RP Legal & Tax

Limited liability company and unlimited liability of shareholders and directors

By Paolo Grandi

It is taught in school textbooks that corporations, i.e. S.r.l. and the S.p.A., are the most suitable instruments for starting and running a business as they benefit of perfect asset autonomy. In other words, there is absolute separation between the assets of the company and those of the individual stakeholders. The latter have no personal liability for corporate obligations, not even subsidiary liability.

The directors as well, in general terms, have no liability for debts or for the negative results of the company's business, except in the case of violation of their duties imposed by the law and the company's bylaws.

However, cases are increasingly common in Italian courtrooms where these principles are being undermined and convictions are being observed against shareholders and directors for debts of the company.

In addition, Italian courts are increasingly identifying cases of liability of individuals who are formally unrelated to the company, setting up situations of "*de facto* directors" and "*de facto* companies" that can potentially expose those involved to unlimited liability.

The pivotal principles on which the rulings we will report are basically as follows:

- Until the company is registered in the Company Register, relations between the company and third parties, all shareholders shall have unlimited and joint and several liability for the debts of the company" (Article 2297 Civil Code).

- In the event of a loss of the company capital, directors must without delay ascertain the occurrence of a cause for the dissolution of the company and proceed to convene a meeting to pass a resolution to wind up the company. In case of delay or omission, directors are personally and jointly liable for damages suffered by the company, shareholders, corporate creditors and third parties (Article 2485 Civil Code).

- Companies or entities that, exercising management and coordination activities of a company, act in their own or others' entrepreneurial interests in violation of the principles of proper corporate and entrepreneurial management of those companies, are directly liable to the shareholders of those companies for the damage caused to the profitability and value of the company's shareholding, as well as to the company's creditors for the injury caused to the integrity of the company's assets. Those who have in any case taken part in the damaging event and, to the extent of the advantage gained, those who knowingly benefited from it are jointly and severally liable as well (Article 2497 of the Civil Code)[1] .

We will try below to summarize, in brief, some of the most relevant and critical situations.

The liability of the "*de facto*" director

The figure of *de facto* director occurs when a person - not formally vested with the office - equally interferes in the administration, effectively exercising the power to manage the company. Italian courts have often pointed out that the figure of *de facto* director can exist if the following conditions are met:

I. Absence of effective and formal appointment;

II. Management activities exercised continuously;

III. Functions reserved for the jurisdiction of the appointed directors;

IV. Decision-making autonomy (not necessarily subrogation, but at least cooperative and non-subordinate) with respect to appointed directors.

In other words, a "*de facto*" director is a person who, without being formally appointed, manages - alone or even with the appointed directors - the company, systematically and comprehensively exercising *de facto* power corresponding to that of the directors.

In this type of situation, case law has long since totally equated the *de facto* directors with the appointed directors, both in terms of civil and criminal liability.

1 There is no liability when the damage is found to be missing in light of the overall result of the management and coordination activity or fully eliminated even as a result of operations directed to that end.

The *de facto* company and the extent of bankruptcy

The *de facto* company is that company in which all the elements from the Civil Code for the establishment of a company can be found (Art. 2247 Civil Code), which can also be inferred by conclusive facts, even in the absence of a written corporate contract and, therefore, of enrollment in the Company Register. Essential elements, in the internal relations between the parties, are the following:

i. The agreement having as its object the joint operation of an economic activity for the purpose of sharing its profits;

ii. the common fund consisting of partners' contributions aimed at carrying out the activity itself,

iii. A commitment (even unwritten) of cooperation with a view to carrying out the activity;

iv. The common risk of possible gains and losses;

v. the representation toward the market in a corporate commitment, that is, the suitability of the overall conduct of one of the partners to generate outside reasonable belief in the existence of a company (e.g., in the form of a partnership or joint venture).

Other incidences that lead Italian courts to hold that an implied corporate contract exists are, for example, keeping joint accounts, advertising the activity with joint names, and spending the name of a joint project.

A *de facto* partnership can arise on the basis of an oral or written agreement between entrepreneurs or simple conclusive behavior which is suitable to demonstrate the parties' intent to enter into an agreement for the collective exercise of a business activity.

A *de facto* company is defined as concealed when the element of externalization of the corporate commitment to third parties is missing. Moreover, the external disclosure of the *de facto* company's existence is not an essential element; the concealed nature of the *de facto* company does not cause its patrimonial liability to third parties to cease, it being sufficient that the company exists *de facto* and that the agreement from which the liability arises is nevertheless referable to a common investment, even if the partner who made it in practice did not act in the name of the company.

What responsibilities does the "*de facto"* company entail?

Article 2297 of the Civil Code establishes the unlimited joint and several liability of all partners until the company is registered in the Commercial Register. Recalling the principle stated above, this means that - in the presence of the other characteristic elements of the company - the fact that a "de facto" partner has acted in his own name but on behalf of the de facto company entails a liability of all other partners.

This important principle has been clarified by a recent ruling of the Supreme Court[2] : the lack of externalization of the corporate relationship is the indispensable prerequisite for the court to legitimately predict the existence of a concealed company, but this does not detract from the fact that the participation of all shareholders in the exercise of corporate activity with a view to a unitary result is still required, according to the rules of the domestic legal system, and that the contributions are aimed at constituting a "common" patrimony, removed from the free disposal of individual participants (Art. 2256 Civil Code) and to the enforcement actions of their personal creditors (Art. 2270 and 2305 Civil Code). The only peculiar feature of the peculiar "*de facto*" collective structure is that transactions are carried out by those who act not in the name of the *de facto* company (i.e., the overall group of partners) but in their own name.

In addition, Article 147 of the Italian Bankruptcy Law rules that the bankruptcy of a company belonging to an unformal company ("*società semplice")* also produces the bankruptcy of the partners, even if they are not natural persons, with unlimited liability. The Italian Courts have extended the application to corporations as well, stating that Article 147(5) of the Italian Bankruptcy Law applies not only when, after the declaration of bankruptcy of a company, it turns out that the enterprise is in fact referable to a *de facto* partnership between the bankrupt and one or more hidden partners, but, by virtue of extensive interpretation, also where the already bankrupt partner is a company, that participates with other companies or individuals in a partnership (the so-called "super corporation")[3] .

2 Civil Cassation, sec. I, May 25, 2021, no. 14365.

3 Court of Cassation, Sec. I Civ., Apr. 17, 2020, no. 7903; Court of Vibo Valentia, Oct. 14, 2021

De facto holding company and management and coordination responsibility

Finally, some courts have also analyzed the case where a *de facto* holding company has set up unitary management and direction of *de facto* subsidiaries either directly or indirectly.

This activity consists in a dominant influence on the management choices and determinations of the directors of the subsidiary company. This activity differs from the *de facto* administration of the subsidiary company in that the "holding" entity does not act by itself performing acts of management of subsidiary company. In this case, the "de facto holding company" influences or determines the managerial choices made by the directors of the subsidiary company, which will result in managerial acts relevant to third parties; acts performed in execution of the directives of the directors (*de facto* or appointed) of the *de facto* holding company.

The holding, therefore, does not exercise the typical powers inherent in the title or function of the director. Management and coordination, on the other hand, is an atypical activity, which can take oral or written form and a variety of modalities.

In this context, the principles of proper corporate and entrepreneurial management are, in business groups, violated whenever the holding company, in carrying out a given strategy or operation, has failed to strike a balance between its own interest and that of its subsidiaries.

The liability of the *de facto* holding company (as well as that of the formally incorporated holding company) arises in the event of violation of the principles of proper corporate and entrepreneurial management and may affect not only the person at the top of the group of companies, but also any other company (de facto or de jure) that is part of the sampe corporate group.

Paolo Grandi
Partner

paolo.grandi@rplt.it

Milano

Piazzale Luigi Cadorna, 4
20123 Milano – Italy
T. +39 02 873131
F. +39 02 87313322
milano@rplt.it

TORINO
MILANO
ROMA
BOLOGNA
BUSTO ARSIZIO
AOSTA

rplt.it