Piercing the corporate veil in Italian company and banking law

Marco SPERANZIN
Company Law Professor at the
University of Udine, Italy

SUMMARY: 1. The issue. 2. Disregard of corporate formalities. 3. Undercapitalised company. 4. Creation of a company solely to dodge the application of mandatory regulations or to prejudice the rights of third parties. 5. Abusive granting of credit. 6. Conclusions.

First of all, I would like to express my sincere thanks to Marmara University and the organisers of the Convention for the invitation to participate in such a prestigious international event on the subject of the piercing (and, some times, lifting) of the corporate veil, to present some general considerations on Italian company and banking law.

I will divide my presentation in 6 points: 1) the issue and the three categories or groups of cases; 2) the first group: disregard of corporate management and organisation rules (in Germany the cases of so called Durchgriffshaftung); 3) the second group: undercapitalisation of the company; 4) the third group: the creation of a company solely to dodge the application of mandatory regulations or to prejudice the rights of third parties (in Germany the cases of so called Zurechnung Durchgriff); 5) a special banking law case: abusive granting of credit and instruments for piercing the corporate veil; 6) conclusions.

1. The Italian doctrine has observed that the subject of lifting of the corporate entity in case of abuse is part of the more general topic of the reaction to the abuse of the law[1]; it would therefore appear more efficient to make an analysis that pay less attention to a reconstruction from a general point of

[1] G.B. PORTALE, Lezioni di diritto privato comparato[2], Milan, 2007, 169; see also A. NIGRO, Le società per azioni nelle procedure concorsuali, in Trattato delle s.p.a., headed by G.E. Colombo and G.B. Portale, 9**, Turin, 1993, 433 and following; N. ZORZI, L'abuso della personalità giuridica, Padua, 2002.

view, and focus on an examination of typical cases instead. I consider this suggestion proper and will therefore try to identify the most interesting cases from the point of view of Italian law, without neglecting particularly significant orientations on the part of other law systems. This distinction into groups of specific cases is useful for purposes of summarising, even if it is obviously schematic, since some cases cannot be pigeonholed within the list I will present, and others may be classified in more than one group.

2. The first group of hypotheses (the largest and most important one) is based on disregard of corporate structure and formalities. In other words, shareholders interfere directly in the management, as if they were directors, or confuse their own assets with those of the company (paying the company's debts with their own assets and vice versa, negotiating directly with the company's creditors, etc.).

The instrument used by Italian case law (including criminal one) to punish this kind of conduct in Italy (a problem that occurs especially when a company goes into bankrupt) has been to hold the shareholders liable through the technique of shadow or de facto directors, or in other words assigning the directors liability to those who, while not formally appointed, actually exercise management functions[2].

However, since the newly enacted company law in 2003, the Italian law system has acquired two new provisions that may be used to punish these cases of abuse:

a) the regulation on company groups, i.e. the regulation on the holding liability due to the 'management and coordination' of its subsidiaries (art. 2497 and following of the Italian Civil Code). This regulation on the one side confirms the liability of the holding (as an entity and not as an individual) causing damage to the integrity of the assets of the subsidiary which is 'managed and coordinated', thus damaging the minority shareholders and mostly (as here it is important) creditors of the subsidiary; and on the other side the liability of the party (which may also be an individual) which has benefited from this 'management and coordination' activity and which has in any case participated in the harmful deed or act (for example: sister subsidiary; directors; shareholders; etc.)[3];

[2] In this sense: Court of Cassation, 6 March 1999, n. 1925, in Corr. giur., 1999, 1396 and following; see also N. ABRIANI, Gli amministratori di fatto delle società di capitali, Milan, 1998.

[3] V. CARIELLO, Direzione e coordinamento di società e responsabilità: spunti interpretativi iniziali per una riflessione generale, in Riv. soc., 2003, 1229 and following.

b) art. 2476 of the Italian Civil Code, which, as far as a private limited liability company is concerned, provides the joint liability of directors and shareholders who have intentionally decided or authorised acts or resolutions which damage the company[4].

Also the Italian bankruptcy law may affect the issue in question, in particular with reference to partnerships law (but, indirectly, as we will see below, also to companies). Art. 147 of the Italian bankruptcy law (Royal Decree no. 267 of 1942) provides the bankruptcy of partners with unlimited liability when partnership has gone into bankrupt; furthermore, the same art. 147 (amplified by the 2006 reform of the bankruptcy law) provides the bankruptcy of the 'shadow or secret partner' (the partner who does not formally appear as such) in partnerships. In other words, if after the bankruptcy, it is discovered the existence of a partner who did not formally appear as such, but who has acted in this capacity (providing guarantees in favour of the company; negotiating with the creditors of the company, executing agreements, etc.), the Italian bankruptcy law contemplates the bankruptcy of said party (and this also applies when it is discovered the existence of a party who has acted as the partner of an apparently individual entrepreneur: bankruptcy of the 'shadow or secret partner' in a silent partnership).

According to a construction[5] the principle that may be inferred from the bankruptcy law (and which as said has been underscored by the reform of the bankruptcy law of 2006) concerns the partners of partnerships, but could also be extended to the "tyrant" or dominating shareholder of stock corporations, or, in other words, to the party who uses a company as his/her own property, violating corporate regulations through a confusion of assets. In these cases the business activity (according to the quoted author) should be attributed to said shareholder, who actually dominates a business that has not been formally assigned to him/her (as it is attributable to the company) with the consequence that said party shall be held liable for the company's debt and may face personal bankruptcy as an individual entrepreneur.

One must keep in mind the great differences arising from the two different approaches: while the first thesis of the shadow director or the holding liability for the "management and coordination" entails that the shareholder will be held liable for the damages arising from the disregard of the "corpo-

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4 See F. GUERRERA, La responsabilità "deliberativa" nelle società di capitali, Turin, 2004.

5 The thesis origins from W. BIGIAVI, L'imprenditore occulto, Padua, 1954, 185 and following; see also F. GALGANO, Diritto civile e commerciale[4], 3**, Padua, 2004, 105 and following.

rate separation", the thesis of the "tyrant" or dominating shareholder entails that the shareholder will be held liable for the debts of the company, and that he may also face bankruptcy.

Perhaps also due to the seriousness of the possible consequences (in addition to the theoretical difficulties of the thesis of the "tyrant" or dominating shareholder) Italian case law has never expressly followed the second orientation, but has always distinguished the principles applicable to partnerships (whose partners may face bankruptcy, even if they have not formally appeared as partners) and those applicable to companies (whose shareholders may be held liable towards the creditors for damages caused to the corporate assets only when the prerequisites for shadow director or responsibility for wrongful act subsist, and now also in the light of the new aforesaid regulations introduced by the new company law)[6].

In any case the subject of piercing the corporate veil due to disregard of corporate regulations has become more important as a result of the 2003 reform of the law on limited companies, also from another point of view: the company owned by a single individual now represents a general figure (a single individual may incorporate or maintain both a public company or a limited liability company: artt. 2325, 2362 and 2462 Italian Civil Code), and the sole shareholder is liable for the obligations assumed by the company only in marginal cases (failure to announce in the company register the existence of a sole shareholder); consequently the 2003 reform has reinforced the principle that the limitation of the liability is a general principle of corporate law (this is also demonstrated by regulations governing the 'allocated assets', so called patrimoni destinati, that a company - but not the private limited liability one - may set up by separating a part of its assets and allocating it to a specific business activity: articles 2447-bis and following of the Italian Civil Code).

I will finally conclude the examination of the first and largest group of cases by pointing out that, from a point of view of comparative law, German case law now appears to be oriented towards the same solution as Italian law; the former, amending the theory of the Existenzvernichtungshaftung (liability of the shareholder for actions that are detrimental to company assets) has recently expressed itself in favour of the application of the principles of liability of the shareholder for wrongful act and thus for damages[7].

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6 The distinction has for instance recently been confirmed by the Court of Appeal of Turin, 30 July 2007, in Giur. it., 2007, 2219 and following. See also Court of Cassation, 25 January 2000, n. 804, in Società, 2000, 846 ss.

7 Trihotel case: BGH, 16 July 2007, in ZIP, 2007, 1552 and following.

The Slovenian law of 1999, on the contrary, provides a different orientation (the shareholders are required to assume liability for corporate debts in case of disregard of corporate formalities)[8].

3. The second group of cases usually mentioned (and actually closely linked to the first one) is the (very controversial) one of undercapitalised companies, or in other words companies which do not possess sufficient means (in particular: share legal capital and reserves) to pursue their business (material undercapitalisation) or which possess these means, not in the form of share capital or reserves, but in the form of loans from the shareholders (nominal undercapitalisation).

In Italy it has been asserted[9] that one may infer, from the law system as a whole, a principle which requires to properly fund a business conducted as a company and prohibits the manifest insufficiency of the share capital, and according to which the shareholders would in this case (of material undercapitalisation) be liable for the debts incurred by the company.

However, the prevailing orientation has rejected this thesis. One may not provide for a further liability (beyond the contributions) on the part of the shareholders, once the minimum share capital required by law has been complied with (_ 120,000 for public companies and _ 10,000 for limited liability companies). According to this prevailing construction, the regulations on directors liability, the organisation of the company (if respected) and the need to prepare financial statements following the European standards serve the purpose of protecting third parties and creditors.

These conclusions on the part of the prevailing orientation appear to be confirmed by the 2003 reform of the company law, which has, on the one hand, provided the aforementioned provisions of articles 2497 and 2476 of the Italian Civil Code, concerning incorrect management of group of companies and shareholders' liability in private company, and not concerning incorrect funding of companies on the part of the shareholders (see above). On the other hand, as far as private limited liability companies are concerned, it contains a provision (art. 2467 of the Italian Civil Code) concerning only nominal undercapitalisation, which establishes that the reimbursement of loans made by the shareholders to the company shall be postponed until the other

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8 As recalled by G.B. PORTALE, op. cit., 173.

9 See G.B. PORTALE, Capitale sociale e società per azioni sottocapitalizzata, in Trattato delle s.p.a., headed by G.E. Colombo and G.B. Portale, 1**, Turin, 2004, 41 and 112 and following.

creditors have been satisfied, if the loan has been granted when the company was facing difficulties, even if only financially.

It is widely discussed if this regulation, which is, as mentioned, provided for limited liability companies but also, within the context of the rules for company groups (art. 2497-quinquies of the Italian Civil Code), is also applicable to the case of public companies[10].

4. The third group of cases is characterised by the incorporation of a company solely in order to dodge the application of mandatory regulations or to prejudice the rights of third parties. In this case the piercing or lifting of the corporate veil is represented by the application of the dodged regulation, or in other words the specific provision that has been disregarded by means of the company that has been created especially for that purpose.

The leading cases in company law appear to be as follows:

i) the incorporation of a company in order to dodge the non-competition obligation assumed by a party disposing of a business. Art. 2557 of the Italian Civil Code establishes that in the case of a sale of a business, the seller cannot conduct – by certain limits – activities representing competition with the buyer of the business; the purpose is to guarantee the goodwill that is (normally) paid for by the buyer when acquiring the business (i.e. the fact that the buyer of the company pays a price that is higher than the sum of the company's assets, also against the purchase of the clientele: the goodwill, precisely; if the seller could conduct the activity in a manner representing competition with that of the sold business, the goodwill paid by the buyer would be compromised). In this case, it might be incorporated a company, that becomes the owner of the business, so that the shares in said company are subsequently sold to the buyer. In such hypothesis (acquisition of shares) there is no transfer, in a juridical sense, of the business, of the assets, which are owned by (are the property of) the company; consequently, the prohibition set forth in art. 2557 is apparently not violated whenever the seller of the shares should, after said sale, compete with the buyer of the shares, by conducting an activity that is similar to that of the sold business.

On the contrary, the Italian Supreme Court considers, as of a sentence from 1997[11] that the prohibition of competition applicable to the seller of a

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[10] G. PRESTI, Art. 2467, in Codice commentato della s.r.l., directed by Benazzo e Patriarca, Turin, 2006, 100 and following.

[11] Court of Cassation, 20 January 1997, n. 549, in Giust. civ., 1997, I, 1289; as to previous doctrine, see G.E. COLOMBO, L'azienda e il mercato, in Trattato Galgano, Padua, 1979, 194, with further references.

business also applies to the sale of the control shareholding of a company, since also in the latter case does one obtain, from an economic viewpoint, a transfer of a business, of the assets, and consequently the need to safeguard the buyer who has also (normally) paid for the goodwill as part of the purchase.

ii) the incorporation of a company in order to dodge the right of pre-emption, whether legal or conventional (i.e. in a company by-laws).

An Italian decision has passed a sentence on an interesting hypothesis: a company, shareholder of another whose charter provides for a pre-emption clause, transfers its shares by assigning them to a third company, of which it is the sole shareholder, without making an offer to the other shareholders under the pre-emption clause.

The Court of Venice[12] has considered that this transfer does not violate the pre-emption clause since the transfer (by means of assignment) of the shares to a company entirely owned by the shareholder does not represent, from an economic viewpoint, a transfer of the asset; as a matter of fact, the original shareholder still retains the "control" of the assigned shares (since the original shareholder is the sole shareholder of the assignee company). The interests safeguarded by the pre-emption clause are thus allegedly respected: the same party essentially remains shareholder, and no change occurs in the structure of the shareholders (the interest which is safeguarded by the pre-emption clause provided by the articles of association).

The thesis does not appear to be followed: in fact, it comes natural to reply that it would then be sufficient for the original shareholder to sell its holding (i.e. 100% of the capital) in the assignee company without having to comply with the pre-emption clause applicable to the "original company" and thus to dodge the right of pre-emption provided by the articles of association. Consequently, scholars have invoked in these cases the application of the principle of the piercing of the corporate veil, when the adoption of the company structure is aimed at dodging a pre-emption clause[13].

iii) In banking law it has posed the case[14] of the incorporation of a company in order to export foreign currency in violation of the national currency laws: some Italians had incorporated an Anstalt (a company governed by the

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[12] Court of Venice, 7 November 2003, in Banca borsa tit. cred., 2004, II, 688 and following.

[13] M. CIAN, Società di mero godimento tra azione in simulazione e Durchgriff, in Giur. comm., 1998, II, 474 and following.

[14] Also this mentioned by G.B. PORTALE, Lezioni di diritto privato comparato, cit., 169.

law of Liechtenstein) in order for this to incorporate another company in Italy, which was registered as the owner of assets purchased with money that had been illegally exported. Also in this case one has posed the problem of applying the regulation that had been dodged by piercing of the corporate veil.

In general, in all the cases identified in this point, lifting of the corporate entity does not appear to consist of anything but a specific application in company law of a general civil law provision: art. 1344 of the Italian Civil Code, which aims to counter fraud against the law or, it may be added, a company by-laws (i.e. hypotheses in which one seeks, through a series of operations, to dodge a mandatory regulation of the law). In this case, consequently, piercing the veil means an interpretative way (what the German doctrine defines as Durchgriff as Normanwendung) which serves to apply the provision a party has sought to dodge.

5. Finally, as far as the banking law is concerned, a brief mention of the liability assumed by a bank for abusive granting of credit, which does not represent a proper case of lifting of the entity, but is associated with the theme in question for reasons we will now see.

Italian case law recognises that the granting of a new loan to a company undergoing a crisis, or the maintenance of a credit that has already been granted, even though the lender is aware of the economic difficulties faced by the borrower, may determine a liability for the bank (to some: only in case of fraudulent intention)[15].

It is a matter of an abusive conduct on the part of the bank: on the one side the violation of a duty (of granting credit in a correct manner); on the other, said conduct often causes damage to the other creditors of the company.

The hypothesis of liability on the part of the bank has however been subject to considerable criticism by the literature[16], which firstly challenges its acceptability in abstract terms (for purposes of motivating financial aid to companies in difficulty), and secondly argues that the official receiver may not, in any case, enforce this liability when the company, that has received abusive loans, has gone into bankrupt (also the above mentioned Court of Cassation has confirmed this orientation).

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[15] Court of Cassation, Sole Section, n. 7029 of 2006, in Riv. dir. fall., 2006, II, 623 and following.

[16] See, most recently, A. NIGRO, La responsabilità della banca nell'erogazione del credito, in Società, 2007, 437 and following.

Scholars consider preferable to follow another way to punish the abusive conducts of banks in the period preceding corporate crises. The granting or maintenance of credit in favour of a company in difficulty is often linked to an agreement containing provisions that allow the bank to take part in the decisions (also concerning management) that are most important for the company: at this point the bank, if it acts in an abusive manner, could be considered (if we want, through the theory of the lifting of the entity) a shadow director of the company, or in any case a party that is liable before the creditors of the company, under the regulations on groups examined in the foregoing, or in other words art. 2497 of the Italian Civil Code[17]; also the official receiver, in case the borrowing company should later face bankruptcy, could enforce its liability actions against the bank.

6. In the final analysis, also in the light of the new principles of the reform of the company law of 2003, we have to follow the doctrine[18] which underscores that remedies for the illegitimate management activities that cause damages to third parties are the main way to repress abuses conducted through the use of companies (as provided by the aforementioned article 2497 of the Italian Civil Code, on the subject of groups, or the thesis of the de facto director, or the provision regarding private limited liability company: art. 2476 of the Italian Civil Code); the theory of lifting of the corporate veil may perhaps serve for purposes of punishing borderline cases (those examined in no. 4), but against which it represents an application of the instrument of fraud with respect to the law (art. 1344 of the Italian Civil Code) or the company by-laws.

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17 A. MAZZONI, Capitale sociale, indebitamento e circolazione atipica del controllo, in La società per azioni oggi, Milan, 2007; 511 and following; see, in this sense, also the French law n. 845 of 2005.

18 A. GAMBINO, La responsabilità dell'impresa e la gestione, in AA.VV., La responsabilità dell'impresa, Milan, 2006, 77 and following.