New Financial Assistance Rules after Implementation of Directive 2006/68/EC in Italy

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Effective September 30, 2008, Legislative Decree no. 142 of August 4, 2008 (the "Decree") implemented EU Directive 2006/68/EC (the "Directive"), which in turn amended the second EU Directive on company law (Directive 77/91/EEC).

The Decree establishes a new framework for Italian companies to grant financial assistance in transactions involving the acquisition of their own shares.[1] This memorandum highlights the main features and prospective implications of the new regime, as compared to that which was in force in Italy following the implementation of Directive 77/91/EEC. In essence, granting financial assistance, which thus far was prohibited in most cases, will be permitted subject to compliance with certain procedural requirements and quantitative limits.

I. Financial Assistance Rules Before the Implementation of the Directive.

Until the Decree entered into force, Italian companies were prohibited from granting loans or credit support to a third party acquiring, or subscribing to, their own shares ("financial assistance"). This prohibition was commonly interpreted as applying to the acquisition of shares of the company providing financial assistance, as well as of its direct or indirect parent company.

Any transactions in violation of the financial assistance rules were, and will continue to be following the Decree, null and void.[2]

Prior to 2003, there was uncertainty as to whether mergers of target companies with acquisition vehicles that had incurred debt for purposes of the acquisition (so-called "merger LBOs") circumvented the ban on financial assistance, on the basis that, through

[1] The Decree also establishes new procedural rules for contributing assets to the share capital of Italian companies. This memorandum, however, focuses solely on the new financial assistance rules.

[2] Notwithstanding this ban, a company could grant financial assistance in order to facilitate the purchase of its own shares (or of the shares in its parent company or subsidiary) by its employees, in an amount not to exceed the sum of its net income, retained earnings and other distributable reserves. This exception has not been affected by the Decree.

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these transactions, the providers of acquisition financing obtain *de facto* recourse to the target company's assets and cash flows. A corporate law reform adopted in 2003 introduced specific procedural requirements with respect to merger LBOs.[3] As a result, merger LBOs complying with such requirements have been generally considered not to violate financial assistance rules.

The prohibitions, however, continued to restrict or altogether prevent financial assistance where a merger-LBO was impossible or impractical (*e.g.*, assistance by subsidiaries of the target company).

II. New Financial Assistance Rules

Under the Decree, Italian joint-stock corporations (*società per azioni*) will now be able to grant financial assistance for the purchase or subscription of their shares, provided that they follow the procedure described below and that the amount of such financial assistance does not exceed the sum of their net income, retained earnings and other distributable reserves as set out in their latest stand-alone financial statements. The Decree, on the other hand, does not amend financial assistance rules as they apply to limited liability companies (*società a responsabilità limitata*). Therefore, those companies will continue to be subject to the restrictions described in Paragraph I.

- Board of directors report

The board of directors of the company intending to provide financial assistance must make available to its shareholders a report describing the legal and financial terms of the transaction (including the consideration payable for the shares in such company) and illustrating its business objectives and rationale, the specific benefits that the company stands to derive from it, as well as the risks such transaction entails for the company's solvency and liquidity position. In such report, the board of directors must also attest that the transaction (including any credit support granted and the interest rate on any loans made) is on market terms and that the board has vetted the creditworthiness of the entity receiving financial assistance.

In addition, where financial assistance is granted to members of the company's board, its parent company or members of its parent company's board, the report must also attest that the transaction is in the company's best interest.

[3] In summary, among other things, the plan of merger must indicate the sources that will be used to service the merged entity debt, the directors of the merging entities must file a report setting out the rationale for the merger and containing a financial plan detailing such financing sources, and independent experts must certify the reasonableness of the foregoing.

- Shareholders' resolution

  The granting of financial assistance must be approved by the shareholders at a duly convened meeting acting with the heightened quorum and majority requirements applicable to extraordinary shareholders' meetings.

- Accounting reserve

  A non-distributable reserve in an amount equal to the amount of the financial assistance granted by the company must be set aside in its stand-alone financial statements.

The Decree expressly states that these new rules are without prejudice to the procedural requirements relating to merger LBOs described in Paragraph I.

III. Conclusions

The Decree opens up the possibility for Italian acquisition targets to grant financial assistance through their distributable income and reserves. In practice, the availability of financial assistance may continue to be substantially limited by the requirements that assistance be given on market terms and in the best interest of the company. This in turn depends on how strictly these requirements will be interpreted by the legal community.

Accordingly, it can be expected that a merger-LBO may still constitute a preferred manner of providing the sources of acquisition financing with *de facto* recourse to the assets and cash flows of the target entity. This is also because, under Italian law, unlike the grant of financial assistance through this new procedure, a merger cannot be challenged after it is perfected. Further, merger LBOs will continue to be the only viable option with respect to limited liability companies.

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