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Italy's new rules on notes and commercial paper

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On August 3, 2012 the Italian Parliament adopted a law (the "Law")¹ to convert, with amendments, Law Decree No. 83 of June 22, 2012 (the "Decree"), that introduced important measures aimed at stimulating the Italian economy (the so called "*decreto sviluppo*" or "development decree"). This memorandum outlines the new rules introduced by the Decree, as amended by the Law,² on: (i) the exemption from the limitations on the issuance of notes provided for in Article 2412, paragraph 1 of the Civil Code; (ii) the issuance of commercial paper (*cambiali finanziarie*); (iii) the issuance of notes with a subordination clause and/or with a profit participation clause; and (iv) the tax regime applicable to notes and commercial paper issued by Non-Listed Companies (as defined below).

The new regime promotes the issuance of commercial paper and listed notes seeking to expand capital-raising alternatives, thus creating a competitive alternative to loan financing, in particular for non-listed companies.

- ***Exemption from the limitations on the issuance of notes***

Article 2412 of the Civil Code, which sets forth limits on the total principal amount of notes that an Italian corporate issuer may have outstanding from time to time, discouraged the issuance of notes by companies that are not listed on a regulated market.³ The Law amended this provision in order to allow all issuers (*i.e.*, both listed companies and companies not listed on a regulated market) that issue notes to be listed on a regulated market or on a multilateral trading facility or notes that include a right to subscribe to or purchase the issuer's stock, to benefit from an exemption from the above limits.

¹ The Law is expected to be published on the Italian Official Gazette on August 11, 2012.

² For an overview of the rules on notes and commercial paper introduced by Article 32 of the Decree before the amendments adopted by the Law, please refer to our previous Alert Memorandum dated June 15, 2012.

³ According to Article 2412, paragraph 1 of the Civil Code, a company may not have outstanding notes whose aggregate amount exceeds twice the aggregate of its share capital, its legal reserve and the available reserves as shown in the latest approved financial statements.

- ***New rules on commercial paper***

The Law re-launches the instrument of commercial paper (*cambiali finanziarie*) by: (i) reducing the minimum period of maturity to one month, and extending the maximum period of maturity to 36 months;⁴ (ii) allowing the issuance of commercial paper by joint stock companies (*società di capitali*), cooperative companies (*società cooperative*), mutual insurance companies (*società mutue assicuratrici*) other than banks and micro-sized enterprises (as defined by European Commission Recommendation No. 2003/361 of May 6, 2003);⁵ and (iii) allowing the issuance of commercial paper in dematerialized form.⁶

The issuance of commercial paper by companies and other entities whose shares are not admitted to trading on regulated or non regulated markets is subject to the following requirements:

- i. the issuer's latest annual financial statements must be audited;⁷
- ii. commercial paper is offered to, and may be endorsed only by, qualified investors that are not direct or indirect shareholders of the issuer;⁸ and

⁴ Under law No. 43 of January 13, 1994, commercial paper could be issued with maturities from three months to one year.

⁵ European Commission Recommendation No. 2003/361 of May 6, 2003 concerning the definition of micro, small and medium-sized enterprises provides that "1. [t]he category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million. 2. Within the SME category, a small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million. 3. Within the SME category, a micro-sized enterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million."

⁶ In order to be able to issue commercial paper in dematerialized form, the company must send a request to an authorized centralized deposit system (*società autorizzata alla prestazione del servizio di gestione accentrata di strumenti finanziari*), which must contain certain information, including the company's unconditional undertaking to pay all amounts due at maturity.

⁷ Such obligation can be exempted for a period of 18 months from the date of entering into force of such requirement, if the issuance is guaranteed, in an amount no lower than 50% of the issuance value of the commercial paper, by a bank, an investment company, or a collective overdraft guarantee consortium (*consorzio di garanzia collettiva dei fidi*), in the latter case, with respect to commercial paper issued by companies participating in the consortium. In case of reliance on this exemption, the commercial paper cannot have a maturity longer than the above-mentioned 18-month period.

⁸ The Law clarifies that the placement of commercial paper with qualified investors controlling the sponsor is subject to the existing rules on conflict of interest.

- iii. a sponsor⁹ must be involved in the issuance and placement of commercial paper issued by small or medium-sized enterprises.¹⁰ Other companies may choose not to appoint a sponsor.

The sponsor must hold in its portfolio, until maturity, an amount of commercial paper issued no lower than: at least 5% of the first Euro 5 million of the value of the securities issued, plus an additional 3% of the value of the securities issued greater than Euro 5 million but lower than or equal to Euro 10 million, plus an additional 2% of the value of the securities issued that exceeds Euro 10 million. The sponsor can be exempted from such obligation in the event that the issuance is guaranteed, in an amount no lower than 25% of the value of the issuance, by a bank, an investment company, or a collective overdraft guarantee consortium (*consorzio di garanzia collettiva dei fidi*), in the latter case, with respect to commercial paper issued by companies participating in the consortium. Furthermore, the sponsor must: (i) report, for each issuer, whether the amount of outstanding commercial paper exceeds the company's current assets as shown in the latest approved financial statements; (ii) classify the issuer's creditworthiness, at the time of the issuance, distinguishing between at least five risk categories (strong, good, satisfactory, weak, and bad) to be matched, for guaranteed or secured transactions, with a guarantee level classification of high, normal, or low; and (iii) make the description of the adopted classification public.

- ***Issuance of notes with a subordination clause and/or with a profit participation clause***

Under the Law, companies, other than banks and micro-sized enterprises (as defined by European Commission Recommendation No. 2003/361 of May 6, 2003), that have no securities listed on a regulated market or a multilateral trading facility ("Non-Listed Companies") may issue notes: (i) with a subordination clause, which establishes the priority of the claims of the issuer's creditors (other than the shareholders) over those of the noteholders¹¹ and/or (ii) with a profit participation clause, provided in each case that such notes have a maturity of at least 36 months. Profit participating notes

⁹ The sponsor can be a bank, investment company, asset management company (*società di gestione del risparmio*), harmonized asset management company (*società di gestione del risparmio armonizzata*), or investment company with variable capital (*società di investimento con capitale variabile*), provided that it has a branch in Italy.

¹⁰ As defined by European Commission Recommendation No. 2003/361 of May 6, 2003, see footnote 5 above.

¹¹ As specified in Article 32, paragraph 20 of the Law, Non-Listed Companies that issue notes with a subordination clause must comply with Article 2435 of the Civil Code, which provides that, within 30 days after the approval of the financial statements, Non-Listed Companies must file with the Italian Companies' Registry a list of the shareholders as of the date of such approval, detailing the number of shares owned by such shareholders, as well as a list of the persons, other than shareholders, who benefit from any rights or security over the shares.

represent a type of floating rate notes whose coupon reflects a fixed component and a variable component linked to the profits of the issuer. In accordance with Article 32, paragraph 21 of the Law, the fixed interest rate component cannot be lower than the applicable Official Rate of Reference (*Tasso Ufficiale di Riferimento*), whereas the variable interest rate component must be paid annually by the issuer to the noteholders within 30 days after the approval of the financial statements.¹²

- ***New Tax Rules on Issuance of Securities by Non-Listed Companies Confirmed.***

In confirming the Decree, the Law partially amended the tax provisions contemplated by the Decree, which, as illustrated in our previous alert memo of June 15, 2012, aimed at ensuring that commercial paper (*cambiali finanziarie*) and notes (the “Securities”) issued by Non-Listed Companies benefit from the same, more favorable tax regime currently applicable to securities issued by banks and listed corporations.¹³

As a result, as of the effective date of the Law, the following tax regime will apply to the issuance of the Securities by Non-Listed Companies:

- **No Special Limits on Deductibility of Interest Expense:** the special rule currently limiting the tax deductibility of interest expense accrued on Securities issued by non-listed companies¹⁴ will no longer apply to issuances made by Non-Listed Companies, provided that the Securities, regardless of whether they are listed or not, are subscribed to by qualified investors that are not direct or indirect shareholders of the issuer.¹⁵ Although the black letter rule only requires that the Securities be subscribed by the above-mentioned qualified investors, it appears reasonable to infer that such condition would be met if the Securities are not only subscribed to but also held by such qualified investors. In order

¹² The methods of calculation of the variable component of the interest rate are set at the moment of issuance, cannot be amended until the note matures, are calculated on the basis of objective criteria, and cannot be influenced by resolutions of the board of directors or at shareholders’ meetings of the issuer. As provided for in Article 32, paragraph 25 of the Law, Italian usury law No. 108/1996 does not apply to the variable interest rate component of profit participating notes.

¹³ The Law has repealed the monitoring obligations previously set for the issuance of non-listed Securities, whereby issuers were obliged to communicate to the tax administration the issuance of such Securities within thirty days.

¹⁴ Pursuant to Article 3, paragraph 115, of Law No. 549 of December 28, 1995, tax-deductible interest expense accrued on securities issued by non-listed companies cannot exceed the official reference rate set, at the time of issuance, by the European Central Bank increased by two-thirds if the securities are not listed, or doubled, if they are listed.

¹⁵ The ordinary interest expense limitation rules, including the deductibility up to 30% of the company’s EBITDA for any amount in excess on interest receivables, would apply.

to have absolute certainty on the application of such regime, which is a key feature to ensure the success of the Securities on the market, issuers will need clear administrative guidance as to the evidence to be provided to demonstrate compliance with the above-mentioned holding requirements that conceivably should contemplate a stream-lined and not too cumbersome procedure.

- Tax Exemption on Interest Income Earned by Certain Foreign Investors: the scope of Legislative Decree No. 239 of April 1, 1996 (“Decree No. 239”) is extended to include Securities listed on a regulated market that are issued as of the effective date of the Decree (*i.e.*, June 26, 2012).

This is an important development as it enables non-listed issuers to access international capital markets without having to bear a tax gross-up cost: under Decree No. 239, foreign Securities’ holders resident in white-listed countries will benefit from an exemption from the ordinary 20% final tax applicable on the relating interest income if, among other things, they are the beneficial owners and comply with certain standard certification procedures.

- Full Deductibility of Issuance Expenses: any expenses (other than interest expenses) resulting from the issuance of securities falling within the scope of Decree No. 239 are now fully deductible in the year in which they are paid, regardless of any different timing imputation for accounting purposes.
- Special Rules on Subordinated Profit Participating Notes: the variable portion of the remuneration accrued on subordinated contingent profit participating notes issued by Non-Listed Companies whereby capital distributions would be limited to the dividend amounts paid out of the annual profits, shall be accounted for as a special profit and loss account provision and, as such, treated as an expense that, while not deductible under ordinary rules, would instead be fully deductible for corporate income tax purposes.

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If you have any questions concerning this memorandum, please feel free to contact Pietro Fioruzzi in our Milan office (+39 02 7260 8214), Vania Petrella (+39 06 6952 2204) or Claudio Di Falco (+39 06 6952 2207) in our Rome office or any of our other Italy-based partners and counsel listed under Capital Markets or Tax Practice Areas under the “Practices” section of our website at www.clearygottlieb.com, or any of your regular contacts at the firm.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

NEW YORK

One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON

2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

PARIS

12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

BRUSSELS

Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

LONDON

City Place House
55 Basinghall Street
London EC2V 5EH, England
T: +44 20 7614 2200
F: +44 20 7600 1698

MOSCOW

Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

FRANKFURT

Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

COLOGNE

Theodor-Heuss-Ring 9
50688 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

ROME

Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

MILAN

Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

HONG KONG

Bank of China Tower
One Garden Road
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

BEIJING

Twin Towers – West (23rd Floor)
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
T: +86 10 5920 1000
F: +86 10 5879 3902

BUENOS AIRES

CGSH International Legal
Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

SÃO PAULO

Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Funchal, 418, 13 Andar
São Paulo, SP Brazil 04551-060
T: +55 11 2196 7200
F: +55 11 2196 7299