

A New Italian Security: The Non-Possessory Pledge

Legislative References

In May this year the Italian Government introduced Law Decree no. 59 in order to improve enforcement and bankruptcy proceedings in Italy. Following some slight amendments to its provisions, the Italian Parliament finally ratified the statute in June under the title Law Decree 59/2016, as amended by Law 119/2016 (the “**Law Decree**”).

The first section of the Law Decree introduces measures which both support businesses and accelerate the recovery of claims by creditors. Included among these measures is a new form of pledge known as a “non possessory pledge” (“*pegno non possessorio*”), representing a major change to the traditional Italian rules governing charges/securities over movable assets.

Traditional Pledge and Special Liens vs. Non Possessory Pledge

The distinguishing feature of a traditional pledge under Italian law is that possession of the pledged assets must be transferred to the secured creditor or to a third party custodian. By doing this, these assets can neither be disposed of or used until both the secured obligation is fully discharged and the pledge is released. The newly introduced non possessory pledge, however, can be granted over assets or receivables which remain at the disposal of the borrower. These assets or receivables can then be freely transferred or used without any restrictions.

The non possessory pledge also has similar features to the special liens provided for under Article 46 of the Italian Banking Law statute (“*Testo Unico Bancario*”), but these can only be created in order to secure medium-long term credit facilities granted by banks and credit institutions. A non possessory pledge on the other hand can be granted as collateral to secure any type of business loan and is not conditional on the characteristics of the secured creditor or the duration of the loan.

Secured Obligations

Below we have provided a brief outline of the main features of this new form of pledge.

The non possessory pledge is characterized by a strict relationship between the secured obligation and the business activity conducted by the borrower. In fact, it may only be created to secure a loan granted for business purposes. In this respect, the Law Decree provides that the secured obligations may be:

- 1) current or future loans, provided that they are identified/identifiable and a guaranteed upper amount is agreed;
- 2) loans to third parties (i.e. the pledge may be granted to secure a third party obligation).

Pledged Assets

A strict relationship also exists between the secured asset and the business activity carried out by the borrower. In this respect, the Law Decree provides that the pledged assets may be:

- 1) tangible or intangible assets used for business purposes, although this excludes registered movable assets (e.g. cars, trucks, ships, etc.);
- 2) receivables acquired during the course of business;
- 3) current assets or future assets, provided they are identified or identifiable (this can include referring to one or more product categories or alternatively by reference to an aggregate value).

As mentioned above, the main feature of this new security is that the pledge is validly created without the need for physical delivery of the pledged assets to the lender or a third party custodian. Thus, unless provided for otherwise in the pledge agreement, the borrower, by retaining possession of the assets, is free to dispose of or use them in the day to day working of its business. In the event that the assets are disposed of, the pledge automatically transfers to the asset resulting from the disposal, i.e. the consideration paid for the asset, an additional asset purchased by any consideration paid for the asset or a new asset that has been created using the original pledged asset. It will not be necessary in any of these scenarios therefore to enter into a new pledge agreement to perfect the

extension of the security. Consequently, the non possessory pledge is regulated in a manner similar to a revolving and continuing pledge and a floating charge.

Perfection Formalities

In order to create a valid non possessory pledge, the following formal requirements need to be met:

- 1) the pledge agreement must be executed in writing;
- 2) the pledge agreement must include, *inter alia* (i) the names of the creditor, the debtor and any third party guarantors, (ii) a description of both the pledged assets and the secured liabilities, as well as (iii) the full amount secured by the pledge.

In addition to those listed above, the Law Decree introduces an additional requirement in order to enable full enforceability of the pledge against any third parties. This involves the registration of the pledge agreement in an electronic register of non possessory pledges (“*Registro dei pegni non possessori*”) held by the Italian Tax Agency (“*Agenzia delle Entrate*”).

The main purpose of the registration requirement is to determine the priority ranking of the security in the chain of creditors. The effect of this is that once a non possessory pledge is registered, it will take priority over any other pledges registered at a later date, regardless of when the actual pledge agreements themselves have been entered into.

There is one exception to this rule: a non possessory pledge ranks lower and may not be enforced against a lender if (i) the amount loaned has been used to acquire a specific movable asset used for business purposes and (ii) it has been secured by way of a retention of title over the financed asset or by way of a non possessory pledge, including if the pledge has been registered after any previously registered non possessory pledges. Additionally, in order for one of these subsequent pledges to take priority, the Law Decree provides that it needs to be registered and that all prior non possessory pledgors are notified at the time of registration of the pledge.

Additionally, the registration of a non possessory pledge must contain the same elements which are required for the main pledge agreement itself. Once registered, it will remain valid for 10 years but can be renewed prior to its expiry, including by way of a new registration. Furthermore, the registration can be

cancelled by either mutual agreement between the relevant parties or a court order.

At the time of writing, the register of non possessory pledges has not been launched yet, pending the approval of a Ministerial Decree which was scheduled to be approved by the end of July 2016.

Remedies Available to the Secured Creditor in case of Enforcement

Following the triggering of an enforcement event under the pledge the secured creditor can choose to take any of the following actions:

- 1) to sell the pledged assets and retain any amount from the sale proceeds up to the value of the loan. Any proceeds in excess of this amount will then need to be returned to the borrower. In order to ensure transparency and achieve the highest amount possible from the sale, it needs to be done in a competitive market environment which is managed by professional sales experts. These experts can be appointed by either the parties or the courts, and the sale will need to be publicised on a specialised website for public sales;
- 2) to lease the pledged assets and retain the lease payments until full satisfaction of the secured amount. This must be expressly permitted by the pledge agreement, which needs to contain provisions outlining the methods for determining the amount to charge for the lease, and must be disclosed at the time the pledge is registered;
- 3) to take possession of the pledged assets with a value up to the amount of the secured credit. This option to take possession must also be expressly provided for in the pledge agreement and disclosed in the public register;
- 4) if the pledged asset is a receivable, to collect it or alternatively sell it to a third party, until full satisfaction of the amount of the loan.

The Law Decree specifies that enforcement of a non possessory pledge may also take place under bankruptcy proceedings. If this is the case, the secured credit must firstly be verified by the court supervising the bankruptcy prior to proceeding with the enforcement of the non possessory pledge.

Enforcement Procedure

The following procedure must be complied with in order to enforce the non possessory pledge:

- 1) the pledgee must notify the pledgor, the debtor (if different) and all other non possessory pledgees found in the public register. The notice can also be made directly by the pledgee (i.e. without requesting the intervention of a court bailiff) by way of certified e-mail;
- 2) the pledgor and/or the debtor (if different) may file an opposition procedure no later than 5 days following receipt of the above notice, and the court has the option to stay proceedings if requested and if there are valid reasons for doing so;
- 3) the pledgor needs to deliver the pledged assets to the pledgee no later than 15 days after receipt of the above notice. If this is not done the pledgee may request, orally if it so chooses, that a court bailiff seizes either the pledged assets, any new assets that have subsequently been created using the pledged assets or any new assets acquired using funds deriving from a disposal of the pledged assets.
- 4) This new process has significantly simplified the enforcement procedure used up until now with traditional pledges, which presented many obstacles making their enforcement particularly time consuming and difficult to achieve. In particular, the new procedure has omitted the previously existing provision whereby in the event of an opposition being filed by the pledgor/debtor, enforcement could not take place until the opposition was determined by way of a final and non-appealable court decision. On the contrary, under the non possessory pledge regime a stay of the enforcement is a potential scenario, which would only ultimately arise upon the occurrence of objective and justified reasons.

Concurrent Pledgees

As mentioned above, a non possessory pledge may be created by two or more creditors over different categories of products or goods (including raw materials) which can be freely transformed by the pledgee. In this case, the original pledges will be automatically transferred to the product resulting from said transformation and will all concur on said product. In this case, each pledgee is entitled to enforce its pledge independently of the other concurrent pledgees,

subject to the obligation to reimburse the other pledgees the value of the goods originally pledged by them prior to the transformation of the same into the new product.

The Law Decree does not provide clarity with respect to the criteria to be used to determine the values to be reimbursed or the apportionment of the reimbursement to concurrent creditors in case the value to be reimbursed does not cover the aggregate amount of their secured obligations. It is somewhat unclear if these provisions may be derogated from by the parties.

Safeguards for the Debtor and for the Secured Creditor

The final paragraph of Article 1 of the Law Decree contains a provision which both protects the debtor and ensures the prompt settlement of the dispute. Under this provision, the debtor can in fact sue the creditor for damages if the enforcement results in any breaches of the criteria set out above. An action for any of these breaches can be brought no later than 3 months following receipt of a report from the creditor outlining the conclusion of the enforcement option chosen.

On the other hand, however, the Law Decree entitles the secured creditor to request injunctive relief if there is a risk of the assets becoming unavailable to the creditor. However, the Law Decree does not specify the actual procedures that may be followed to protect the secured creditor against the risk of abuses on the part of the debtor.

Conclusions

The introduction of the non possessory pledge regime should be seen as an innovative attempt by the Italian legislature to reduce a number of significant obstacles that have previously arisen during the enforcement of traditional pledges. The traditional pledge has consequently been rendered obsolete as it is no longer in line with current needs of business parties. The non possessory pledge on the other hand promises to be a novel mechanism aimed at both providing a boost to the Italian lending market and modernizing the framework governing security over assets in Italy. This has largely been achieved by replicating the types of instruments used in global markets and which are also frequently required by international players.

The biggest challenge that lies ahead, determining the eventual success of this new form of security, will depend on the actual approach taken by the Italian courts when interpreting this new set of rules. As these provisions are such a departure from the traditional principles governing security over assets in Italy it is likely that disputes could arise between pledgees and pledgors.

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