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the legal profession®

International Litigation News

Publication of the International Bar Association Legal Practice Division

SEPTEMBER 2016



**Maurizio
Vasciminni**

Pavia e Ansaldo, Rome
maurizio.vasciminni@
pavia-ansaldo.it

Caterina Mancini

Pavia e Ansaldo, Rome
caterina.mancini@
pavia-ansaldo.it

**Giovanni
Gigliotti**

Pavia e Ansaldo, Rome
giovanni.gigliotti@
pavia-ansaldo.it

Failure to satisfy credit agreement payments: a new alternative to the expropriation procedure under Italian law

Introduction

Legislative Decree No. 72/2016 (the 'Law') entered into force in Italy on 4 June 2016. The Law implements the European Directive 2014/17/EU¹, which provides a regulatory framework for consumer credit related to residential immovable property (ie, credit agreements² either secured by

a mortgage over residential immovable property or aimed at acquiring or retaining property rights in land or in a building). Following the path of the EU Directive, the Law introduces several provisions³ in the Italian Consolidated Banking Act (the 'TUB') aimed at promoting responsible borrowing and lending, in order to ensure a sustainable financing.

Expropriation procedure under the Code of Civil Procedure

The most significant provision introduced by the Law is Article 120 *quinquiesdecies* of the TUB (the 'Provision'), which is applicable only to future credit agreements. The Provision constitutes a new alternative to the application of expropriation⁴, and both are applied in the case of failure by a consumer (the 'Borrower') to make the payments required under the credit agreement.

Until now the creditor bank (the 'Lender') could only resort to the expropriation procedure, which provides, in the following order: (i) the termination of the credit agreement; (ii) the foreclosure and consecutive sale of the mortgaged property; (iii) satisfaction of the debt using the proceeds of the judicial sale; and (iv) the release of the debtor but only for an amount corresponding to the sale proceeds.

The Provision

Under the Provision, at the time of entering into the credit agreement, the parties can agree a clause providing for alternative ways to satisfy the Lender in case of failure to pay a sum equal to 18 or more monthly instalments by the Borrower. These alternative ways are: (i) the return of the property to the Lender; (ii) the transfer of the property to the Lender; and (iii) the transfer of the revenues of the sale of the property to the Lender.

The parties are free to negotiate the operational mechanics to reach any of the alternative solutions. Up to now, commentators have pointed out three possible methods: (i) the provisions to the Lender of a call-option, subject to the suspensive condition of the failure to pay by the Borrower; (ii) the issuance, by the Borrower to the Lender, of a mandate to sell the property, subject again to the suspensive condition of the failure to pay by the Borrower; and (iii) the transfer to the Lender of the proceeds of the sale of the property carried out by the Borrower.

Non-violation of the prohibition of *pactum commissorium*

The Law also provides for an important rule in order to avoid a possible conflict of the Provision with the prohibition of the 'agreement of forfeiture'⁵ (ie, establishing that, upon the failure to pay within the fixed

time limit, ownership of the mortgaged property is transferred directly to the creditor, notwithstanding its value). In fact, at the time of the breach, it is mandatory for the value of the mortgaged property to be estimated by an expert appointed either by the parties or through a judicial procedure.

This valuation is instrumental in establishing whether the value of the debt corresponds to the actual value of the mortgaged property. As a consequence, the Lender is obliged to give any surplus back to the Borrower. This rule constitutes a limit to the enrichment of the Lender, protects the Borrower and ensures the legitimacy of the procedure.

On the other side, the parties can agree that the Borrower be released even if the value of the property (or if the proceeds of the relevant sale) is not sufficient to cover the mortgaged debt. This provision marks an important change in the system, as there was not any similar rule in the Italian law prior to the entry into force of the Provision.

Other aspects

Since the determination of the actual method of satisfaction of the Lender is left to the parties, the Law provides for some guarantees for the Borrower in order to ensure a responsible choice. For instance, the Borrower has to be assisted by a consultant during the negotiation of the clause and the clause shall not be a mandatory requirement for entering into the agreement.

Unlike the traditional rules, which provide that the bank can terminate the agreement and commence the expropriation process when the outstanding debt exceeds seven monthly instalments, the new procedure in Article 120 *quinquiesdecies* of the TUB is available to the banks only if the outstanding debt is equal to 18 monthly instalments.

On the other side, the possibility for lenders to insert a clause determining in advance the consequences for non-payment provides legal certainty. In this way the banks can not only rapidly satisfy the credit, but also estimate the time needed with acceptable accuracy. In the long term, this could generate a considerable improvement of the system, leading towards increased efficiency, lower credit costs and it hopefully will have a deflationary effect on the courts' workload.

Notes

- 1 Also known as 'Mortgage Credit Directive'.
- 2 In the form of: deferred payment, loan or other similar financial accommodation.
- 3 TUB, articles from 120 *quinques* to 120 *novedecies*.
- 4 In relation to immovable property, provided under articles 555 *et seq* of the Code of Civil Procedure.
- 5 Prohibition of *pactum commissorium*, provided by articles 2744 and 1963 of the Italian Civil Code.