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LIABILITIES OF DIRECTORS AND SHAREHOLDERS OF A COMPANY LIMITED BY SHARES UNDER ITALIAN LAW

1. Liability of directors[1]

1.1. Introduction

Under Italian Law, the management of a company limited by shares ("*società per azioni*" or "*S.p.A.*")[2] can be entrusted to one person or to more directors, who compose the board of directors, chaired by a chairman. Directors are in charge of carrying out all the activities necessary for the achievement of the corporate purpose.

On the whole, directors must carry out the duties established by the law and by the by-laws with the appropriate care (duty of care), depending of the kind of task and on their specific skills and competences. Directors are jointly and severally liable to the company for damages caused by the failure to

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[1] For a deep analysis of the director's liabilities, altough in Italian, see V. FERRARO "*Note in tema di responsabilità degli amministratori nelle società per azioni ed in tema di azione di responsabilità: profili pratici*, 20.09.2012 available at http://www.businessjus.com/articoli_commerciale.aspx?id=117.

[2] For a description of the main characteristic of a "società per azione" see, inter alia, E. GILARDI *Incorporation of a limited liability company under Italian Law,* 29.08.2011 available at http://www.businessjus.com/autori_egilardi.aspx.

comply with their duties, except for functions vested solely in the executive committee or in one or more directors.

In any case, as a general remark, it should be underlined that the assessment of whether directors acted with the appropriate standard of care requires a case-by-case analysis. Moreover, the directors do not owe to the company any duty to perform the business successfully. It will be ascertain only whether, at the time the management decision was taken, the directors acted in a sound manner (so-called "*Business Judgment Rule*").

In principle, directors may have a civil liability towards the company; the creditors of the company; the company's shareholders and other third parties.

Liability for acts or omissions of directors does not extend to a director who, being without fault, has had his dissent entered without delay in the minutes of the board of directors and has immediately given written notice to the chairman of the board of statutory auditors.

1.2. Civil[3] directors' liability

(a) Liability towards the company

As mentioned above, directors may incur liability towards the company("*azione sociale di responsabilità*"[4]). The directors' duties towards the company can be divided into (1) general duties (namely, the duty of care and the duty of loyalty), and (2) specific duties set out in statutory provisions of law or in the company's by-laws.

The assessment of whether directors acted with the necessary standard of care requires a case-by-case analysis.

Directors also owe to the company a duty of loyalty which includes, *inter alia*, the duty to disclose any interest the director may have in a transaction to the board of directors and the board of statutory auditors.

As a general rule, directors may be held liable towards the company only when the breach of their duties has caused a damage to the company itself. The burden to prove the damage rests with the company claiming for the directors' responsibility (see Section IV below).

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[3] Finally, certain actions/omissions in breach of the directors' duties may also be relevant from a criminal perspective. This aspects will not be addressed by this article.

[4] See Article 2393 of the Italian Civil Code ("ICC", adopted with Regio Decreto 262 of 16 March 1942) which is the Italian equivalent of the Anglo-Saxon notion of "derivative action".

(b) Liability towards creditors of the company

Directors are also liable towards company's creditors for any breach of their duty to preserve the company's assets in case the latter are not sufficient to satisfy the creditors' claims. In principle, a company may not have enough assets to face its debts when due also without being technically insolvent.

(c) Liability towards company's shareholders and third parties

Furthermore, any shareholder or third party may bring an action for damages arising from willful misconduct or negligent behavior of the directors[5], provided that it has suffered direct damage (different from that suffered by the company). In fact, the above described lawsuit may be brought only for damage specifically and personally suffered, i.e. the damage cannot be a mere consequence of the damage caused by the company.

(d) Legitimacy to bring actions against the directors

(i) Action for directors' liability brought by the company

Pursuant to Article 2393 of the ICC, the action for directors' liability is brought pursuant to: (1) a resolution of the ordinary shareholders' meeting. Such resolution concerning directors' liability can be adopted when the shareholders' meeting convened for the approval of the annual financial statements even if not included in the agenda when it relates to matters pertaining to the financial year to which the financial statements refer; or (2) a resolution of the statutory auditors adopted with a two-thirds majority.

The action may be commenced within 5 (five) years from the termination of the director's appointment.

The resolution to bring an action for liability causes the removal from office of the directors against whom the case is brought provided that it is adopted with the favorable vote of at least 20% of the share capital. Accordingly, the same shareholders' meeting provides for their replacement.

Pursuant to Article 2393, last paragraph of the ICC, the company can waive the right to bring an action for liability and can settle it provided that

[5] See Article 2395 of the ICC.

such waiver and settlement are approved by an express resolution of the ordinary shareholders' meeting and unless 20% or more of the share capital vote against.

(ii) Action for directors' liability brought by shareholders[6]

The company's action for liability may also be exercised by a qualified minority of shareholders: in particular, in closed companies a qualified minority of shareholders representing at least 20% of the company's share capital registered in the shareholders' ledger (or the lower percentage set out in the by-laws) is needed, while in public companies (and in general in companies that make recourse to the risk capital market) the lawsuit may be brought by qualified minority of shareholders representing 1/40 of the share capital (unless the by-laws provides for a lower threshold). The shareholders who intend to promote the action may appoint, by majority of the share capital owned, one or more common representatives for the exercise of the action and for the performance of the related acts. If the claim is accepted, the company reimburses the plaintiff's judicial expenditures and those incurred for the ascertainment of the facts which the judge does not charge to the losing party or which may not be possible to recover upon enforcement against them. Shareholders who have initiated the action may abandon it or settle it. Any compensation for waiver or settlement must be for the benefit of the company.

(iii) Individual action of the shareholders and of third parties

Individual shareholders or third parties who have been directly injured as a result of malice, fraud or negligence by the directors can sue the company for damages. Such action can be brought within 5 (five) years from the act that damaged the shareholder or the third party.

(iv) Action for directors' liability brought by creditors

Directors are liable *vis-à-vis* creditors of the company if they do not fulfill their obligations in connection with the keeping of the integrity of the

[6] See Article 2393-bis of the ICC.

company assets. Creditors may exercise their action in the event that the company assets are not sufficient to satisfy their credits.

(e) De facto or shadow director

It is not unusual in companies and in particular in groups of companies that individuals (other than directors of a certain company) participate, to a certain extent, to the management of such company, either by providing advice to the directors or by taking strategic decisions. Such individuals may be directors or managers of a parent company or of another company of the group, as well as directors of a consulting or advisory entity that is not part of the chain of control of the company but provides advice to the company by virtue of certain other contractual or group relationships.

Under latest Italian case law, any individual who interferes in the management of the company - although not being formally appointed as its director - is considered to be a *de facto* or *shadow director*.

Generally speaking, the existence of shadow directors operating for a company must be assessed on a case-by-case basis.

Being a shadow director, as previously noted, implies the possibility to be found liable vis-à-vis the company, its shareholders and creditors, within the same terms applying to formally appointed directors (as described in Part 1 of this Article).

(f) Liabilities of Managing Directors ("Direttori generali")

Pursuant to Article 2396 of the ICC, the provisions regulating the liability of dir
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2396. General managers. The provisions regulating the liability of directors also apply to the general managers appointed by the meeting or under a provision of the by-laws, in respect of duties entrusted to them, save for actions which may be initiated on the basis of the employment relationship with the company.

2. Shareholders' liability

3.1 Introduction

Under Italian law shareholders of a company limited by shares are, generally speaking, not liable for the obligations of the company *vis-à-vis* its creditors[7]. They are not bound by any specific fiduciary duty *vis-à-vis* the company. However, resolutions of shareholders' meetings adopted by the decisive vote of shareholders with, either directly or indirectly, a conflict of interest with the company may be challenged if the resolution prejudices the company itself. Furthermore, case law and scholars, based on general principles of fairness and good faith, censure and condemn any acts that are intentionally carried out by majority shareholders for the purpose of causing detriment to the minority's interests, as well as any obstructionist behavior by the minority shareholders that may be prejudicial to the company.

Moreover, there are cases in which shareholders and other entities/individuals may be found liable *vis-à-vis* the company's shareholders or creditors under the set of rules concerning the so-called guidance and coordination ("*direzione e coordinamento*") Generally speaking, pursuant to such rules, an entity that leads and co-ordinates the management and conduct of the operations of one or more other entities in the same group may incur liability towards the shareholders and/or the creditors of any guided entity in case it exercises its influence over such entity in breach of the principles of sound and prudent management. Liability is however excluded if the damages caused to the guided entity's shareholders or creditors are counterbalanced by any other actual or expected benefits to the guided entity resulting from its being part of the group.

3.2 Direction and coordination of companies within groups

A notion of the interest of a group, on which the case law and the scholars have deeply discussed[8] was inserted by the legislator with the

[7] In terms of liability vis-à-vis the company's creditors, shareholders' responsibility is limited to the amount of their respective contribution (i.e. the relevant portion of subscribed stock capital). However, a single shareholder may incur unlimited liability if certain formalities prescribed by the law fail to be fulfilled (e.g. in case of failure to pay up, upon incorporation, 100% of the initial share capital).

[8] See in this respect, L. AGOSTARA, *Appunti in tema di attività di direzione e coordinamento*, Il Nuovo diritto delle Società, 5/2012 page 49 and ff. and V. SALAFIA, *La responsabilità della holding verso i soci di minoranza della controllate*, in Società, 2004 page 6 and ff., SANTOSUOSSO, *La riforma del diritto societario. Autonomia privata e norme imperative nei D.Lgs. 17 gennaio 2003, nn. 5 e 6*,

company reform of 2003[9] with article 2497 and ff. of the ICC. This article, reported below provides for a specific liability of the parent company, *vis-à-vis* (1) the shareholders and (2) the creditors of the subsidiary, whenever the former: (i) directs and coordinates the activities of the latter; and (ii) exercises such power of direction and coordination for its own benefit or for the benefit of third parties, in breach of the correct corporate and entrepreneurial management ("*corretta gestione societaria ed imprenditoriale*").

Article 2497 of the ICC reads as follows:

"*The company or entities that, by exercising a direction and coordination activity over subsidiaries, act for their own benefit or for the benefit of third parties in breach of the principles of sound management of companies, are directly liable vis-à-vis the shareholders of the subsidiary for any* ***prejudice caused to the profitability and the value of their shareholdings****, as well as vis-à-vis the creditors of the subsidiary for any* ***prejudice caused to the ability of the latter to pay back its debts****. There is no liability when the damage does not exist in the light of the aggregate result of the activity of direction and coordination or entirely eliminated also as a consequence of transactions directed to such purpose.*

The person who contributed to the damage is jointly liable and, to the extent of the benefit received, the person who consciously obtained a benefit.

The member and the creditor of the company may act against the company or the entity which exercises the activity of direction and coordination only if not satisfied by the company being subject to the activity of direction and coordination.

In the event of bankruptcy, administrative liquidation and extraordinary administration of a company subject to the direction and coordination of others, the action belonging to the creditors of said company is exercised by the trustee or by the liquidating commissioner or by the extraordinary commissioner".

(a) Notion of direction and coordination

A definition of direction and coordination is not provided for by the laws, but should be interpreted as something more specific than the mere

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Milano, 2003, 241 e ss.; AA.VV., *La riforma del diritto societario*, vol. 9, "*Gruppi, trasformazione, fusione e scissione, scioglimento e liquidazione, società estere*", LO CASCIO, Milano, 2003, 241; GIOVANNINI, *La responsabilità per attività di direzione e coordinamento nei gruppi di società*, Milano, 2007.

[9] Adopted with legislative decree 6 of 17 January 2003.

"control" over a subsidiary, as it is the expression of a stronger interference, constituted by a constant flow of directives given by the parent company and incorporated in the decisions of the corporate bodies of the subsidiary, concerning significant aspects of the company's business, such as – for example – investments, financing, accounting policies, the entering into important agreements[10] etc."[11]

Pursuant to legal scholars and Italian courts, direction and coordination can be identified whenever: (i) the parent company can significantly affect management decisions of the subsidiary, e.g. strategic or business choices with respect to financial, industrial or commercial affairs of the subsidiary or (ii) there are specific offices, employees or procedures within the corporate/group structure through which the activities of the parent company and those of the subsidiary are integrated and coordinated[12].

Pursuant to Article 2497- sexies of the ICC, it is presumed that, unless proof to the contrary is given, the activity of direction and coordination is exercised on the company which is controlled in accordance with Article 2359 of the ICC or is under the obligations to consolidate its accounts. Pursuant to Article 2359 of the ICC, a company "controls" a subsidiary whenever:

(i) it can exercise the majority of votes at the general meeting of the subsidiary;
(ii) it can exercise a number of votes that is sufficient to have a prevailing influence ("*influenza dominante*") at the general meeting of the subsidiary;
(iii) it can exercise a prevailing influence on the subsidiary by virtue of particular contractual relationships.

Other examples of direction and coordination have been identified by legal scholars[13], such as, *inter alia*, when the parent company (i) prepares

[10] Important agreements such as franchising, agency, licensing agreements under the notion of Article 2359 of the ICC.
[11] See Palermo First Instance Judgment dated 15 June 2011.
[12] See Pescara First Instance Judgment dated 3 February 2009.
[13] RESCIGNO, *Eterogestione e responsabilità nella riforma societaria fra aperture ed incertezze: una prima riflessione*, in *Società*, 2003, 333 e ss. V. anche GALGANO, *Direzione e coordinamento di società*, in *Comm. Cod. Civ. Scialoja-Branca*, a cura di Galgano, Bologna, 2005, 59 e 104, Circolare Assonime

(and approves) business and financial plans, or budgets, for the subsidiary; (ii) directs financial and credit policies of the subsidiary and/or cash pooling mechanism is in place between the subsidiary and the parent company or intra-group guarantees have been awarded; (iii) defines or influences the commercial strategies of the subsidiary; (iv) the parent company authorizes investments of the subsidiary exceeding certain thresholds.

Moreover, direction and coordination is relevant - for the purposes of the liability of the parent company - only when it is constantly and actually exercised (i.e. when it is not occasional and not merely potential)[14].

(b) Assessment of direction and coordination activity

The existence of direction and coordination must always be assessed on a case-by-case basis. Pursuant to Article 2497-*sexies* of the ICC, the exercise of direction and coordination by the parent company can be presumed whenever the latter prepares consolidated accounts for the group; controls the subsidiary pursuant to Article 2359 of the ICC.

The abovementioned presumption admits rebuttal, i.e. the parent company can demonstrate that - although it prepares consolidated accounts and/or "controls" the subsidiary - it does not exercise any direction and coordination.

At any rate, rebuttal can be difficult, especially when - in addition to the consolidated accounts and the "control" over the subsidiary - there are other evidence that can strengthen the idea of a direction and coordination exercised over the subsidiary (such as, for example, the fact the directors of the parent company are also directors of the subsidiary).

Direction and coordination alone is not enough to ground the liability of the parent company, also the following requirements must be met:

(i) the actions amounting to direction and coordination must be

n. 4/2006, *Direzione e coordinamento di società. Profili di organizzazione e responsabilità del fenomeno del gruppo*, *Riv. soc.*, 2006, 1097 ss.

[14] See Palermo First Instance Judgment dated 15 June 2011 and Pescara First Instance Judgment 3 February 2009.

performed in breach of the correct corporate and entrepreneurial management; and

(ii) direction and coordination must be exercised by the parent company for its own business interest, or for the business interest of third parties.

In fact, Italian law has also taken into consideration the fact that the direction and coordination activity performed by the parent company is not necessarily detrimental to the subsidiary and can actually have positive implications. That is why there is no liability, as mentioned in last part of first comma of Article 2497 of the ICC, "*when the damage does not exist in the light of the aggregate result of the activity of direction and coordination or entirely eliminated also as a consequence of transactions directed to such purpose*". In other words, when (i) in light of the *overall* activity of direction and coordination, there are no relevant damages because the prejudices that may be imposed on the subsidiary are balanced by the benefits that the latter obtains from the directives given by the parent company; (ii) the damage caused to the subsidiary is removed, also as result of specific initiatives undertaken to remedy.

(c) Damages

Direction and coordination must have caused damages to the subsidiary, to the value and profitability related to its shares and to its assets. In particular, the shareholders and the creditors of the subsidiary can submit a claim for damages against: (i) the parent company that exercises direction and coordination; and (ii) any other entity or individual that took part in the detrimental direction and coordination or that took advantage from it. Those who took part in the direction and coordination are jointly liable with the parent company, while those who benefited from it are only liable within the limits of the advantage they took.

As stated in comma 3 of Article 2497 of the ICC, the shareholders and the creditors of the subsidiary must submit their claims, first, against the subsidiary and secondly, only if their prejudices have not been fully compensated by the latter, against the parent company and the other entities or individuals.

(d) Duty of disclosure

It is worth to mention that, under Article 2497-bis ICC, subsidiaries subject to direction and coordination shall disclose this circumstance (i.e. indicate the company or the entity to whose direction and coordination is subject) (1) to the Companies' Register (in a specific section) and (2) in their correspondence and in their annual accounts (in which they must include a summary of the results of the parent company, together with a description of the activities carried out as a result of the direction and coordination of the parent company).

The directors which breach the above disclosure obligations are liable for damages caused to members or third parties.

Finally, Article 2497-ter of the ICC imposes other disclosure duty on the subsidiary subject to direction and coordination. In particular. the decisions of the companies under direction and coordination, when influenced by the latter, must be motivate and must contain the punctual indication of the reasons and of the interests therein. They are taken into account in the management report (prepared pursuant to Article 2428 of the ICC).

E. GILARDI, *Liabilities of directors and shareholders of a company limited by shares under Italian Law*,
4 Businessjus 20 (2012)