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Capital Markets Focus Team

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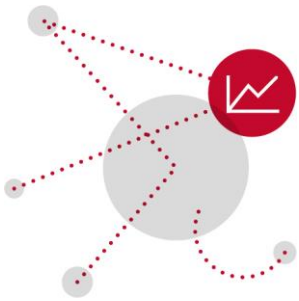

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Article 56 of the "Cura Italia" Decree: *moratorium* on the payment of loan instalments and effects on derivative contracts

1. Introduction

In order to tackle the Covid-19 outbreak, the Italian government has passed a series of decrees and orders, gradually limiting the freedom of citizens and imposing restrictions on workers and companies. These measures have inevitably hindered the ability of businesses to carry out their daily activities and, in some cases, to fulfil their contractual obligations, such as the repayment of loans.

On 17th March 2020, the government passed Law Decree no. 18/2020 (the **"Cura Italia" Decree**), as converted into law and in course of publication in the Italian Official Gazette, introducing, *inter alia*, new measures to support businesses suffering from cash-flow shortages.

2. Moratorium on the payment of loan instalments pursuant to Article 56 of the "Cura Italia" Decree

Article 56(2)(c) of the "Cura Italia" Decree provides that eligible companies may **defer the payment of loan instalments until 30th September 2020**, for all payments which are due before such date. The repayment schedule – together with any **ancillary elements** (*elementi accessori*) – is postponed accordingly, without it being necessary to implement any formality and by means of modalities which guarantee the application of no further costs.

The companies which are eligible to benefit from such measures are the **micro, small and medium-sized enterprises**,[1] based in Italy, which are

[1] As defined under the EU Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises. Such definition includes those enterprises which have less than 250 employees and a turnover of less than € 50 million or an annual budget below € 43 million.

not in a distress situation and do not have debt exposures classified as non-performing, unlikely to pay or overdue.[2]

Eligible companies which are seeking to benefit from these measures will need to send to their banks or financial intermediaries a specific communication, containing a self-declaration by means of which the company certifies that it is suffering from cash-flow shortages due to the Covid-19 emergency.[3]

3. What is the meaning of "ancillary elements" under Article 56 of the "Cura Italia" Decree?

In order to provide clarity on the scope of application of Article 56 of the "Cura Italia" Decree, the Italian Ministry of Economics and Finance has published on its website a series of FAQs, which also provide some preliminary clarifications on the meaning of "ancillary elements", but do not specifically mention derivative contracts amongst those contracts which are deemed as ancillary to the loans and, therefore, subject to the moratorium.[4] However, on 24th March 2020, the Italian Banking Association ("**ABI**") produced a document which, *inter alia*, sheds some light on the meaning of "**ancillary elements**" as per Article 56(2)(c) of the "Cura Italia" Decree.[5] In particular, such document clarifies that the term "ancillary elements" comprises "all **contracts** which are **connected to the loan agreement**, among which, in particular, guarantees and insurance agreements (as well as **derivative contracts**); such contracts shall be deferred without any formalities, automatically, at the same conditions of the underlying agreement".[6]

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2 See Article 56(4) and (5) of the "Cura Italia" Decree.

3 See Article 56(3) of the "Cura Italia" Decree.

4 The FAQs are available at http://www.mef.gov.it/focus/La-moratoria-per-microimprese-e-Pmi-cosa-ce-da-sapere/

5 The document produced by the ABI is available at https://www.abi.it/DOC_Mercati/Crediti/COVID-19-%20Misure%20per%20le%20imprese/COVID-19-%20Misure%20per%20le%20imprese%20-%20Imprese/UCR-000593_24%20marzo2020.pdf

6 See p. 2 of the ABI document.

4. Which derivative contracts are concerned?

In light of the above, it would appear that derivative contracts which are entered into to hedge – directly or indirectly – the risks of the underlying loan subject to the moratorium under Article 56(2)(c) of the "Cura Italia" Decree (e.g. interest rate or currency risk), would be subject to the same measures without any formalities, automatically, at the same conditions. However, it is unclear whether derivative contracts governed by English law would be affected.

5. Do the moratorium apply also in respect of ISDA derivative contracts?

Indeed, it remains open to debate whether the provisions of the "Cura Italia" Decree also apply to ISDA derivative contracts.

Should all relevant elements of the transaction – other than the governing law of the ISDA derivative contract – be attributable to Italy (i.e. both parties are based in Italy, underlying loan agreement governed by Italian law, etc.), it could be argued that the "Cura Italia" Decree would apply to ISDA derivative contracts, as a provision of Italian law "which cannot be derogated from by agreement" pursuant to Article 3(3) of the Regulation (EC) No 593/2008 (the "**Rome I Regulation**").[7]

On the other hand, should the conditions under Article 3(3) of the Rome I Regulation not apply, it is questionable whether ISDA derivative contracts would be affected by the "Cura Italia" Decree.

In any case, it should be noted that Italian courts may still determine that the "Cura Italia" Decree would also apply in respect of ISDA derivative contracts, as an Italian "overriding mandatory provision" under Article 9 of the Rome I Regulation.[8] Nonetheless, it must be stressed, that the

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[7] Article 3(3) of the Rome I Regulation provides that: "Where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement".

[8] Article 9 of the Rome I Regulation states that:
"1. Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.

moratorium measures under Art. 56 of the "Cura Italia" Decree do not have a general application, but are optional. Indeed, a specific communication must be sent to the bank or financial intermediary by the eligible company seeking to benefit from the moratorium.

6. Which ISDA provisions may be triggered by the "Cura Italia" Decree?

Should the "Cura Italia" Decree not apply in respect of the ISDA derivative contracts, then any failure to make any payment in accordance with the payment schedule may constitute an Event of Default under Section 5(a)(i) of the 1992 and 2002 ISDA Master Agreements.

On the contrary, should the application of the "Cura Italia" Decree extend to ISDA derivative contracts, then the relevant bank or financial intermediary would not be allowed to call an Event of Default. However, in the latter case it could be argued that the "**Illegality**" or "**Force Majeure**" clauses may still be available. Although, it must be pointed out that by enforcing such clauses, one could argue that the counterparty is seeking to circumvent the objective pursued by the "Cura Italia" Decree.

7. "Illegality" under the 1992 and 2002 ISDA Master Agreements

In case that the "Cura Italia" Decree is found to apply also to ISDA derivative contracts, Section 5(b)(i) of both the 1992 and 2002 ISDA Master Agreements provides that a Termination Event will occur **if it becomes unlawful, under any applicable law, for a party to make or receive a payment** or delivery under a derivative transaction.[9]

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2. Nothing in this Regulation shall restrict the application of the overriding mandatory provisions of the law of the forum.
3. Effect may be given to the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful. In considering whether to give effect to those provisions, regard shall be had to their nature and purpose and to the consequences of their application or non-application".

[9] The "Illegality" clause under the 2002 ISDA Master Agreement states that a Termination Event will occur if it becomes "**unlawful under any applicable law** (**including** without limitation **the laws of any country in which payment**, delivery or compliance **is required by either party** […])" for the Affected Party to **make or receive payments**. The "Illegality" clause under the 1992 ISDA Master Agreement provides for a wording which is more comprehensive.

Indeed, considering the measures introduced by Article 56 of the "Cura Italia" Decree, which require that the payment schedule under the derivative contracts should be deferred automatically, it could be argued – in theory – that it has become (temporarily) unlawful for such parties to make and receive payments under the relevant derivative transactions. This would allow the affected bank or financial intermediary to trigger the "Illegality" clause under Section 5(b)(i) of the 1992 and 2002 ISDA Master Agreements and call a Termination Event.

However, it must be noted that Article 56 of the "Cura Italia" Decree did not introduce an absolute prohibition to make payments under derivative contracts. It rather provides a right for certain companies to request a moratorium of the underlying loan, which is **not automatic**, as the company must specifically send a communication to the bank or financial intermediary, as explained above. It must also be stressed that the special measures (indirectly) make it unlawful to make and receive payments under the specific derivative transactions **only temporarily**, that is for a limited period (i.e. until 30th September 2020). These circumstances may indeed weaken the claim that an "Illegality" event has occurred.

8. "Force Majeure" under the 2002 ISDA Master Agreements

In principle, it could also be argued that the "Force Majeure" clause under the 2002 ISDA Master Agreement may be triggered by the application of the moratorium measures. This would allow the affected bank or financial intermediary to call a Termination Event.[10]

Section 5(b)(ii) of the 2002 ISDA Master Agreement will be triggered in cases of "force majeure or act of state" preventing the office through which the affected party makes and receives payments or deliveries from performing such obligations or posting collateral. It must be highlighted that Section 5(b)(ii) covers situations where performance of the above-mentioned obligations would be either impossible or impracticable and

[10] The 1992 ISDA Master Agreement does not contain a "Force Majeure" clause. However, parties may have either a) inserted the ISDA Impossibility Clause in the Schedule, in accordance with the ISDA User's Guide to the 1992 ISDA Master Agreements; or b) adhered to the ISDA Illegality/Force Majeure Protocol, which incorporates a "Force Majeure Event" as an Additional Termination Event (as per the 2002 ISDA Master Agreement).

only applies where the force majeure or act of state is beyond the control of the office and all reasonable efforts have been taken to overcome the relevant event.

It is debatable whether the measures introduced by the "Cura Italia" Decree may amount to force majeure under the 2002 ISDA Master Agreement, as they are beyond the control of the bank or financial intermediary and effectively prevent it to make or receive payments under the contract.

9. Conclusion

As a general remark, it must be noted that the benefits of the moratorium under Article 56 of the "Cura Italia" Decree is limited to the micro, small and medium enterprises, based in Italy, which are suffering from cash-flow shortages and which have sent a specific communication to their banks or financial intermediaries.

It remains uncertain whether the application of such measures also extends to ISDA derivative contracts governed by English law. Should all elements of the derivative transaction be attributable to Italy, it is likely that the "Cura Italia" Decree would apply to ISDA derivative contracts, as a provision of Italian law which cannot be derogated from by agreement pursuant to Article 3(3) of the Rome I Regulation. Moreover, in case of litigation before an Italian court, the judge may still determine that the "Cura Italia" Decree applies in respect of an ISDA derivative contract, as an Italian "overriding mandatory provision" under Article 9 of the Rome I Regulation.

If the "Cura Italia" Decree is not found to apply, banks and financial intermediaries which are affected by the rescheduling of the payment plan could – in case of any failure to pay – potentially call an Event of Default under Section 5(a)(i) of the 1992 and 2002 ISDA Master Agreements, subject to a case-by-case analysis.

On the other hand, should the "Cura Italia" Decree also be applicable in respect of ISDA derivative contracts, then there may be room to argue that the "Illegality" and/or "Force Majeure" clauses would be triggered. Nonetheless, the engagement of such clauses may be disputed on the basis that by doing so, the counterparty may be seeking to circumvent the objective pursued by the "Cura Italia" Decree.

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The Focus Team is a constellation of skills in different areas of activity with *focus* on *capital markets*.

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