Private Equity Comparative Guide

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Private Equity Comparative Guide

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1.Legal framework

1. 1. Which general legislative provisions have relevance in the private equity context in your jurisdiction?

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Legal rules of a general nature – which apply not only to private equity funds, but also to companies and other entities, as the case may be – can be found in the Civil Code and in the Income Tax Code. The main statutes of relevance are as follows:

- the Finance Law (Law Decree 58 of 24 February 1998, as amended);
- *Commissione Nazionale per le Società e la Borsa* (CONSOB) Regulation 11971 of 14 May 1999 (as amended);
- Decree of the Ministry of Economy 30 of March 2015;
- the Alternative Investment Fund Managers Directive (2011/61/EC), adopted in 2015;
- the Regulation of the Bank of Italy of 19 January 2015 (as amended);
- Italian Income Tax Office Circular 6 of 30 March 2016 on tax matters and leveraged buyouts;
- CONSOB Regulation 20307 of 15 January 2018; and
- the Regulation of the Bank of Italy of 5 December 2019 on corporate governance prerequisites.

1. 2. What specific factors in your jurisdiction have particular relevance for and appeal to the private equity market?

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Italy is an attractive country for private equity investors due to its renowned industrial sectors, such as high-tech, fashion, design and food. Italy is blessed with thousands of businesses that offer products and services which compare favourably to those that can be found in other markets.

In the last three years, Italy has begun offering robust tax credit schemes with the aim of increasing the competitiveness of Italian companies that allow companies to enjoy the benefit of tax credits in percentage amounts that depend on the type and amount of the of investment made (e.g. r&d, machinery and equipment, digitalization etc.).

2.Regulatory framework

2. 1. Which regulatory authorities have relevance in the private equity context in your jurisdiction? What powers do they have?

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The Bank of Italy and CONSOB are the main regulatory authorities that have relevance in this context. The Bank of Italy has the powers that are typical of a central bank (with the caveat that Italy is an EU member state and the European Central Bank has had powers reserved to it since 1999); while CONSOB has the powers that are typical of national securities commissions in other countries.

2. 2. What regulatory conditions typically apply to private equity transactions in your jurisdiction?

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Where the target operates in sectors such as banking or finance, insurance, telecommunications or pharmaceuticals, specific regulations apply and the transaction must be cleared with the national supervisory authorities (eg, the Bank of Italy, the Institute for the Supervision of Insurance Companies, the Authority for Communications Guarantees, the Italian Companies and Exchange Commission or the Italian Medicines Agency).

3.Structuring considerations

3. 1. How are private equity transactions typically structured in your jurisdiction?

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The common denominator in the structure of a private equity transaction is that a special purpose vehicle company – usually in the form of a minimum capital (€10,000) *società a responsibilità limitata* (Srl) – will be incorporated by the fund to perform the acquisition (newco). Generally speaking, in cross-border transactions the newco will be 100% owned by a holding incorporated in a tax-friendly jurisdiction (eg, Luxembourg or Ireland). If the circumstances should so suggest, the newco will then be merged with the target to push down the debt, if any, taken by the investor in connection with the acquisition (see question 3.3). A management leveraged buyout structure is valid under current regulations, as long as certain requirements set out in Article 2501 of the Civil Code are met and the legal considerations relating to the financial assistance issues that this structure presents are addressed.

To avoid taking up assets and liabilities that are not of interest to the investor, a contribution in kind of the 'business' ('*azienda*' within the meaning of Article 2555 of the Civil Code) of the target will be contributed into a newco by the target's management, net of whatever is not to be acquired, so that upon completion of the contribution of the target's business, its shares can be sold to the investor. This structure presents some attractive tax advantages, as outlined in question 3.2

3. 2. What are the potential advantages and disadvantages of the available transaction structures?

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Investing directly in a target – particularly in the case of a family-owned business – may not be advisable, for many reasons. The contribution and subsequent sale of the share structure described in question 3.1 allows the investor to pick and choose, to the extent possible, the assets and liabilities that are to be acquired at the end of this process. The validity of this transactional scheme has long been disputed and on numerous occasions has been rejected by the Supreme Court – despite the existence of a specific provision in the Income Tax Code that specifically allows or its exemption from the payment of registration taxes (Article 20 of the Income Tax Code). This debate was finally resolved by a decision of the Constitutional Court (Judgment 158 of 21 July 2020), which confirmed the neutrality of this scheme for indirect tax purposes.

As regards direct taxes and capital gains on the contribution, this scheme also achieves dramatic tax savings, including at participation exemption level. However, particular attention must be paid to the attempt to exclude some employees of the target from the acquisition, as all of them should be transferred by operation of law in such case; any cherry picking in the selection of the personnel to be transferred is unlikely to be upheld by the competent court (Article 2112 of the Civil Code, which contemplates all forms of transfers of a corporate business – including leases and the creation of enjoyment rights such as a usufruct over it – and provides for the automatic transfer of personnel to the acquirer).

3. 3. What funding structures are typically used for private equity transactions in your jurisdiction? What restrictions and requirements apply in this regard?

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The funding of the purchase price will usually take the form of equity, bank debt and/or shareholders' loans, in different proportions in accordance with the investor's business plan for the acquisition project. The amount of debt will largely depend on the level that the target can absorb, keeping in mind that these days, acquisition debt is still more difficult to obtain than was the case prior to the 2008 global financial crisis. Highly leveraged acquisitions are no longer common, due to a limitation on the tax deductibility of bank interest, which is permitted within the limits of 30% of annual earnings before interest, tax, depreciation and amortisation as regards the excess spread between active and passive financial interest.

3. 4. What are the potential advantages and disadvantages of the available funding structures?

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Shareholders' loans in Srls are subject to some restrictions in their repayment under Article 2467 of the Civil Code, and are to be considered junior debt if they were made at a time when the company was largely indebted or when it would have otherwise been advisable to inject equity into it, given the circumstances.

3. 5. What specific issues should be borne in mind when structuring cross-border private equity transactions?

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Regulatory issues will be addressed by setting up a transaction that involves a foreign fund and its operations in Italy, as well as through the opportunity to proceed with the acquisition through a special purpose vehicle (see question 3.1).

3. 6. What specific issues should be borne in mind when a private equity transaction involves multiple investors?

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Syndication agreements will be a feature in such cases and the exit procedures of each investor must be carefully addressed, as they may be different in time.

4.Investment process

4. 1. How does the investment process typically unfold? What are the key milestones?

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Typically, a private equity fund will know in advance, through its market intelligence searches, of the intentions of the target's shareholders either to sell out or to partner with an institutional investor. Tips received from trusted lawyers or other professionals who know about potential off-market investment possibilities are another potential source of information. The process usually starts with an indication of interest put forward directly to the shareholders, often with a non-disclosure agreement (NDA) attached. Unlike larger companies with experienced and internationally trained managers, family-owned companies are generally not very appreciative of a cold call approach; it is advisable to introduce the fund with a softer, more personalised line of attack. If the initial talks meet the target's expectations, at least in principle, the following are the key steps in what seems to be an unwritten but widely adopted protocol:

- An NDA will be negotiated and executed. In this case, the exclusivity of dealings in favour of the investor and the duration of the non-disclosure obligations will be the main issues to address.
- In parallel, a non-binding document in the form of a letter of intent, a memorandum of understanding, heads of terms or similar will be negotiated and executed. The most important points to be addressed in that document include the regulation, procedures and duration of the due diligence verifications.
- Following a positive investment decision by the private equity fund, which will be based on the results of the due diligence, a non-binding offer is usually, but not always, put forward. It will usually contain the basic terms and conditions on which the private equity fund is ready to negotiate the prospective transaction. Utmost care must be paid to the wording of the offer: if the offer is somewhat ambiguous as to its non-binding nature, it will lead to a binding agreement if it is accepted by the recipient, even though it purports to be non-binding (Article 1326 of the Civil Code).
- If the offer is accepted, the share purchase agreement (SPA) and the other contractual documents and annexes are negotiated. Negotiations must be conducted in good faith, in compliance with Article 1337 of the Civil Code, which provides that if the negotiations are interrupted abruptly (unjustifiably), the party responsible for their breakdown will be liable to the other for any damages suffered. However, these are limited to the expenses incurred by the other party in connection with the negotiations, unless it is possible to prove that a loss of profit was also suffered.

4. 2. What level of due diligence does the private equity firm typically conduct into the target?

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(a) Commercial?

Yes.

(b) Financial?

Yes.

(c) Legal?

Yes.

(d) Other?

Where appropriate or necessary due to the circumstances or the nature of the business to be purchased, environmental or other specific administrative regulatory due diligence will be conducted (eg, compliance with zoning regulations), in addition to the above.

The extent of the due diligence will normally depend on the size of the target and the sector in which it operates. However, experience shows that, especially in the case of targets that are small or medium-sized companies (see question 4.6), the use of limited reviews or red-flag due diligence may ultimately prove disastrous; only in-depth diligence verifications will prevent possible surprises. This is particularly true in relation to net working capital levels and potential claims, which should not only be addressed in the SPA, through solid representations and warranties or specific engagements, but also be verified accurately beforehand, to the extent possible.

4. 3. What disclosure requirements and restrictions may apply throughout the investment process, for both the private equity firm and the target?

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Disclosure is an issue that is invariably dealt with at the very beginning of the negotiations and is addressed in an NDA, which is increasingly becoming an essential part of the first phase of an M&A and/or private equity transaction. While the legal validity of an NDA cannot be disputed in principle, its effectiveness as a deterrent against leaks is somewhat doubtful in practice. In practice, the possibility of leaks is so strong that even the most restrictive NDA cannot give reasonable comfort to the target's management that the confidential information disclosed will be kept entirely secret by the recipient. Recent practice also indicates that targets are often reluctant to make any disclosure unless the investor has given a serious indication of its interest in the acquisition. Thus, the use of a NDA by an investor that is not institutional or professional with the covert intent of surveying the market or learning about the target, even if coupled with an indication of interest in its potential acquisition, will prove unsuccessful. Breach of the non-disclosure engagements can theoretically be remedied by the imposition of strong penalty (liquidated damages) clauses in the NDA, given the renowned sluggishness of the Italian judiciary, as these will avoid a pre-trial discovery phase to determine the amount of damages suffered. However, in common practice, remedies of this type are not usual.

4. 4. What advisers and other stakeholders are involved in the investment process?

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Business counsel ('*commercialista*' – a hybrid between a transactional lawyer and an accountant, who usually has generic tax expertise and is invariably the day-to-day counsel in family-owned companies) will always be involved in the investment process on the target side. On the private equity fund side, lawyers will be involved from the outset of the process. Investment bankers are not always involved – not only due to the traditional reluctance of Italian business owners to seek assistance from high-end experts of this type, but also because the business counsel of family-owned companies are often opposed to the idea of private equity specialists getting in their way when negotiating the deal.

5.Investment terms

5. 1. What closing mechanisms are typically used for private equity transactions in your jurisdiction (eg, locked box; closing accounts) and what factors influence the choice of mechanism?

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Locked box mechanisms are becoming increasingly common, as they ensure certainty in the purchase price and thus seem to be favoured by sellers. Another advantage of these mechanisms is that they prevent squabbles between the parties in the closing account scenario over potential price adjustments sought by the investor. Usually, discussions will revolve around the target's receivables yet to be cashed and the actual inventory, which will be checked in detail in the months following the closing date. One remedy that is often agreed in the share purchase agreement (SPA) to ensure that such issues do not lead to litigation or arbitration is the *arbitraggio* procedure, which is specifically provided for under Article 1349 of the Civil Code. This involves deferring the decision on the issue at stake to a single 'umpire' or a committee (which will hopefully have already been identified in the SPA). This role habitually falls to an audit company, as if individual experts are selected, they may be unavailable at the time the procedure commences. If the decision is left to the 'mere discretion' of the umpire, it will not be subject to appeal, unless bad faith is proven.

5. 2. Are break fees permitted in your jurisdiction? If so, under what conditions will they generally be payable? What restrictions or other considerations should be addressed in formulating break fees?

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Although not as common in practice, break fees are to be considered permitted under the application of the general principle of freedom of contract established by Article 1322 of the Civil Code. Their use seems to be more appropriate in auction-type transactions, where more than one investor is invited to bid for the target or for a certain percentage interest in the target. Similarly, reverse break fees are also permitted.

A stark example of the use of such fees was the March 2016 sale of a large Italian company in the railway sector, Grandi Stazioni, in which a staggering reverse break fee of 10% was established in case the transaction failed to close for causes other than the fault of the seller, including failure to obtain clearance from the Antitrust Authority. Other than this particular example, in broad terms, break fees would be expected to be in the range of 1% to 3% of the deal's total value. Utmost care should be taken to label these fees as a reimbursement of the costs and expenses incurred, rather than a penalty for withdrawing from the negotiations, as the latter could be subject to scrutiny by the courts if the amount is deemed manifestly excessive, and could be reduced accordingly ('*reductio ad equitatem*' under Article 1384 of the Civil Code).

5. 3. How is risk typically allocated between the parties?

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A solid indemnification system in the form of a full set of representations and warranties (see question 5.5) affords the best protection to the investor. Typically, the enforcement of the seller's indemnity obligations will be supported by a guarantee for the amount agreed to be indemnified. Just as typically, private equity funds will request a bank guarantee of this type, to be issued by a primary bank in the form of a true and legally indisputable first demand guarantee, as against one that would fall under the Civil Code provisions on a surety contract. There are many differences between these two types of guarantees, including:

- the impossibility for the guarantor to raise the same exceptions that can be asserted by the debtor (Article 1945 of the Civil Code); and
- the right for the investor to get paid directly and immediately by the guarantor, save for any future recourse that the guarantor will have against the debtor.

Bank guarantees of this type have long been used in M&A and private equity deals, and their legal validity has long been accepted. The cost of such guarantees is generally reasonable; the real difficulty for the seller in obtaining one is that a one-to-one ratio for the collateral to counter-guarantee the issuer will most likely be requested by the bank, except in the case of triple A customers. Alternative indemnification mechanisms include:

- the provision to the investor of an insurance indemnification policy, whose soundness will largely depend on its contractual wording and the standing of the issuer; or
- the establishment of an escrow account.

While escrow agency agreements are also common and enforceable, first demand bank guarantees still appear to be the most effective remedy in favour of an investor.

5. 4. What representations and warranties will typically be made and what are the consequences of breach? Is warranty and indemnity insurance commonly used?

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Representations and warranties have long been an essential part of Italian SPA agreements, even in exclusively 'domestic' acquisitions. Although they are tough to negotiate and gaining acceptance is difficult – especially from the sellers of family-owned businesses – no transaction will take place unless the sellers provide a full set of representations and warranties. These typically cover everything from the parties' authority and power to enter into the agreement to virtually all areas of operation of the target. The main issues covered by the representations and warranties will include:

- the target's balance sheet (and that of its controlled or participated companies, if any);
- contracts;
- litigation;
- employment;
- real estate;
- environmental;
- tax; and
- privacy.

Additional specific representations and warranties will be made as required due to the nature of the business to be acquired. In such case, these will concern the level of the working capital, along with a commitment by the target to keep this unchanged, or substantially unchanged, until the closing date.

The period of validity of the representations and warranties must be negotiated very carefully. In extreme cases, a private equity buyer may demand (albeit seldom successfully) that this period coincide with the statute of limitations provided by law for each representation and warranty. In broad terms, and at the risk of over-generalising, such representations and warranties remain valid for three to five years (the latter term applying in particular to tax and employment representations and warranties). Exceptions to this rule, which require the provision of a longer period of validity, will involve situations which have been identified in the due diligence as constituting areas of concern for the buyer. The provision of 'specific' or 'analytical' representations and warranties, as they have previously been labelled by the courts, is a remedy available for the buyer to seek indemnification for their breach. Indeed, apart from a scant but troubling number of cases in which the courts have held that the warranties afforded by operation of law in connection with sale and purchase contracts will also apply to the acquisition of shares, according to the prevailing case law, such warranties will not apply to the acquisition of a corporate interest. The courts' reasoning in these cases is based on the fact that shares are not representative of the quality of the business and of the assets that are indirectly acquired through their purchase. For this reason, representations and warranties in Italian deals tend to be as lengthy and detailed as they would be in the SPA that are typically used in Anglo-Saxon jurisdictions.

With the exclusion of cases involving fraud or misrepresentations – which, irrespective of the remedy of indemnification set out in the SPA, may lead to the award of damages suffered by the injured party or even to the criminal liability of the responsible party – the consequences of breach of a representation and warranty are typically addressed in the agreement and are usually covered by a standard indemnification system. This will invariably contemplate:

- a *de minimis* provision;
- a basket provision; and
- a number of threshold amounts over and above which the buyer is entitled to be fully indemnified within the limits agreed with the seller.

The distinction between representations and warranties under Italian law does not appear to be as sharp as it is in common law countries, where an action for misrepresentation will be in tort and not in contract. One reason for this distinction is the fact that a representation is a statement, whereas a warranty is *per se* a commitment whose violation will result in a breach of contract. Suffice to say that while a few scholars have disputed the tort nature of representations versus the full contract nature of warranties, we would argue that, depending on the relevance of the representation, its violation can lead not only to a claim for damages, but also to an action for termination of the SPA.

The indemnification system will typically be backed by a bank or at least an insurance policy guarantee – which, in the expectation of the buyer and invariably at its initial request, will be of first demand type (see question 5.4). To overcome the discussions that inevitably take place between the parties on this issue, the use of 'transactional insurance' has become increasingly common in recent years, especially in connection with transactions made by private equity funds. The type of insurance that is most commonly used in such cases is a warranty and indemnity policy, which covers the risks of misrepresentation and breach. In a note issued in July 2019, the Insurance Authority (IVASS) expressly acknowledged the validity of warranty and indemnity insurance, albeit under certain conditions, thus clearing up doubts in this regard which were grounded on a 2009 regulation issued by IVASS.

Other forms of insurance that can be very useful in acquisitions include those covering contingent liability, tax and known litigation risks.

6.Management considerations

6. 1. How are management incentive schemes typically structured in your jurisdiction? What are the potential advantages and disadvantages of these different structures?

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Typically, the compensation of managers will be variable and will depend on the achievement of the specified objectives. It will generally comprise a blend of a base compensation (fixed) and a number of variable targets, capped at the top end. Stock options and sweet equity incentives are also common.

6. 2. What are the tax implications of these different structures? What strategies are available to mitigate tax exposure?

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Income received by managers will be treated as employment income or capital income for personal income tax purposes (Article 6 of the Income Tax Code), depending on the nature of the contractual relationship between the company and the manager. If the manager is employed by the company, the tax rate on that income will be progressive (the highest tax bracket being 43%); otherwise, the income will be subject to a substitute tax at a rate of 26%. Being a company employee (in this case, top level) thus presents certain tax disadvantages, which should be weighed carefully against the advantages afforded by employment status in terms of greater job security (albeit perhaps not as strong today as in the past).

6. 3. What rights are typically granted and what restrictions typically apply to manager shareholders?

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In the absence of a shareholders' agreement or provisions in the company bylaws that envisage specific protections in favour of minorities or classes of shares that are reserved to management, no specific rights will be afforded to manager shareholders. In broad terms, unless the specific management contract provides for certain specific rights, the Civil Code provisions will apply. Carried interest provisions are frequently envisaged in these types of contracts. Restrictions will primarily relate to potential conflict of interest situations and non-compete covenants – the latter being valid if limited geographically and in time (up to a maximum of five years) (Article 2596 of the Civil Code).

6. 4. What leaver provisions typically apply to manager shareholders and how are 'good' and 'bad' leavers typically defined?

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Leaver provisions are always subject to complex negotiations and their content will inevitably depend on the specific circumstances and the nature of the business. Suffice to say here that, very broadly speaking, a 'bad leaver' is generally considered a manager who resigns voluntarily, especially when resignation is tendered with a view to accepting a new job with a competitor; while 'good leavers' are those who are dismissed for cause or who cease their employment for reasons other than their will.

7.Governance and oversight

7. 1. What are the typical governance arrangements of private equity portfolio companies?

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The governance structure will largely depend on the percentage of interest acquired. In the case of 100% ownership, the board will consist only of members appointed by the private equity fund; if a different interest is acquired, the targets' shareholders will likely have one or more representatives on the board. Typically, in the acquisition of a family-owned business where a majority interest is initially purchased and the outstanding minority interest will eventually be acquired through a put and call system, continuity in management is required, to ensure a seamless transition in the target's operations. This is especially the case if such operations entail interaction with public authorities or key suppliers and corporate customers that have a privileged relationship with the previous management. In such cases, the key manager will be appointed as chairman of the board, albeit with no or limited executive powers, and the private equity fund will retain the executive powers to run the business through a new chief executive officer appointed following or at closing. Invariably, however, irrespective of the percentage interest initially acquired, a new chief financial officer and chief operations officer will be appointed by the private equity fund and accounting practices will be aligned with those of the institutional investor. This will most often result in the adoption of International Accounting Standards or International Financial Reporting Standards.

7. 2. What considerations should a private equity firm take into account when putting

forward nominees to the board of the portfolio company?

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Experienced directors should be appointed, with a solid track record in the relevant field. Replacing the previous management team entirely often leads to very poor results over time, as a seamless transition in the company's operations is highly recommended.

7. 3. Can the private equity firm and/or its nominated directors typically veto significant corporate decisions of the portfolio company?

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The possibility to veto certain corporate decisions implies the coexistence of past and new shareholders and managers. In such case, the bylaws and/or the shareholders' agreement will contain a list of items on the agenda that require the mandatory consent of the private equity fund. These will always include:

- lock-up provisions;
- disposal of (important) assets; and
- other corporate finance decisions that involve a change in the target's business structure (eg, issues of new stock or corporate bonds, mergers and acquisitions).

7. 4. What other tools and strategies are available to the private equity firm to monitor and influence the performance of the portfolio company?

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The answer to this question is based on the same assumption as that under question 7.3. The shareholders' agreement and/or any other contractual arrangements entered into as part of the acquisition documents can include requirements on reporting commitments and monitoring practices.

8.Exit

8. 1. What exit strategies are typically negotiated by private equity firms in your jurisdiction?

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Exit is one of the basic principles in any investment by a private equity fund and any restrictions on the possibility of exit will likely be a deal breaker in the negotiations with the target. Thus, if the previous shareholders retain a minority interest in the target, any proposal to be granted a right of first refusal on exit will not be considered favourably by the private equity fund. The usual compromise in such cases is to agree on the grant of a matching offer right in favour of those shareholders. If there are no limitations on exit by the private equity fund, the available strategies will be numerous, as all doors will be kept open. An initial public offering is one solution, although this will hinge on the financial results of the target and on market conditions and outlook. Strategic sales and secondary buyouts are more common, and the choice of one or the other will largely be influenced by the market conditions at the time of exit – in particular, as regards the prevailing multiples. Strategic sales are probably a better option and are indeed the preferred choice for exit. Trade buyers are likely to pay a higher price, as long as the core business activities of the target have been kept intact and the target has performed well during the period of ownership by the private equity fund.

8. 2. What specific legal and regulatory considerations (if any) must be borne in mind when pursuing each of these different strategies in your jurisdiction?

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Regulatory considerations must be taken into account if the exit concerns an investment in a company that operates in a regulated industry. The survival of the representations and warranties originally given by the initial seller and the enforceability of the indemnity system, if still active, are issues that will also need to be addressed at the time of exit.

9.Tax considerations

9. 1. What are the key tax considerations for private equity transactions in your jurisdiction?

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Generally speaking, the tax treatment of private equity transactions – with the specific exception of leveraged buyout transactions, which are addressed in a circular issued by the Italian Income Tax Office – is the same as applies to any other acquisition. Share deals are basically tax free as regards indirect taxes (registration tax is charged at the fixed and nominal amount of €200 on the sale of units of *società a responsibilità limitata* companies; while the sale of share certificates is subject to Tobin tax at 0.2% of the purchase price). Asset deals are more complex, and the rate of indirect tax will vary depending on the composition of the business transferred. The sale of a business (or 'going concern') will be taxed on average at a default rate of 3% of the value of the business; while a transaction structured on the contribution of the business into a newco and the subsequent sale of newco's shares will be tax free (registration tax is charged at the nominal value of €200).

Specific tax regimes apply to real estate sales; the rates will depend on the zoning destination of the single property, although value added tax, if due, will not be levied where the reverse charge regime applies. The circular cited above is of vital importance, because the vast majority of private equity transactions take place in the form of a leveraged buyout scheme. In a nutshell, this circular contains guidelines on:

- the deductibility of the costs relating to the funding of the price and the acquisition costs in general; and
- the tax treatment of dividends, interest and capital gains.

9. 2. What indirect tax risks and opportunities can arise from private equity transactions in your jurisdiction?

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Mergers and demergers are tax free as a matter of principle, although any such transaction must be supported by 'valid economic reasons' beyond merely achieving a tax advantage. In the event of merger, certain restrictions on the carry forward of tax losses (equity and activity test) also apply to previous years' non-deductible interest. Treaty access for foreign investment funds is still subject to debate – in particular given that the treaties to which Italy is a party usually do not include special rules concerning the applicability of treaty provisions to investment funds. Accordingly, reference must be made on a case-by case basis to the general principles governing the application of treaty provisions and the nature of the income collected by the fund.

9. 3. What preferred tax strategies are typically adopted in private equity transactions in your jurisdiction?

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Leveraged buyout structures are by far the most common transactional scheme adopted and share deals are thus the rule when it comes to tax strategies.

10.Trends and predictions

10. 1. How would you describe the current private equity landscape and prevailing trends in your jurisdiction? What are regarded as the key opportunities and main challenges for the coming 12 months?

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It is very hard to tell at this stage how the COVID-19 pandemic will continue to influence the M&A and private equity market. In early 2020, there were 149 direct investments in Italian companies by private equity entities (including special purpose acquisition companies and investment companies, as well as funds); for the first six months of 2020, this figure appears to have been comparatively lower that the corresponding figure for 2019, with an emphasis on add-on deals, which increased in 2020.

The most important deals in the first six months involved Engineering Informatica SpA (main investor Bain Capital) and, as an add-on deal, the acquisition of Renovalia Energy by Italian company EF Solare (main shareholder F2i). Other relevant deals involved Depobank, Nactarome, Neronobile, Margot, Panapesca and Impresoft.

10. 2. Are any developments anticipated in the next 12 months, including any proposed legislative reforms in the legal or tax framework?

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The new budget law for 2021 provides that individual shareholders of companies can step up the value of their shareholding interest by paying a substitute tax of 11%. It has therefore extended in time the application of the previous more favourable tax regime for those who are planning to divest their interest.

11.Tips and traps

11. 1. What are your tips to maximise the opportunities that private equity presents in your jurisdiction, for both investors and targets, and what potential issues or limitations would you highlight?

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In broad terms, most private equity transactions involve family-owned businesses. According to the latest report from the Italian Private Equity Venture Capital Association, in the course of 2019, 370 transactions involving 272 companies were completed (a 26% drop on the figure for 2018 (370)), with a total value of €7.223 million, of which €6.443 million comprised private equity investment.

Tips and traps for the investor:

- The investor should ensure, from the very outset of the negotiations, that the seller has engaged experienced counsel who are familiar with private equity transactions. Dealing with family counsel who look after the target's daily business and have no specific private equity expertise, but only some superficial M&A experience at best, could prove disastrous for the transaction. As any private equity fund manager knows well, M&A and private equity transactions have a lot in common, but are the perfect example of false friends.
- Due diligence should be carried out by different counsel, depending on their specific area of expertise. Budget constraints for due diligence should be disregarded, as 'quick and dirty' or red-flag types of diligence might ultimately backfire because of their incompleteness.
- English is the most common choice of language in cross-border transactions. In such case, the drafting of the contracts should be very accurate and should fall to a lawyer with an excellent command of written legal English. While all documents must be translated into Italian in case of litigation, unclear expressions or bad English may be a source of interpretation problems. This can also be a major issue in any arbitration proceedings that will take place in English.
- The negotiation of the representations and warranties and of the indemnity system will likely prove to be the most difficult and time consuming part of the deal; but no concessions should be made by the investor in this regard, especially as regards any financial (balance-sheet) and tax matters.
- Earn-out clauses should be drafted very accurately, to avoid the risk that any future extra payments in addition to the purchase price could be construed as a deferred part of the price that is due irrespective of the occurrence of the events to which it is subject.
- Management contracts should focus on management buyouts and not provide for 'free lunch' types of compensation. Furthermore, no executive powers should be retained by the previous management that may have an impact on events that come under the scope of the adjustment price clauses, if any.

Tips for the target:

- A vendor due diligence report that is well prepared and detailed will be useful and appreciated by the investor, especially if it is prepared by a reputable law firm and a reputable audit firm.

- Experienced counsel should be involved in the whole process and should be made aware of all factual situations regarding the company that could become areas of concern for the investor. Hiding or underestimating, for example, tax issues and not disclosing the truth to their counsel is the biggest mistake that the target's managers can make: any surprise that is eventually discovered by the investor's counsel will undermine the credibility of the management, to the point of jeopardising the conclusion of the deal. Full disclosure to the investor of all issues regarding the target by a seasoned counsel who knows best how to address such points will attest to the transparency and seriousness of the target's management.
- Negotiating the highest possible multiple for the acquisition of targets that are evaluated on an earnings before interest, tax, depreciation and amortisation basis is a must. However, shareholders should not underestimate the importance of partnering with a private equity fund. Indeed, few seem to realise that in most cases, if a minority interest is retained by the selling shareholders, at the time of their final exit, that interest may be worth proportionally far more than the price that was initially paid for the majority of the shares.

Private Equity

Comparative Guide

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