

ABSTRACT OF THE RESEARCH DOCTORATE THESIS ABOUT 'DIRITTO DEGLI AFFARI'
(LAW OF TRANSACTION) – XXI COURSE

TITLE: 'COLLATERAL TAKER'S ENFORCEMENT RIGHTS AND COLLATERAL PROVIDER'S AND THIRD PARTIES' REMEDIES IN SECURITY FINANCIAL COLLATERAL ARRANGEMENTS'

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The study whose title is '*Collateral taker's enforcement rights and collateral provider's and third parties' remedies in security financial collateral arrangements*' deals with the rules and regulations governing the financial collateral arrangements with regard to remedies as reported in Italian Legislative Decree No. 170 of 2004 implementing financial collateral Directive 2002/47/EC. As a consequence of the European Directive implementation in the Italian Law, significant issues have arisen: the implementation has contributed to redrawing the traditional framework of rules and regulations referring to security interest and patrimony liability in Italian Law. The thorniest issues to be taken into consideration concern the collateral taker's enforcement rights and the rules and criteria to control the exercise of the right aiming at protecting both the collateral provider and other creditors. Therefore the research is about the interpretation of Articles 4 and 8 of the Decree, omitting the profile of the revocatory-type insolvency law. The approach of the Collateral Directive can lead to situations in which the proceeds and the valuation of enforcement are not optimal, and that are disadvantageous to the collateral provider and his creditors.

The research starts from the systematic classification of the new discipline assuming that it represents a real special system of uniform law among specific categories: as a matter of fact, the Directive, originally addressed to the wholesale financial market alone, now concerns the retail market, too, and thus all kinds of security interest where security is represented by financial collateral. It seems the new discipline realizes a sort of "contractualisation" of the levy by giving the collateral taker the power to have recourse to enforceable remedies. As shown by the most recent studies on irregular pledge and regular pledge agreements in Italian Law, the collateral taker meets its interest satisfaction by protecting itself against the collateral provider's risk of default, thus realizing the content of the financial arrangement which has to be considered satisfied to all intents and purposes. In particular the set of rules extends the security margin system already effective in specific sectors such as the payment and securities settlement systems, the derivatives market, the interbank market and the ECB monetary policy transactions. Therefore the so called "collateralisation" is also analysed as a technique of credit risk mitigation by the Basel II Accord; the research focuses on the collateralisation power to eliminate all serious inefficiency characterizing, in Italy as well, the financing relation between the bank and its client especially referring to levy. As for the connection of the new discipline with the prohibition of the '*pactum commissorium*' to which paragraph 2, Article 6 of the Decree explicitly makes an exception, the study specifically refers to the most recent comparative studies on the matter which came together in the 2006 French securities on movables reform. The comparative studies identify the '*ratio*' of the prohibition in the unjust enrichment. As a consequence of that, a generalization of the '*pactum marcianum*' model from Roman Law can be found at the basis of the new discipline as well. The validity of that model derives essentially from the necessary correspondence between the asset value and the secured credit value governed by the commercial reasonableness standard as mentioned in paragraph 1, Article 8 of the Decree. The research goes on analysing the collateral taker's enforcement rights connected to sale and appropriation of financial collateral or to cash employment. The new discipline is compared to the general rules on the matter of pledge, even from a historical and comparative point of

view, passing from an *ex ante* necessary control (i.e. before the enforcement) to an *ex post* possible control (i.e. after the enforcement).

The most complex question discussed in this study is the adjustment of the commercial reasonableness standard to the Italian law; that standard governs the enforcement of the security interest in financial collateral arrangements. First of all even in the light of the connection among the concepts of good faith, commercial reasonableness and fair dealing that can be found both in Article 9 of the Uniform Commercial Code representing the new discipline's most immediate set of rules reference and in master agreements, the ISDA one in particular, the above-mentioned standard is analysed with regard to the general clause of good faith in Italian Law. On the basis of a preliminary remark according to which the good faith in Civil Law has a function generating protection duties (*'obligation de sécurité'* - in French Law -; *'Nachvertragliche Pflichten'* - in German Law -), while the reasonableness concerns the procedure by which the duties themselves can be better carried out, as stated in Recital 17 of the Directive proclaiming the protection of the collateral provider and third parties, the good faith is considered the collateral taker's source by which the protection must be granted to the collateral provider meaning that the latter's (negative) interest must be safeguarded so that the collateral is not sold below cost or undervalued and this for the benefit of the collateral provider's other creditors, too. When the market is in normal condition the realization economic result is examined in the Italian Law having recourse to the Common Law which refers not to the price but to the collateral 'fair market value' (in American Jurisprudence)/ 'true market value' (in English Jurisprudence) to be estimated through the mark-to-market standard.

As a consequence, the economic result has not to necessarily correspond to the *best price* nor has it to correspond to the proper price. It is clear that where the "fair/true market value" can be found the observance of the commercial reasonableness standard must be examined under the other aspects of time and manner in which rights concerning financial collateral are enforced. The major difficulties arise talking about illiquid and distressed markets: with regard to that, the research is particularly interesting. The present crisis, which has affected the structured credit as for the well-known subprime loans affairs, besides posing difficulties for the *collateral* liquidation through sale, has also caused many problems as for the collateral valuation in case of appropriation. In fact, even when the financial instrument has its market price that cannot be representative of its "fair/true market value", not to mention the difficulty of making a valuation since the market wrongly considers illiquidity to be synonymous with toxicity. The proof of that is the increasing litigation, especially in the U.S.A., caused in 2007 and 2008 by the mark-to-model standard employment in the margin calls in repurchase agreements and credit default swaps and by the question of time as for the exercise of collateral taker's enforcement rights. As to this last issue, the New York Courts' jurisprudence is in contrast with that of the London Chancery Court: talking in terms of commercial reasonableness, the former ask for the enforcement rights' immediate exercise by the collateral taker, the latter, on the contrary, thinks a deferred sale can be consistent with the reasonableness standard until the market stabilizes. Up to today, the only leading case relating to the Directive is *Alfa Telecom Turkey Ltd v. Cukurova Finance International Ltd* filed in the first degree in 2007 and in the second degree in 2008 by the British Virgin Islands' Courts. At present, the Privy Council is examining the case; on 23rd February 2009, it reserved its decision till later. That leading case merely analyses the collateral's appropriation remedy in English Law without considering the issue relating to the valuation of the appropriated assets. Basically the Privy Council will have to establish whether or not, when the certificated shares are the subject of the financial collateral agreement, it is necessary to transfer, in addition to the legal title, the equitable title as well to the collateral taker so that it can exercise the right of appropriation in a valid way.