LATHAM&WATKINS

Number 1350 19 June 2012

Client Alert

Latham & Watkins
Corporate Department

New Italian Law Decree to Open Bond Market for Italian Private Companies

The Italian Council of Ministers recently approved a reform decree focused on helping Italian businesses

The new law decree includes reforms to regulations governing financial instruments and securities and seeks to expand capital raising alternatives for unlisted Italian companies by facilitating issuances by such companies of bonds and similar securities, commercial paper, profit participation bonds (*obbligazioni partecipative subordinate*) and hybrid capital securities. We believe that these new rules represent a significant step forward in the ability of Italian private companies, including in connection with stand-alone corporate bond issuances and leveraged buyout financings, to raise indebtedness in the capital markets, putting them on a near equal footing with Italian public companies and other European companies in terms of capital raising alternatives in the bond markets. The new rules, as summarized below, remain subject to potential modification until the definitive version of the law decree is published.

"We believe that these new rules represent a significant step forward in the ability of Italian private companies to raise indebtedness in the capital markets, putting them on a near equal footing with Italian public companies and other European companies in terms of capital raising alternatives in the bond markets."

Direct Bond Issuance by Italian Private Companies

The decree aligns the tax treatment of bonds and similar securities issued by Italian companies whose shares are not listed to the more favorable treatment enjoyed by public companies. In particular, like public companies, under the new rules Italian private companies will be able to:

(i) qualify for the exemption on withholding tax (currently equal to 20 percent) on interest and other proceeds paid on bonds and similar securities, provided that such securities are listed for trading on a regulated market or on a multi-lateral trading platform (including the Euro MTF and other exchange regulated markets) and are held by persons resident in so-called "white list" countries (meaning countries that allow sufficient exchange of residency/tax information with the Italian state); and

(ii) deduct interest paid on bonds and similar securities in accordance with the same rules applicable to Italian public companies (which limit interest deductibility to 30 percent of EBITDA as reported in the issuer's most recent annual financial statements), provided that such securities are held by "qualified investors" (as defined under the Prospectus Directive as implemented in Italy) that are not directly or indirectly shareholders of the issuer.

Commercial Paper

The law decree also expands the rules governing commercial paper as a means to re-launch this instrument — relatively unused to date — in the Italian financial markets. The primary reforms consist in: (i) setting a quantitative limit for the issuance of commercial paper by Italian public and private companies, (ii) requiring commercial paper to have a maturity of at least one month and no more than 18 months from the issue date, (iii) permitting the issuance of commercial paper in dematerialized form to encourage the circulation, exchange and liquidity of these securities among market participants and (iv) the application to commercial paper of the same tax treatment applicable to bonds.

Profit Participation Bond / Hybrids

Another important reform provided by the law decree is the introduction of profit participation bonds, defined as bonds with a maturity of less than 60 months that contain subordination and profit participation clauses. Profit participation bonds issued by Italian private companies will be subject to regulation under the Italian Civil Code and can be structured to provide payment that is fixed in part (in the form of a fixed interest rate) and variable in part (in the form of a payment linked to a percentage of the issuer's income, as determined pursuant to the terms and conditions of the security). The subordination clause in the terms and conditions of the security will also set forth the terms for deferral of the security holders' rights vis-à-vis the other creditors of the issuer. Because of these characteristics, profit participation bonds will be treated as hybrid capital instruments.

Instruments Issued by Small and Medium Enterprises to Have a Sponsor

The decree requires Italian private companies which constitute small and medium-sized enterprises (meaning companies with fewer than 250 employees having less than €50 million in annual revenues or whose total assets as of the most recent year end do not exceed €43 million) to engage a "sponsor" if they wish to issue bonds, commercial paper or profit participation bonds. The sponsor's role will be to: (i) support the issuer in the issuance and placement phase, (ii) purchase and hold until maturity a limited percentage of the securities issued and (iii) act as a market maker for the securities until maturity. If the securities are not listed, the sponsor will also be required to publish a quarterly valuation of the securities and a classification of the issuer's risk profile with reference to its credit worthiness. Italian private companies which do not constitute a small or medium enterprise are, on the other hand, free to determine whether they wish to engage a sponsor in connection with an issuance of such securities.

Amendment of Net Worth Limitation

Lastly, the law decree provides that Italian private companies will no longer be subject to the two times net worth (*patrimonio netto*) limitation on indebtedness issued or guaranteed by such companies contained in Article 2412 of the Italian Civil Code for issuances of bonds which are either listed on a regulated market or on a multi-lateral trading platform or which are convertible into shares. This exception will apply even where such securities are not held exclusively by professional investors subject to supervisory control (*vigilanza prudenziale*), a condition which is otherwise required for Italian private companies to exceed the two times net worth limitation.

Effectiveness

The law decree, which is subject to potential modification prior to its publication (expected to occur shortly), will become immediately effective upon publication and must be converted into law by the Italian Parliament thereafter. We expect that, in parallel with the process to convert the decree into law, the Ministry of the Economy and Finance will promulgate a ministerial decree with additional measures necessary for, in certain instances, the clarification and implementation of the foregoing rules. We will keep you informed to the extent that any modifications to the new law decree as described above are made in the definitive version or any additional implementing measures are undertaken by the Italian Government.

If you have any questions about this *Client Alert*, please contact one of the authors listed below or the Latham attorney with whom you normally consult:

Antonio Coletti
+39.02.3046.2061
antonio.coletti@lw.com
Milan

Jeff Lawlis
+39.02.3046.2039
+44.20.7710.1151
jeff.lawlis@lw.com
Milan and London

Richard Trobman
+44.20.7710.1180
richard.trobman@lw.com
London

Ryan Benedict
+39.02.3046.2035
ryan.benedict@lw.com
Milan

Abu Dhabi
Barcelona
Beijing
Boston
Brussels
Chicago
Doha
Dubai
Frankfurt
Hamburg
Hong Kong
Houston
London
Los Angeles
Madrid
Milan
Moscow
Munich
New Jersey
New York
Orange County
Paris
Riyadh*
Rome
San Diego
San Francisco
Shanghai
Silicon Valley
Singapore
Tokyo
Washington, D.C.

* In association with the Law Office of Mohammed A. Al-Sheikh