Acquisition of Italian On-going Business within the frame of Group to Group Cross-Border Acquisition Projects - Selected Issues -*

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The number of cross-border acquisitions has been rising for several years, and today this kind of operation represents one-third of the total number of acquisitions executed world-wide. Although the economic recession of the last few years has slowed down such growth, cross-border acquisitions still represent a relevant instrument by which companies are able to acquire market shares, eliminate competitors, restructure business organizations and cut unsustainable branches of their business. This article aims to highlight, from the perspective of Italian law, the main issues related to an acquisition project involving companies or on-going businesses located in different countries and jurisdictions (i.e. Cross-Border Acquisitions Project).

In addition to the problems normally associated with all kinds of acquisitions projects, Cross-Border Acquisitions Projects face some specific issues arising from the differences between the legal systems involved. These issues, if not adequately addressed, may lead to inconsistencies between contractual provisions contained in the Cross-Border acquisition contract and the provisions of the national legal systems that are invoked by the transaction.

In order to provide some guidelines for handling these issues, this article deals with the acquisition of an Italian On-going Business within the following framework, which may be considered the most common:

(a) the Cross-border Acquisition Project involves multinational groups, where one group (Group A) wishes to acquire from another group (Group B) a number of subsidiaries located in different jurisdictions ("the Target Companies");
(b) the Acquisition is negotiated between the Group Head Companies, or between the Territorial/Branch Head Companies of the Groups, which are competent in a specific region or business;
(c) the Acquisition Agreement is a single contract (usually, and hereinafter, referred to as the "Master Agreement"), the provisions of which are intended to apply to the acquisition of every Target Company;
(d) the Acquisition is structured as share transfers, an asset transfer or as a combination of the two[i]; and/or
(e) in Italy the Acquisition concerns the On-going Business of the Italian Target Company.

Although recourse to the Master Agreement is the appropriate way to proceed in group-to-group Cross-Border Acquisition Projects, the need to implement the Master Agreement in different jurisdictions may raise some delicate issues due to overlapping of different legal systems. Some legal systems (such as in Italy)

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may require the application of some legal provisions to the Master Agreement, which would supersede any contractual provisions found in the Master Agreement, including any "choice of governing law" provision. Therefore, the Master Agreement must be consistent with the local laws.

It is possible to overcome these issues by addressing during the negotiation and drafting of the Master Agreement the peculiarities of the local legal systems in order to meet the compulsory requirements, and to acknowledge any unavoidably- linked legal effects.

In reference to the Italian Law system, special issues arise out of the particular discipline provided by the Civil Code for the transfer of On-going Business.

Transfer Of Assets or On-going Business Transfer

Before examining the above issues, it is essential to clarify that Italian law makes a clean-cut distinction between assets and On-going Business.

Assets are the tangible or intangible goods owned by a business enterprise, **individually considered,** while an On-going Business is the aggregate of assets and legal relationships organized for the running of the undertaker's business activity (Article 2555 of the Italian Civil Code - hereinafter Civil Code)[ii]. This distinction has some relevant practical consequences, particularly due to the different legal discipline provided by Italian law for the transfer of assets and the transfer of On-going Business.

Whether the implementation of the Cross-Border Acquisition Project involves a transfer of assets or a transfer of an On-going Business should be verified on a case- by-case basis, regardless of the contract's heading and the express definition given by the parties. When the Acquisition Project transfers at least two of the following elements: (a) assets, (b) contracts, (c) employees, (d) Public licences and authorizations, (e) know-how, and/or (f) list of clients and suppliers, the transfer should be considered an On-going Business transfer, and be dealt with accordingly.

In order to avoid delays and subsequent difficulties, the peculiarity of the Italian Law with regard to on-going business[iii] should be considered in planning the Cross-Border Acquisition Project and in the negotiation of the Master Agreement. Particular attention should be paid to the following aspects:

A) Formal requirements for the execution of the transfers;

B) Effects on pending employment contracts; and

C) Joint and several liability of the transferor and the transferee for certain debts.

Execution of Transfer

Pursuant to Article 2556 of the Civil Code, the transfer of On-going Business must be executed by means of a public deed or a private deed with legalised signatures ("Deed of Transfer"). Article 2556 has a heavy impact on the Cross-Border Acquisition Project schedule, and should be kept in mind when planning the Project in order to assure, as this kind of project usually requires that all of the local transactions are closed simultaneously.

First, Article 2556 imposes the execution of an *ad hoc* Deed of Transfer of the Italian On-going Business. The *ad hoc* Deed of Transfer cannot be inconsistent with the provisions of the Master Agreement. To the contrary, it is advisable that the provisions of the Master Agreement applicable to the Italian Acquisition are reiterated in the Deed of Transfer as much as possible.

Moreover, the deed's public nature (also in the case of a private deed with legalised signatures) imposes strict formalities concerning signatory powers. The persons authorized to sign in the name and on behalf of the parties must give evidence of signatory power by means either of the appropriate corporate resolution or by means of a special proxy, the legalised copy of which must be delivered to the Notary[iv].

Whether executed by public deed or by a private deed with a legalised signature, the deed of transfer must be filed with the Registry of Companies within thirty days of the transfer.

This guarantees public and general evidence of the transfer. Even if the fulfilment of this requirement does not impact the validity of the transfer itself, it is necessary to file the Deed of Transfer in order for the transfer to be effective vis-à-vis third parties. At least seven to ten days are required for the filing to take effect.

Effects on Employment Relationships

Two binding provisions of the Italian Civil Code greatly narrow the degree of flexibility granted to the parties with respect to the transfer of employees and the terms and conditions under which the transfer will be effected. Employment relationships are an area where the Italian legal system offers ample protection to the employees and to the conservation of their acquired rights. Consistent with this attitude, the transfer of the On-going Business is governed by two main provisions, in the related matters:

1. Article 2112 of the Italian Civil Code; and
2. Article 47, law of December 29th, 1990, n. 428 (as modified with Law Decree February 2nd, 2001, n. 18, entered into force on July 1st, 2001 and hereinafter referred to as "Article 47 Law 428/1990") [v].

Pursuant to Article 2112:

- in the case of transfer of an On-going Business, the employment relationship continues with the transferee and the employees retain all the personal rights that they have accrued prior to the transfer;
- transferor and transferee are jointly and severally liable for all the employees' credits accrued prior to the transfer. But the employee can release the transferor from the liability, provided that the waiver is formalized according to the special procedures set forth by Articles 410 and 411 of the Italian Civil Proceeding Code[vi];
- transferee is bound to apply to the employees the economical and contractual conditions established in the National Labor Collective Contracts (hereinafter; "NLCC") applicable to the transferor at the moment of the transfer, or in the NLCC conditions applicable to the business of the transferee, provided that the latter guarantees economical and contractual treatment of the same level;
- the transfer of the On-going Business cannot, *per se,* serves as grounds for employee dismissals;
- should the transfer substantially affect the employee's work conditions, the employee can legitimately resign during the three months following the transfer of the On-going Business.

Pursuant to the Article 47 Law 428/1990:

- When the transferred On-going Business employs more than 15 employees, it is mandatory that the transferor and transferee give written notice regarding the transfer to the Trade Unions.

➢ The notice must be given less 25 days before the Deed of Transfer is executed, or

before the first binding agreement on the transfer is reached between the parties.

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➢ The notice must provide all information concerning:

a) the proposed date of the transfer;
b) the reasons for the transfer of the On-going Business;
c) the legal, economical and social effects that the transfer will have on the employees;
d) the foreseen measures, if any, that will be taken with respect to the employees.

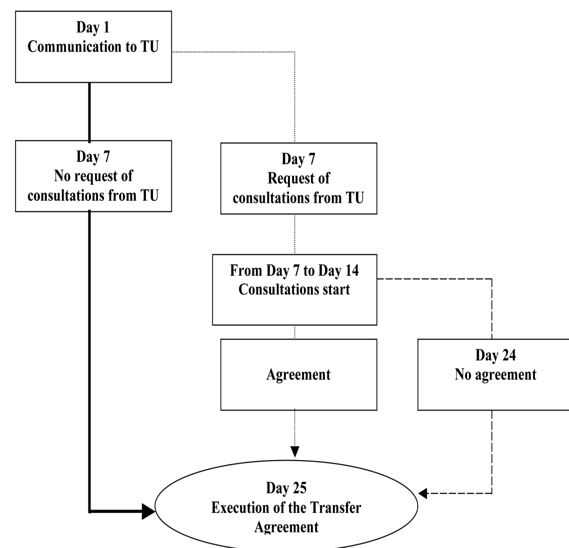
- Within 7 days from receipt of the above notice, the Trade Unions may, in writing, request a consultation with the parties to the transfer. If this occurs, the transferor and transferee must start joint consultations with the Trade Unions within 7 days of receiving the request.

- The consultation is aimed at settling any disagreements that may exist about the effects of the transfer on the employees' rights, properly applying the provisions of Article 2112 Civil Code, and protecting the employees' interests, individually and collectively.

- Any agreement reached with the Trade Union must be formalized in a report signed by all the parties involved. If no agreement is reached within ten days of consultation, the consultation is considered complete in any case and the On-going Business transfer can be legitimately executed.

- A final warning: the transferor and transferee commits "anti-trade union behaviour" if they do not give notice to the Trade Unions regarding the transfer, or if they refuse the requested consultations. Should this occur, the Trade Unions would have recourse under Article 28 of Law of May 20, n. 300, under which the Labour Judge can order that the procedure be immediately started.

As summarised below, the procedure for communication with the Trade Unions is such that, if the communication has been given and the consultation has been conducted upon the Trade Unions' request, the transfer can be legitimately executed 25 days after the communication to the Trade Unions, regardless of whether or not an agreement has been reached:



Obviously, lacking agreement, Trade Unions are always free to act through the usual instruments granted to them in order to protect the employees' rights (i.e. strikes or similar measures). Of course, this represents a strong deterrent to the execution of the transfer without having reached the prior consent of the Trade Unions.

In light of the above, the following matters should be taken into consideration in planning the Cross-Border Acquisition Project and in drafting the Master Agreement:

(a) the scope of pre-closing due diligence, as far Italian On-going Business is concerned, must duly cover the potential joint liability risk;
(b) explicit representation and indemnification-procedures regarding the employees' actual or potential credits during the pre-closing period should be

included in the Master Agreement and in the ad hoc Italian deed of transfer;

(c) the timetable of the Project must consider the conduct and completion of the activities noted in this section, with special regard given to the 25-day proceeding addressed in Article 47;

Joint and Several Liability for Commercial and Tax Debts

In negotiating and drafting the Master Agreement, particular attention must be paid to the issue of the transfer of the On-going Business' liabilities. The Italian legal system provides some specific provisions concerning the commercial and fiscal liabilities of the On-going Business. These provisions apply, notwithstanding any agreement to the contrary that may be reached by the parties.

Commercial Liabilities

Regardless of any express agreement reached by the parties, pursuant to Article 2560 Civil Code, the parties are jointly and severally liable for the debts incurred prior to the transfer if they are recorded in the accounting books, and the creditors have not expressly released the transferor.

Debts for taxes

Pursuant to Article 14 Legislative Decree 18 December 1997, n. 472, the parties are jointly and severally liable for taxes and sanctions originating from violation of tax laws incurred in the two preceding years, and during the year the transfer of the On-going Business is executed. The parties are also jointly and severally liable for violations of tax laws that are noted during the same period of time, even if violated in the preceding years. The transferee's liability accrues only for debts assessed until the date of transfer and is limited to the amount equal to the On-going Business's value. Upon request, the Italian tax authority issues a certification of the amount resulting from the violation or from debts assessed. The transferee is exempt from liability if: a) the certificate does not report notifications of violations or assessments of debts; or b) the certificate is not granted within 40 days from the request. No exemption is granted if the transfer is made with the purpose of fraudulently avoiding the payment of taxes.

Once again, the above issues may affect the timing of the Cross-border Acquisition Project and should therefore be carefully addressed in planning the Project and in preparing the agreements. In particular, in light of the above, is always opportune that:

(a) the pre-closing due diligence of the Italian On-going Business covers the potential risks resulting from the debts that the parties do not intend to include in the transfer;

(b) specific representations and indemnification procedures in favour of the transferee are included in the Master Agreement and in the *ad hoc* Italian deed of transfer; and

(c) the timetable of the Project is coordinated with the time period in which the Italian tax authority must certify the amount resulting from violation of tax laws and from debts assessed by transferor.

Conclusions

The implementation of Cross-Border Acquisition Projects is now a frequent business scenario. Undoubtedly, it is also a challenging transaction in which the usual problems of a national merger are amplified by the co-existence and overlapping of several different legal systems, which must be considered and coordinated while designing the entire project. It is essential to know the laws of the involved countries, and to thoroughly analyze the

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consistency of the contractual provisions with the laws of those involved jurisdictions. These preventive measures will protect against *ex-post* re-negotiation and subsequent revision of the contractual documents, which often prove to be more time-consuming and are never as effective as they would have been had the highlighted issues been addressed at the appropriate time.

Notes:

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[1] The transfer of assets is often chosen instead of a share transfer since it can be materially more advantageous from a tax point of view and can limit the transfer of liabilities, which would unavoidably pass from the seller to the buyer in a share transfer.

[2] An example of the interpretation of Article 2555 can be found in several decisions of the Court of Cassation, such as: "Transfer of On-going Business exists when object of the transfer is an functional complex of assets suitable for the prosecution of a business activity" (*Court of Cassation, June 23rd, 2001, n. 8621*); "The peculiarity of the transfer of the On-going Business is the organization of the assets finalized to the run of the business" (*Court of Cassation, April 28th, 1998, n. 4319*).

[3] The On-going Business legal concept is not retraceable in the Common Law legal systems.

[4] The legalisation of the legal documents originated outside Italy must be made according to the Hague Convention of 1962, in the member countries of said Convention, or by the Italian Consulate.

[5] Article 47 of Law 428/1990 accomplishes the European Directive 2001/23/CE, of March 12, 2001. Thus the provisions of Article 47 do not pertain to the Italian Legal system only. Similar laws can be found in the other European Member States' legal systems.

[6] According to Articles 410 and 411, the waiver must be formalized during a meeting fixed before the Local Labour Office. In the meeting the employee can be assisted and represented by the Trade Unions.

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