission Phase, with the Creditors’ Meeting, as shown in the following Figure 4.

A. The Post Petition Phase’s Risks and Remedies

The first risk for the Investment is the Court’s potential refusal to issue the Admission Decree. The Court’s behavior and considerations, at this stage, can be predicted and the risk reasonably avoided. With the filing of the petition the Court faces a difficult choice: granting or rejecting the Debtor’s petition and its Plan.

20 The Court, in his scrutiny, has to consider the opinion of the Pubblico Ministero, the US Prosecuting Attorney equivalent, who is charged to make a fast scrutiny on the Debtor’s balance sheets and behavior in order to research tax-offences or white collar crimes.
Both the possibilities have important social and economic implications: i) opening the procedure and granting the admission means, automatically, allowing the accruing of procedural expenses on top of all the other claims; ii) refusing the Plan probably means missing an important (and sometimes unique) occasion to avoid the liquidation and to preserve the Creditors’ rights.

As said, at this stage the Court is not able to understand in depth the Plan’s economics due to the lack of the Judicial Commissioner (not yet appointed) and its decision is based, mostly, on pragmatics. Moreover the Court has a limited knowledge of the Plan (far from a hypothetical full-disclosure), based only on the Debtor’s assumptions, and therefore its perception of the Plan’s risks is likely to be overestimated in respect to the real risk. Only after the Judicial Commissioner Report which explains the Plan’s economics, will the Court have a more realistic perception of the risk. The following Figure 5 shows these concepts.

![Figure 5](image)

The risk of rejection, following these concepts, can be avoided by a Plan that solves the Court’s main concern providing an immediate transfer of the costs related to the daily activity (as provided by the transfer of the Target Assets to the Investor) and providing income to cover the procedural expenses (as provided by the rents to be paid by the Investor according to the Lease Agreement).

The Plan has to also clearly point out how, and why it should be preferred to other possible scenarios, such as the liquidation. This allows the Court not only to value the Plan but to figure out in advance the possible response of the Creditors and the Judicial Commissioner. This aim is usually easily achievable in the Plan at this stage because the reorganization’s going concern value (as provided by the Investor’s proposals) is always greater than the liquidation value, including the
goodwill and a higher asset valuation. The Plan, to be successful, has to highlight a surplus, in terms of more assets or reduced costs, available only in the Plan scenario.

If, notwithstanding these efforts, a rejection occurs, the most important potential loss suffered at this point by the Investor is the costs of the initial due diligence. These risks have to be treated carefully considering the situation of the Debtor. In case of its liquidation in fact, the damages or break-up fees are generally treated as unsecured claims. In practice this risk is usually lessened by negotiating though side agreements which avoid the risks and operate to recover the potential losses\(^{21}\).

\[B.\text{ The Post Admission Phase’s Risks and Remedies}\]

Once the Admission Decree is obtained, the Investor can possess the Target Assets due to the Lease Agreement and it can start to run the Debtor’s business under its business plan. The risk of failure depends on the accuracy of the initial due diligence and on the shaping of Investor’s business plan.

On the side of the risks connected to Concordato Preventivo, the Admission Decree, even if undoubtedly positive, does not also grant the subsequent Confirmation Decree and the signing of the Sale and Purchase Agreement. This contract in fact is triggered by the Confirmation Decree that is issued only if the Creditors approve the Plan. The Investor theoretically could be deprived of the Target Assets in case of rejection of the Plan and forced to give back the Target Assets to the Debtor at the expiring of the Lease Agreement.

As said the hurdles to be passed by the Plan are the Judicial Commissioner Report, the Creditors’ vote and finally the Court’s Confirmation Decree. In this sense the final authorization of the Sale and Purchase Agreement depends on all of these elements.

The Judicial Commissioner Report is the first check of all the economics of the Plan conducted by a business oriented entity, the Judicial Commissioner, sensitive about the concepts of risks, time cost and valuation. As said the Judicial Commissioner has the power and the duty to examine all the Plan’s assumptions, all the balance sheets, all the schedules and all the Appraisal’s reports and to check the transparency of the entire Plan. Judicial Commissioner investigates the Plan’s real convenience and feasibility and his job is to compare, day by day, the Plan’s outcomes with all the other possible solutions (primarily the liquidation scenario). In doing this the Judicial

\(^{21}\) Contractual freedom here provides a wide range of options. One possible way is the intervention of a healthy and solvent parent company which can release a guarantee because of its interests in the positive outcome of the Plan.
Commissioner has to verify the correctness and the fairness of the Target Assets’ valuation in the Plan compared to the hypothetical value in a liquidation sale.

The Judicial Commissioner’s check is complex and involves not only the mere comparison between the asset valuations available in the different scenarios (Plan and liquidation) but he considers also factors such as the assets’ devaluation, the possible costs arising in a liquidation scenario and other possible amounts available in the liquidation scenario related to, for example, the avoidance powers of a hypothetical trustee. The Judicial Commissioner creates a simulation, as realistic as possible, of the future cash flows from liquidation in order to compare it with the Plan’s proposal. All these considerations are crucial in order to shape a successful Plan. In practice, a well understandable and fair Plan finds in the Judicial Commissioner a precious proponent instead of an obstacle. The Judicial Commissioner in fact is able to explain the Plan to the Creditors and to the Court better than the Debtor or the Investor, being more trustable as an impartial party. The positive Judicial Commissioner’s opinion is crucial but not necessary to the final approval of the Plan which remains in the Creditors’ hands.

The Creditor’s vote is the biggest issue of the entire proceeding because, even if the Plan’s alternative appears as the most advisable, the Creditors’ choice is a synthesis of complex, and not always perfectly rational, considerations. Just as in a classic negotiation the point is to step into the shoes of the counterpart (here the Creditors) and analyze, in the most pragmatic way possible, the real alternatives and possible outcomes for them including the possibility, for the Creditors, to continue their business with the Investor. The accuracy of this analysis, often conducted by matching economic and business considerations with legal knowledge, allows the Debtor and the Investor to predict the Creditors’ behavior and avoid the possible risk of a negative vote.

The IBL offers to Plan the lawful opportunities to prevent, and in part orient, the Creditors’ vote by means of the construction of different Creditors’ classes. Once having respected the IBL rules, the Debtor can create the classes in a flexible way, for example by categorizing strategic and non strategic Creditors, and thereby preventing the possible outcome of the Creditors’ vote. IBL provides mechanisms able to render inoffensive the instrumental Creditors’ refusals or objections, as the discussed cram down provisions or the limited ground for objections.

If, notwithstanding all these cares, the Plan is not approved by the Creditors, the Investor will not be able to complete the Sale and Purchase Agreement and acquire the ownership of the Target Assets. To reduce the potential risks arising from the loss of the Target Assets Investor has
to: i) arrange in advance exit rights, and ii) run its business during the Lease Agreement under a short term point of view. On the one hand, the Investors has often the possibility to include in the Lease Agreement (and in the Plan) contractual provisions structured to avoid or mitigate the potential losses or to make refusal of the Plan difficult and unprofitable. On the other hand, the Investor should avoid, or limit, its long-term investments while waiting to become owner of the Target Assets.

C. The Post Confirmation Phase’s Risks and Remedies

The Confirmation Decree, the discharge, the Court’s decrees and the IBL’s provisions all ensure to Investor its ownership of the Target Assets free of unforeseen contingent liabilities. In practice, the risk of Concordato Preventivo’s avoidance for fraud, is rare and does not affect the Investor in good faith. Side agreements can be provided (if necessary) to avoid any residual potential damages.

The following Figure n.6 summarizes the discussed risks and remedies.

<table>
<thead>
<tr>
<th>Phase</th>
<th>Risks</th>
<th>Remedies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Post Petition Phase</td>
<td>Petition’s Rejection by Court</td>
<td>Providing instant saving (stop procedural costs) and Cash income (rentals).</td>
</tr>
<tr>
<td></td>
<td>Economic Losses: time &amp; DD costs</td>
<td>Side agreements.</td>
</tr>
<tr>
<td></td>
<td>Investor’s Business failure</td>
<td>DD &amp; BP accuracy.</td>
</tr>
<tr>
<td></td>
<td>Judicial Commissioner’s Report</td>
<td>Transparency and Fairness.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Convenience: Liquidation benchmark (surplus).</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Figuring out in advance the objections.</td>
</tr>
<tr>
<td>Post Admission Phase</td>
<td>Creditors’ Vote</td>
<td>Negotiation: Step into Creditors’ shoes</td>
</tr>
<tr>
<td></td>
<td>Economic Losses: short term costs</td>
<td>IBL: Classes, cram down and limited ground for objections.</td>
</tr>
<tr>
<td>Post Confirmation Phase</td>
<td>Residual risk of avoidance for Fraud</td>
<td>Business Plan: profitable, short term investments.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Keep the revenues.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Contractual provisions.</td>
</tr>
</tbody>
</table>

IV. WHY SELECT THIS OPPORTUNITY? BENEFITS AND ADVANTAGES

The Investment not only allows the Investor to substantially reassess the risk connected to the Concordato Preventivo ’s procedure but presents direct and valuable advantages. Some of these advantages comes from the distressed status of the target company. Others are due to the applicable Italian Law. As a consequence, the Investment becomes attractive for the Investor under many aspects.
A. Distressed Investments vs. Non Distressed Investments

Dealing with a distressed target company presents many direct advantages. The Investor finds attractive conditions in every transaction included in the Investment as below explained.

The first advantage is represented by the general leverage that the Investor has on all Concordato Preventivo’s players during the described phases. The leverage, in particular, is on: i) the Debtor, ii) the Court, iii) the Judicial Commissioner and iv) the Creditors. The Debtor, in the negotiation of the Plan, has the aim to avoid a liquidation by the means of the Concordato Preventivo and to avoid potential liabilities arising in this case. This put the Investor in a favorable position because it deals often as a unique player. In fact, the negotiation of the Plan with the Investor happens not in an healthy scenario but in a critical moment for the Debtor. Usually at this stage all the Debtor’s debts are overdue and the Creditors have started executive actions against the Debtor’s assets. The Debtor has the absolute need to accelerate the beginning of the Concordato Preventivo in order to stop all the actions by means of the automatic stay and to avoid the risk of losing all the valuable assets. In this context, the first Investor coming has the greatest opportunity to seal the deal because the Debtor has no time for long multilateral negotiations.

The Court and the Judicial Commissioner, as mentioned, are sensitive to procedural cost accruing. The key to a successful Plan is to save costs and provide cash for the Concordato Preventivo. Moreover, the Court and the Judicial Commissioner pay attention to preserve employment levels, to optimize Creditor’s satisfaction and to avoid the loss of value of the company, typical in a liquidation. This offers the Investor a great occasion to solve all these issues, obtaining, as a result, favorable conditions for the Lease Agreement and Sale and Purchase Agreement, otherwise not obtainable.

The leverage on the Creditors comes from the position of the Investor, who is able to offer them the only concrete chance to recover part of their claims. Moreover, the Investor can offer the Creditors the continuation of the business relation previously existing with the Debtor, usually obtaining more favorable conditions.

The second advantage is the possibility for the Investor to reshape the old Debtor’s business in a tailor made way with a limited cost. On the one hand, this implies not only a mere choice of

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22 Even though part of the bankruptcy Criminal Law is applicable to the Concordato Preventivo, in practice the trustee appointed in case of Fallimento, is generally more strict than the Court and the Judicial Commissioner in the Concordato Preventivo.
23 Due to this, exclusivity agreements, even if available, are often useless.
assets but the possibility to freely\(^{24}\) rebuild a new business keeping or renegotiating the contracts. This occasion is unique in the investment’s scenario also because the Investor has the possibility to take advantage of the track records and cooperation of the Debtor, who is interested in the success of the Plan. Notwithstanding the old managers are generally viewed as a cause of the default, the Investor is free to hire them, especially in relation to complex business. On the other hand in calculating the price the Investor can value the Target Assets less than the actual real valuation and provide a little more than the hypothetical liquidation value. The use of liquidation value as benchmark effects, in the price setting, a great devaluation of all assets including the good will of the company, often not valuable in a liquidation. This offers advantages in dealing with target companies owning assets whose worth, in case of liquidation, are subject to a quick drop such as semi-finished goods (not yet marketable because not finished), illiquid credits (because of debtor’s solvency) or intangible assets (as trademarks or patents). In other words, the Investor is allowed to acquires still valuable assets by paying a price reflecting a hypothetical and not actual liquidation valuation.

The third advantage is represented by the Concordato Preventivo’s proceeding and by dealing with the Court. The Court is the unique entity able to grant the complete discharge of all Debtor’s pre-petition debts and to assign to the Investor the property of Target Assets free from liens. This allows the Investor, after the Confirmation Decree, to avoid the accruing of possible contingent liabilities and to save costs in the negotiation of the Plan.

The last general advantage for the Investor is its freedom in the shaping of the Investment often not available in dealing with healthy target companies. The Investor can finance the Investment which is, in this sense, easily bankable. The presence of a new profitable business in the Lease Agreement makes possible a system of guarantees founded, for example, on the accounts receivable. The Investor is able to built its SPV with the desired actual leverage ratio fitting its business plan.

The following **Figure n.7** summarizes the discussed direct advantages of the Investment not available in a deal involving a non-distressed target company.

\(^{24}\) Except the mentioned Labor Law.
### Advantage Elements

<table>
<thead>
<tr>
<th>Advantage</th>
<th>Elements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investor’s Leverage</td>
<td>Debtor: peculiar situation and needs. No multilateral negotiation.</td>
</tr>
<tr>
<td></td>
<td>Court and Judicial Commissioner: sensitive to the costs accrual, preservation of employment level, Creditor’s satisfactions, avoidance of wastes.</td>
</tr>
<tr>
<td></td>
<td>Creditors: only concrete chance to recover credits and continue the business</td>
</tr>
<tr>
<td>Business Reshaping Opportunity</td>
<td>Choice of Target Assets</td>
</tr>
<tr>
<td></td>
<td>Renegotiation of contracts</td>
</tr>
<tr>
<td></td>
<td>Track records and Debtor (“s old managers) cooperation</td>
</tr>
<tr>
<td>Attractive Price</td>
<td>Liquidation value as benchmark.</td>
</tr>
<tr>
<td>Court Dealing</td>
<td>Assets free from charges.</td>
</tr>
<tr>
<td></td>
<td>Avoidance of contingent liabilities: discharge.</td>
</tr>
<tr>
<td>Others</td>
<td>Freedom: Investment bankable, SPV leverage ratio.</td>
</tr>
</tbody>
</table>

**Figure 7**

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**B. Italian Legal System vs. US Legal System**

The IBL, and in general the entire Italian legal system, presents features able to render the Investment more attractive for the Investor if compared to a similar investment carried out in the US legal system.

One of these advantages is the possibility, offered by the Italian Civil Code, to lease the Target Assets, through the Lease Agreement, during the period required for the completion of the Plan. In this period, with a duration of approximatively one year, the Investor is authorized to use the Target Assets before becoming formally the owner. This scheme, even if lawful, is not common in the US Legal system. This way to take control of a target company makes the Investment attractive. The Investor has in fact the chance to buy the Target Assets after having experienced them under the Lease Agreement.

The second advantage is the will of the Italian legislator in reforming the IBL. The IBL is now worded in order to make easier private solutions of the defaults, with the aim to reduce the power of public subjects, such as the Court. The scrutiny on the merit of the Plan by subjects different from the Creditors is essentially limited to the Court’s scrutiny in case of objections. The IBL has not a provision equivalent to the USBC Section 105, under which the US Courts keep a strong discretionary power in the approval of the plans. IBL, under this point of view, makes the investment more predictable and safe. The Italian landscape, in this sense, is more attractive for the investments than the US landscape which, on the contrary, is marked by a strong (and unpredictable) presence of public powers.
The third advantage is represented by the lack, in the IBL, of provisions similar to those in USBC which grant adequate protection to the secured creditors. Under the IBL in fact, after the commencement of the Concordato Preventivo, the secured creditors cannot gain possession of their collateral but have to wait for the sale of such collateral being secured on the proceeds. This aspect is crucial for the Investor because the Target Assets identified in the Lease Agreement will remain mostly the same in the Sale and Purchase Agreement. Moreover, leverage of the secured creditors on the Debtor and the Investor is substantially reduced.

The fourth advantage is the presence of a simple majority, required for the approval of the Plan by the Creditors. This element and the possibility to categorize the Creditors into classes, makes the Investor and the Debtor able to predict the possible outcome of the Creditors’ vote at an early stage of the Investment. Even if the Creditors’ vote remains the most important and theoretically unpredictable issue of the Plan and of the Investment, the Investor can often run its business, during the Concordato Preventivo, being pretty sure about the Creditors’ approval. The double majority required by the USBC renders the forecast of the vote more difficult and, in general, renders the vote more uncertain.

The fifth advantage is the possibility, offered by the IBL, to write down and completely discharge most of the tax and the social security contributions debts of the Debtor. This feature represents a great innovation for the Italian bankruptcy system and it is completely different from the USBC under which the discharge of the tax debts is not allowed. Usually tax debts represent one of the most important liabilities of the target company and this allows the Debtor (and the Investor) to save a significant amount of money in the shaping of the Plan.

Finally the Italian system looks at new investors with more attention than the US system. The reason for this is the common mistrust of the old debtor and of its management which, in Italy, are generally viewed as cause of the default. In Italy it is rare that a debtor is able, alone and without the presence of new capital or investors, to carry on again a distressed company. With the default in fact the debtor loses all its reliability and most of the banks, suppliers and clients are reluctant to again deal with it. This consideration makes investments by a new subject generally highly valued by the Creditors and by the Court.

The following Figure n.8 summarizes the discussed advantages of the Italian legal system in comparison with the US legal system.
<table>
<thead>
<tr>
<th></th>
<th><strong>Italian Legal System</strong></th>
<th><strong>US Legal System</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Target Assets</td>
<td>Possibility control / rent by the Lease Agreement.</td>
<td>Not common.</td>
</tr>
<tr>
<td>Landscape</td>
<td>IBL reduces the public power and favor private solution of the default.</td>
<td>The Court keeps a strong discretionary power, USBC Section 105.</td>
</tr>
<tr>
<td>Automatic Stay</td>
<td>No provision for adequate protection.</td>
<td>Adequate protection.</td>
</tr>
<tr>
<td>Creditors Vote</td>
<td>Simple majority.</td>
<td>Double majority.</td>
</tr>
<tr>
<td>Tax and social security contributions debts</td>
<td>Discharge and writing down allowed.</td>
<td>Discharge not allowed.</td>
</tr>
<tr>
<td>New Investors</td>
<td>“Mandatory”</td>
<td>Possible</td>
</tr>
</tbody>
</table>

**CONCLUSIONS**

This article presents a scheme to profitably invest in distressed Italian companies by taking advantage of the Italian Bankruptcy Law. The risks connected to the insolvency proceeding are analyzed under their economic effects and foreseen in their general appearance. Specific remedies to avoid or mitigate the potential risks are provided. Singular advantages, available only in the proposed investment scheme under the Italian Law, are described. As a result the investment produces a less risky and more profitable outcome than an investment in a non-distressed and non-Italian target company.