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Autor: Lener, Raffaele

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Directors' liability, conflicts of interest and business judgement rule under the new Italian company law

Raffaele Lener*

I. Introduction

On January 1, 2004, a major reform of most of the sections of the Italian Civil Code *(ICC)* dealing with company law (the *Reform*) came into force. Under the new regime the *società per azioni* may choose among three alternative models of governance: (i) the «standard model» (which applies unless the by-laws specifically provide otherwise); (ii) the «dualistic model»; and (iii) the «monistic model».

- The *«standard model»* is based on a shareholders' body, namely the *assemblea* (the shareholders' meeting), a sole director (*amministratore unico*) or a board of directors (*consiglio di amministrazione*) and an internal supervisory body called the *collegio sindacale* (the board of statutory auditors).
- Under the *«dualistic model»*, the shareholders' meeting has fewer powers, and there is no *collegio sindacale*. The management and control of the company is to be performed by (a) a management board (*consiglio di gestione*) and (b) a supervisory board (*consiglio di sorveglianza*) respectively.
- Under the *«monistic model»*, the management of the company is handled by the board of directors, which is appointed by the shareholders' meeting. The board of directors then appoints a committee for management control (*comitato per il controllo sulla gestione*).

The Reform contains, *inter alia*, certain amendments to the provisions concerning the directors' liability (*i. e.* art. 2392–2395 of the ICC), aimed at distinguishing between the role and responsibilities of executive and non-executive directors. In general terms, under Italian law the directors of a company may be held liable for damages arising as a consequence of a breach of their duties towards:

(i) the company (art. 2392, 2393 and 2393bis of the ICC);

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* Full Professor of Securities Regulation and Private Comparative Law at the Faculty of Law, University of Rome Tor Vergata; Partner at Freshfields Bruckhaus Deringer.

(ii) the company's creditors (art. 2394 of the ICC);
(iii) any company shareholder and/or any third party, directly damaged by the directors' improper management activity (art. 2395 of the ICC).

In particular, according to art. 2392, 1st para., of the ICC – which sets forth the scope and extent of the directors' liability – all directors have to fulfil their duties – as provided for by the law and the memorandum of association of the company – with the *«care required by the nature of their office and their specific responsibilities»*. In the event of a breach of the above mentioned duties, the directors shall be jointly and severally liable for any damages arising therefrom.[1]

However, according to art. 2392, 1st para., should the acts in breach of the directors' duties fall within the powers delegated to the executive directors, the non-executive directors [who have not participated in the execution of such acts] would not be held jointly and severally liable with the executive directors. Notwithstanding the above, according to art. 2392, 2nd para., of the ICC, the non-executive directors who – being aware of acts detrimental to the company – did not act in the appropriate manner in order to avoid the execution of such acts or to eliminate or reduce the detrimental consequences thereof, shall be jointly and severally liable with the executive directors.

The Reform has eliminated the express reference – which was previously contained in art. 2392 of the ICC – to the non-executive directors' general duty to supervise the company's overall management and to undertake – if and to the extent necessary – any such actions as might be required to protect the company's interest and assets.[2] Notwithstanding the lack of a specific reference to the duty to supervise the company's overall management, as of today, scholars have taken the following positions:

(i) Following the Reform, the non-executive directors' general duty to supervise the company's overall management has been replaced by the specific duties of supervision set forth under art. 2381 of the ICC (see para. 7 above), namely: (a) the duty to assess – on the basis of the information received by the executive directors – the appropriateness of the organisational, administrative and accounting structure of the company; (b) the duty to examine the strategic industrial and financial plans of the company, if available; and (c) the duty to evaluate – on the basis of the

1 In any event, according to art. 2392, last paragraph, of the ICC, any director who is exempt from fault and who had his/her dissent recorded without delay in the book of the minutes of the board of directors' meetings and who gave notice in writing of such dissent to the chairman of the board of statutory auditors, cannot be held liable for the acts and the omissions of the other directors.

2 Prior to the entry into force of the Reform, art. 2392 of the ICC stated that «In any case, directors are jointly liable, if they do not supervise the management activity of the company [omissis]».

reports made by the executive directors – the overall management of the company[3]; and

(ii) Following the Reform, the non-executive directors' general duty to supervise the company's overall management is still applicable, since the Reform was only intended to prevent non-executive directors' liability from becoming strict liability for any decision/action taken by the executive directors, but not to exclude non-executive directors' liability for negligence (*i. e.* for lack of supervision).[4]

II. Directors' Conflicts of Interest

The ICC gives great importance to situations of conflicts of interests in its rules on the decision-making process in the shareholders' meeting (art. 2373) and the board of directors (art. 2391). It provides rules which are based on the common principle of not allowing resolutions to be passed when the decisive vote was expressed by persons having conflicting interests with the company. Therefore, generally speaking, it can be said that conflicts of interests in joint stock companies constitute a limit to the majority voting system, whereby the arguments of the majority are imposed on the dissenting minority.

In other words, the majority's power to bind absentees and dissentors is conditional upon the fact that the process which gave rise to the decision was in compliance with the law and the articles of association. However, such process is deemed not to be in compliance both when there is a breach of the procedure by which the resolution is approved, and also in cases in which the majority has decided to approve a resolution on the basis of *«extra-corporate»* interests. On the other hand, the solution to *«inter-corporate»* conflicts, *i. e.* the different judgements that the shareholders or directors may make in relation to such corporate interests, is subject to the majority voting system.[5]

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3 See C. Granelli, La responsabilità civile degli organi di gestione alla luce della riforma delle società di capitali, in: Le Società, 12, 2003, p. 1568. In particular, according to this Scholar, under the Reform, the non-executive directors are, in principle, entitled to rely on the information received by the executive directors. However, because of the general duty to act in an informed manner, non-executive directors would still have to ask the executive directors to provide any additional information required to supplement the information/plans already provided by the executive directors, should uncertainty exist in relation to the completeness/correctness of such information/plans.

4 See S. Ambrosini, Appunti in tema di amministrazione e controlli nella riforma delle società, in: Le Società, 2003, 2bis, p. 356.

5 On this point see Ferro-Luzzi, La conformità delle deliberazioni assembleari alla legge e all'atto costitutivo, Milan 1993, p. 163 et seq.; R. Lener, L'invalidità delle deliberazioni, in: R. Lener/A. Tucci, L'assemblea nelle società di capitali, Turin 2000, p. 230 et seq. More recently, Salanitro, Gli interessi degli amministratori nelle società di capitali, Milan 2003, p. 47.

These are the principles which are common to the rules on the conflicts of interests in the shareholders' meeting and the board of directors.

The various rules laid down for the approval of resolutions by the two company organs are, on the contrary, an expression of the substantive difference between the position of the directors and of the shareholders in relation to the decisions of the organs of which they are a part. In fact, shareholders pursue their own economic interests when voting, while the directors are managing interests which are not their own. The logical consequence is that while shareholders are allowed to exercise their voting rights to achieve their personal interests (including those of an extra-corporate nature) – provided that this does not expose the company to the risk of damages, directors always have to vote in the exclusive interests of the company, thereby abstaining from any decisions in which they have interests, either their own or on behalf of third parties, which conflict with those of the company.[6]

III. The previous rules

This was clearly the case, prior to the recent company law reform. Both art. 2373 and 2391 appeared to provide for a prohibition on voting for shareholders and directors with conflicting interests. Pursuant to art. 2373, para. 1 (before the reform), in fact, «shareholders may not vote in relation to resolutions where they have conflicting interests, either of their own or on behalf of third parties, with those of the company».

Art. 2391, para. 1 (before the reform) has a virtually identical content: «directors having an interest in a certain transaction, whether of their own or on behalf of third parties, which may conflict with the interests of the company, shall inform the other directors and the board of statutory auditors and shall refrain from the decision-making process on such transaction».

The punishment for breaching such prohibition was, however, different in the two cases. In fact, the legislator merely provided that any resolution adopted due to the decisive vote of a shareholder with a conflict of interests could be annulled if it were held to be potentially damaging for the company. This was a clear contradiction of the voting prohibition provided under para. 1, since breaches of the (alleged) prohibition were not automatically

6 Thus, as rightly stated by Jaeger, L'interesse sociale, Milan 1964, p. 216 («unlike the shareholders, directors have no power to pursue extra-corporate interests»).

punished, but were merely considered to be one of the factors which could combine to make the resolution annullable.[7]

On the contrary, breaches of the voting prohibition in cases of conflicts of interests were automatically (and severely) punished by the rules governing the board of directors under art. 2631, which imposed a fine on «directors having interests in certain transactions, whether of their own or on behalf of third parties, which may conflict with those of the company» who failed to refrain from «the decision-making process of the board or the executive committee in relation to such transaction». Moreover, if the transaction gave rise to detrimental effects for the company, this constituted an aggravating circumstance which, in addition to the fine, was punished by imprisonment for up to three years.

The rules of directors' conflicts of interests were apparently very rigorous, which is consistent with the fact that directors handle interests which are not their own and that, therefore, they have a duty to behave in a loyal and diligent manner when performing their tasks. Consequently, they are not only prohibited from pursuing their own personal interests to the detriment of the company's interests, but they also have a duty to pursue *exclusively* the company's interests.[8]

Moreover, although under *ius commune* the agent merely has to inform the principal of any conflicts of interests, thereby leaving the principal to decide whether the transaction should be allowed (art. 1395, civil code), the presence of an corporate internal structure severs the link between the individual shareholders and the directors, since the latter are not the formers' «agents», but have a «function» which has to be carried out in the common interest of all the shareholders (or, if you like, in the interests of the company). This is, therefore, a «fiduciary relationship with no principal», which is why they have to refrain from voting in the event of a conflict of interests.[9] The conflict of interest rules laid down by the civil code are intended to facilitate the burden of proof in relation to damaging transactions effected by the director with a conflicting interest. In fact, although it may be agreed that directors – unlike

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7 Thus, the 2003 reform rightly removed the ambiguous reference to the voting prohibition contained in the now-repealed para. 1 from the wording of art. 2373. For this interpretation of the system even before the reform, see Gambino, Il principio di correttezza nell'ordinamento delle società per azioni, Milan 1987, p. 257; Ferrara/Corsi, Gli imprenditori e le società, Turin 1999, p. 528; Sena, Il voto nell'assemblea delle società per azioni, Milan 1961, p. 388 et seq.

8 With regard to the difference in the shareholders' and the directors' positions, see, *inter alia*, Jaeger (note 6), p. 213 et seq.; Gambino, Il principio di correttezza nell'ordinamento delle società per azioni, Milan 1986, p. 222, note 104.

9 See G. Visentini, La disciplina del conflitto d'interessi nel mercato mobiliare, Milan 2002, p. 477.

shareholders – have a duty to pursue the company's interests, it is not at all easy to define in concrete terms the contents of such duty, since it is very difficult to find a unanimous opinion on the concept of corporate interests.[10]

In second place, legal academics and case law agree that the director's business decisions cannot be challenged on their merits, since the choice of the means and timing required to achieve the corporate purpose is at the directors' discretion and no assessment of whether or not such choice was appropriate or not may not be subsequently carried out (*business judgment rule*).[11] There have been many judgments, such as, for example, that by the Supreme Court on 28 April 1997, no. 3652, in *Società*, 1997, p. 1389, which states:

> «Company directors cannot be held liable, pursuant to article 2392 ICC for choices which are inappropriate from an economic point of view, since such assessments fall under the concept of business judgments and may, therefore, be invoked as a just cause for revoking the director in question, but not as a source of contractual liability *vis-à-vis* the company. Consequently, any judgment on the director's diligence in carrying out his/her mandate can never regard the latter's management choices (or the manner or circumstances of such choices), but may only concern the omission of any such precautions, inquiries or prior information as is usually required for a choice of that kind, taken in such circumstances and in such a manner».

Therefore, it would be excessively difficult, without the rules contained in art. 2391, to establish whether a director had, in carrying out a certain transaction which has proved detrimental to the company, breached his/her duty to pursue the company's interests or whether he/she had chosen an inappropriate, but unchallengeable, means to achieve such interests.[12] Appropriately, art. 2391 does not provide for a general punishment for breaching the duty to pursue the company's interests, but provides that directors are under an obligation to compensate any damages they have caused to the company by virtue of their personal interest in a certain transaction. The case has clearly been simplified and the claimant only has to prove:

(i) that the director has a personal interest – even on behalf of a third party – in such transaction;
(ii) the damage suffered by the company, even that of loss of profits[13];
(iii) the causal link between the conduct of the director concerned and the damage suffered by the company

and not

(iv) any corporate interest in the transaction in question.

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10 On the many concepts of «corporate interests» see Preite, Abuso di maggioranza e conflitto di interessi del socio nelle società per azioni, Milan 1993.

11 For an overview of the case law on this point, see Quatraro/Picone, La responsabilità di amministratori, sindaci, direttori generali e liquidatori di società, Milan 1998, p. 236 et seq.

12 Cf. Bonelli, La responsabilità degli amministratori, Milan 1994, p. 374.

13 Notwithstanding the literal meaning of art. 2391, para. 2 (previous Civil Code), which refers to «losses» suffered by the company. On the new wording of the provision see note 26 below.

For an application of these rules, see the Supreme Court judgment of 4 April 1998, no. 3483, in *Giust. civ.*, 1999, p. 1809:

> «For the purposes of establishing whether directors are liable as a result of voting in relation to a resolution concerning a transaction which conflicts with the company's interests, such transaction merely has to show some sort of benefit for the counterparty in which the aforementioned directors have an interest. An assessment of the management choices and the reasons which induced the directors to carry out such transaction is of no importance, since when there is a conflict of interests the liability arises from the actual deed itself, which is unlawful as it was effected in breach of precise general and specific principles of conduct and by the damaging nature of the management choice. The merits of such choice are, however, of no importance whatsoever».

Therefore, the mainstay of the rules on directors' conflicts of interests – as regulated by the 1942 Civil Code – is that a situation of conflict has to be verified on a case by case basis, by judging whether the director has a personal interest in a certain transaction and whether the circumstances under which the transaction was carried out could damage the company. In other words, the rules contained in art. 2391 (previous Civil Code) do not take abstract cases of conflict into consideration – such as, for example, the nature of the counterparty or of the director even of other companies involved in the transaction in question – but require a case by case examination of *particular transactions*.[14]

IV. Gaps in the Civil Code

Although this reconstruction of the previous system is valid, it has to be said that it actually brought about a decisive scaling down of the ban on directors pursuing extra-corporate interests even before the abrogation of art. 2631, with the ensuing decriminalisation of voting in cases of conflicts of interests.[15]

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14 Also see, Supreme Court, 13 February 1992, n. 1759, in: Società, 1992, p. 794 et seq.; Supreme Court, 26 February 1990, n. 1439, in: Foro it., 1990, I, c. 1174 et seq.; App. Milano, 11 July 1991, in: Società, 1991, p. 1664 et seq. Legal academics: see Bonelli, Gli amministratori di società per azioni, Milan 1985, p. 224 et seq.

15 The reference is to Legislative Decree of 11 April 2002, no. 61, which reformed the codified rules of corporate criminal law. Unlike the abrogated art. 2631, the new offence of *infedeltà patrimoniale* [economic disloyalty] (art. 2634) does not consider the mere vote by directors with a conflict of interests to be a crime. The abrogated rules correctly provided that an essential condition for the occurrence of criminal liability was that the vote be exercised *in conflict with the company's interests*. There was no liability in cases in which the director had sacrificed its personal interests in the name of the company's interests by voting in conformity with the company's interests (see, for example, Supreme Court [criminal division] judgment, 25 February 1959, in: Foro it., 1960, II, c. 9). This is the meaning of the expression «prohibition on voting» for directors with conflicting interests.

In fact, the need to assess whether an area of conflict exists on a case by case basis excludes from the scope of application of art. 2391 all cases in which directors have a personal interest which is not incompatible with the company's interests or in which the achievement of such interest is not detrimental to the company. In terms of «living law», therefore, the danger of actual damages has thus become a requirement and not an aggravating circumstance which only has to be verified for the purposes of annulling the decision and of the tortuous liability of the director.[16]

Although the literal meaning of the provisions would appear to provide for a prior assessment as to whether there is a *situation of conflict*, in practice such provisions invariably led to a subsequent assessment based on the effective contents of the resolution, which was intended to verify whether the transaction was in the interests of the company or whether it was in conflict with the company's interest *in that* it was potentially damaging.[17] Finally, the abrogated rules did not regulate cases of conflicts of interests concerning managing directors and sole directors, to whom the provisions of art. 2391 were definitely not applicable – at least not directly – since, as we saw, they regulated the decision-making process of collegial organs.[18]

V. The reform of company law

The introduction of new provisions to the civil code is intended to move the emphasis from the prohibition on carrying out transactions in situations of conflicting interests to the requirement to disclose any interests a director[19] may have in relation to any given transaction. This emerges even in the new wording of the title of the provision in question, which now considers «directors' interests», instead of (merely) «conflicts of interests». Therefore, direc-

16 See G. Visentini (note 9), p. 482 et seq.; Denozza, Rules vs. Standards nella disciplina dei gruppi: l'inefficienza delle compensazioni «virtuali», Milan 2000, p. 327 et seq.

17 The point is well explained by Maffeis, Il nuovo conflitto di interessi degli amministratori di società per azioni e di società a responsabilità limitata: (alcune) prime osservazioni, Milan 2003, p. 521–522.

18 The prevailing theory is that in such cases article 1394, which regulates agency relationships, would have been applicable. Please see, for example, Supreme Court, 1 February 1992, n. 1089, in: Foro it., 1992, I, p. 2139; Court of Catania, 9 September 1999, in: Riv. dir. comm., 2001, II, p. 37.

19 The rule contained in art. 2391 is also applicable to the management board, within a dual system of management and supervision and, in such case, even the supervisory board may challenge the decision (art. 2409^{undecies}, para. 2). Within a monistic system, on the other hand, the law does not expressly refer to art. 2391 for the members of the management supervisory committee, provided by art. 2409^{octiesdecies}, such persons are also members of the board of directors to whom the rules at hand are directly applicable pursuant to art. 2409^{noviesdecies}.

tors have a duty to disclose not only any situations which make their position *incompatible* with the company's interest – as was provided under the previous rules –, but also any situations in which they have a personal *interest,* even if such interest is *compatible* with that of the company.

The importance of the disclosure requirements is also revealed by the detailed description of the contents of the information which the director is required to provide. In fact, art. 2391, para. 1, provides that directors must inform the other directors and the members of the statutory board of «any interest they may have, of their own or on behalf of third parties, in a particular company transaction. They shall specify the nature, the time limits, the origin and the scope of such interest».[20] Such detailed information is required for the subsequent decision by the collegial organ, which will have to «justify the reasons and the advantage for the company of the transaction in an adequate manner».

Finally, the fundamental importance of the requirement that the directors' interests be transparent in relation to the decision-making process emerges from para. 3 of art. 2391, which provides that the board's decision may be challenged for the mere breach of the disclosure requirements laid down by the preceding paragraphs, provided that there is a risk of damages for the company.[21] In addition to the other directors, and the board of statutory auditors[22], even the interested director is entitled to challenge the board's decision.[23] Therefore, the latter is allowed to take measures to eliminate or reduce

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20 More far-reaching disclosure rules for «suspicious» transactions were introduced for listed companies by art. 150, T. U. F., in relation to directors' disclosure requirements vis-à-vis the board of statutory auditors. On this point, see CAVALLI, sub article, in: Commentary, Milan 2002, p. 1250, who correctly states that transactions «with potential conflicts of interests» have to be disclosed regardless of how important they are. Following the issue of the «corrective decree» (Leg. Dec. 6 February 2004, no. 37), art. 150, T. U. F., has been reworded and brought into line with the company law reform. The new first paragraph now specifies that directors shall, in particular, «report transactions in which they have an interest, of their own or on behalf of third parties or which are influenced by the entity exercising direction and coordination activities».

21 Actually, this last provision risks scaling down the innovative scope of the rule set forth by para. 1, in that it would appear to deprive of sanctions any breach of the disclosure requirement in relation to situations in which directors have personal interests which are not, however, in conflict with the company's interests, due to the fact that there is no danger of damages.

22 The new wording of art. 2391 appropriately replaces the reference to «statutory auditors» contained in the old rules with the expression «board of statutory auditors», thereby endorsing the overwhelmingly prevailing interpretation according to which the individual members of the board of statutory auditors were not entitled to challenge the decision.

23 As are the individual shareholders, if the requirements set forth by art. 2388, para. 4 (i. e., detriment to their interest) are met. Under the previous rules, see Supreme Court, 28 March 1996, n. 2850 (1998), p. 343: «Resolutions of the board of directors may also be challenged by the shareholders, when they directly injure their rights».

the damaging consequences of his/her conduct, in light of a possible liability claim (see art. 2392, para. 2).[24]

The change in perspective compared to the abrogated rules is of considerable importance. The civil code of 1942 considered conflicts of interests to be pathological situations which were, on the whole, rare and had, consequently, adopted a merely repressive approach. In practice, however, situations in which one or more directors have extra-corporate interests in relation to a given transaction are anything but rare. Such situations occur, for example, in the case of groups of companies when the same people, all of whom have been chosen by the parent company, are members of the boards of directors of the various subsidiaries and a resolution has to be passed on infragroup transactions.

In these cases – but, in reality, also in general – it may be more advantageous for the company if the board of directors' decisions illustrate the reasons for a particular management choice, so as to allow a more penetrating subsequent control on the intrinsic rationality of any decision which may turn out to be detrimental to the company. In fact, a collegial examination of the actual situation, on the basis of the information provided by the interested director could induce the board to decide that the transaction is not only advantageous but also compatible with the company's interests. In the event that the decision subsequently turns out to be wrong, an explanation of the reasons which led the directors to pass the resolution may allow the decision-making process, but not the merits of the decision itself, to be examined by the Court in order to assess whether the directors decided to carry out the transaction in the reasonable belief that they were achieving the best interests of the company.[25]

Therefore, it is easy to see why art. 2391, para. 3, provides that the board's decisions may even be challenged just because the interested director failed to comply with his/her disclosure requirements or because the decision was not justified. In fact, the very directors which took part in passing the resolution – and the board of statutory auditors – could be interested in preventing a transaction which was decided upon in the absence of all the information required to make a prudent choice from taking place. When, however, such disclosure requirements have been fulfilled, the general rule on collegial decisions applies, whereby persons whose vote contributed to the formation of the resolution are not entitled to challenge such decision. In fact, the last part

24 On this point, there has been appropriate talk of a sort of «voluntary disclosure» (U. Patroni Griffi, sub art. 2391, in: Commentary, Milan 2003, p. 465).

25 On the contrary, the abrogated rules were easily avoided, since the mere abstention by the director in question was sufficient to make art. 2391 inapplicable and to rule out, as a matter of fact, any liability of the directors. On this point, see Salanitro (note 5), p. 48.

of art. 2391, para. 3 provides that «a challenge may not be lodged by any person who approved the resolution *if the disclosure requirements provided for by the first paragraph have been fulfilled*» (italics added).

Under the new changes to the law, it could appear that in theory the interested director is not prevented from taking part in the discussion or the vote during the board meeting. This is not only because we cannot rule out in advance that the director may actually vote in conflict with his/her personal interest and to the advantage of the company interest[26], but also because the completeness of the information and the reasons behind the decision could be deemed sufficient to safeguard the company's interests.[27]

However, the wording of the rule is not very clear on this point. In fact, pursuant to art. 2391, para. 3, decisions by the board may not only be challenged when the director's interest has not been fully disclosed or if adequate reasons have not been provided, but also when the board's (or the executive committee's) resolution has been approved *«with the decisive vote of the interested director»*, provided that there is a risk of damages to the company.[28]

Finally, the next paragraph provides that «directors are liable for damages suffered by the company as a result of their actions or omissions». It would appear, therefore, that the interested director – and not just the director «with a conflicting interest» – has a duty to provide detailed information as to his/her personal interest in relation a particular transaction, *and* to *refrain* from taking part in the voting – but not, it seems, the discussion – thereby leaving the task of deciding whether it would appropriate to effect a transaction which could benefit the director to the other members of the board, once they have carefully considered – even on the basis of the information provided by the interested director – whether such transaction would be worthwhile for the company.[29] Therefore, the new rules would appear to be more rigorous since board resolutions which were passed with the decisive vote of an interested director may be challenged regardless of whether such personal interest is compatible with the company interest or not.

In reality, that is not the case. In fact, breaches of the prohibition to vote have no legal consequences when the vote was not decisive for the approval of the resolution or when the latter is not potentially damaging. Although board resolutions may be challenged when they have been approved thanks

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26 See Salanitro (note 5), p. 48.

27 See, for example, U. Patroni Griffi (note 24), p. 464, who states «the new rule [...] does not provide that the interested director has a duty to abstain, even if he/she has a conflicting interest with that of the company».

28 The fact that this is an additional case of invalidity of resolutions is clear from the use of the conjunction «or».

29 However, the first academics to comment on the reform were of a different opinion. See, for example, Galgano, Il nuovo diritto societario, Padua 2003, p. 261; Salanitro (note 5), p. 51.

to the decisive vote of the interested director, but only if they are potentially damaging for the company, it is clear that the rules allow the interested director to vote in all cases in which his/her interest is compatible with that of the company, i. e. the transaction will not be in any way detrimental for the company.

In this case we have gone back to the interpretation adopted in practice under the old rules, at least as far as the rules on *conflicts of interests* are concerned, since the conclusions reached by case law and legal academics still have to be considered valid, especially with regard to the need to assess whether there is a conflict of interests on a *case by case* basis. On the contrary, the disclosure rules are innovative. They have replaced the «selective disclosure» rules (*i. e.*, only the *conflicting interests*) with «complete disclosure» rules (*i. e.*, all the directors' interests). It is the legislator's intention that this should constitute an impediment to transactions involving conflicts of interests.[30] Summing up our conclusions so far, we can say that:

(i) when a directors has a *personal interest* in a particular transaction, he/she has a duty to provide detailed information to the board;

(ii) once the interested director has provided such information, the board – with the participation of the interested director – is required to ponder the various interests involved;

(iii) if the board decides that the director's interest in a particular transaction is compatible with that of the company, it may allow the aforementioned director to vote for the adoption of the resolution;

(iv) if, on the other hand, the board decides that the director's interest in the *actual case in question is in conflict* with that of the company, the interested director will, *in theory*, have a duty to abstain. However, the resolution may not be challenged if it was adopted with the favourable votes of the «disinterested» directors alone or with the non-decisive vote of the interested director, provided that the disclosure and justification requirements have been complied with.[31]

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30 From a liability point of view, moreover, the new wording of art. 2391, para. 4 refers to the «damages» suffered by the company as a result of the transaction, rather than the «losses» referred to under the previous rules. In fact, in light of the new rules there can be no doubt that the compensatory obligation not only includes *actual damage*, but also *loss of profits*, in accordance with the general rules. Finally, the rules on liability are completed by the provisions contained in the last paragraph of art. 2391, which punishes the appropriation of corporate opportunities, establishing that directors are also liable for any damages suffered by the company as a result of their having used data, news or business opportunities of which they became aware during the course of their appointment for their own advantage or for that of third parties.

31 This does not mean that the disinterested directors cannot be held liable for transactions which subsequently turn out to be damaging, if the requirements set forth by art. 2392 are met.

With regard to the gaps in the abrogated rules, the last part of art. 2391, para. 1 provides that managing directors with a personal interest in a particular transaction shall – in addition to providing complete information in relation thereto, which is a general requirement for all directors – «refrain from effecting the transaction and shall entrust it to the collegial organ».

On the other hand, it is worth noting that, after the reform, the civil code now specifically mentions the cases in which management activities are carried out by sole directors with a conflict of interests with the company, providing that they have to inform the shareholders in the first general meeting (art. 2391, para. 1, last sentence).

Finally, according to the new provisions of art. 2391[bis] the directors of listed companies have to adopt internal rules granting sufficient disclosure of the operations with connected parties. Such rules must follow the general principles approved by Consob. The internal auditing committee has to control the correct application of these rules.

VI. Conflicts of interest and groups of companies

Groups of companies definitely provide a more delicate test for the rules on conflicts of interests. In fact, the boards of directors of the subsidiaries invariably contain people from the parent company who are chosen by the parent company and who, therefore, represent the interests of the controlling shareholder, which do not necessarily coincide with that of the shareholders as a whole.[32]

An analysis of this issue can only be based on the fact that, even after the recent reform, Italian company law still does not provide a legislative definition of groups of companies and a general, systematic set of rules in relation thereto. In principle, Italian law is based on an «atomistic» vision of joint stock companies, according to which the existence of economic ties between several companies does not prevent each entity from being considered as an independent centre of interests.

Neither the civil code, nor the special legislation ignore the phenomenon of *ties between companies*, and regulate some aspects of the relationships arising from this phenomenon, which constitutes a set, albeit fragmentary and unsystematic, of rules on some typical problems relating to groups of compa-

32 It is worth mentioning that there can be no conflict of interests when the parent company is the sole shareholder. The point is worth considering, since the most significant judgements on groups of companies (see below) concerned cases in which the parent company held the entire share capital of the subsidiary and so cannot, strictly speaking, be considered as «precedents» for conflicts of interests in groups of companies, if there are «external shareholders».

nies.[33] The reform of company law has also introduced *ad hoc* rules on «the direction and coordination of companies», under art. 2497–2497[sexies], which undoubtedly offer several points from which the issue may be revisited.

Although the rules have been changed, the interpretation can only be based on the principle general whereby directors have a duty to pursue exclusively the company's interests. As a result, directors of companies belonging to a group may not, in principle, sacrifice the company's interests for those of supposed «group interests» or for the exclusive interests of the parent company. However, it is the very concept of «sacrifice» or «detriment» to the interests of the individual companies belonging to the group which has registered the most significant evolution of case law. In fact, on the basis of the aforementioned general principles the courts have attempted to reconcile the rules on conflicts of interests contained in (former) art. 2391, ICC, with the phenomenon, which characterises groups of companies: the parent company's «unitary direction» of the group companies.

The leading case is Supreme Court judgement no. 1439 of 26 February 1990[34], in which the Court recognised that although the unitary direction within the group is not specifically regulated by law, its function is worthy of protection under the principle of freedom of contract (art. 1322, ICC) and does not breach any current mandatory company law rules. In particular, the Supreme Court has stated that «the requirement for the organs of operational companies to adhere to the more general group global and management choices, as outlined by the parent company's management organs, does not necessarily imply that the subsidiaries' interests are subordinated to external interests, since the group objective could be perfectly compatible with the interests of the individual subsidiaries».

With particular regard to the issue of conflicts of interests involving directors of subsidiaries, the Supreme Court has recognised that the requirement which has to be met if the rules set forth by art. 2391, ICC, are to apply is «not only that there is a potential conflict of interests, but that the conflict is effectively likely to be detrimental to the group company. The scope of the restriction on the management organ of the group company is, therefore, limited by the need to conform with the interests of the group company, since its directors have a duty to refrain from resolutions and policies which may damage the company itself».

The Supreme Court decided that the mere fact that a director of a subsidiary holds a management position in the parent company is not in itself sufficient to determine a conflict of interests. This is because, as we have seen, the

33 See, by way of example, art. 2359–2359[quinquies], civil code; art. 25–43 of legislative decree of 9 April 1991, no. 127; art. 60 et seq. of legislative decree of 1 September 1993, no. 385.

34 Published in: Foro it., 1990, I, c. 1174.

rules on conflicts of interests set forth by art. 2391, ICC do not apply to abstract cases, but require a case by case examination of *particular transactions*.[35] It is also necessary to establish the cases in which directors of the subsidiary have conflicting interests as a result of the positions they hold in the parent company. There has been considerable development in the case law of the Supreme Court since judgement no. 1439/90, especially with regard to the problem of whether there is such a thing as a «group interest».

To begin with, the Court held that the concepts of company interests and detriment pursuant to art. 2391, ICC, should be assessed in light of the statutory autonomy of the individual companies in the group, which the Italian legislator considers as autonomous centres of interests. Therefore, although the directors of each subsidiary may take into account the directions imparted by the parent company, they should refrain from executing resolutions and policies which may damage the *individual companies* they manage, since any advantages to the company which arise from being part of the group are entirely irrelevant.[36]

Although the Supreme Court's most recent position has maintained the principle whereby directors of subsidiaries may not sacrifice the interest of the individual companies for a supposedly higher group interest, it has clarified that the concept of *detriment* to the company has to be assessed differently when dealing with companies belonging to a group. This is due to the fact that because the individual company «is part of a larger aggregation which was created for objective needs of coordination and rationalization of the business activities, it often has advantages which offset any detrimental effects arising from other transactions».[37]

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35 On this point, it is worth noting that the same approach was adopted by the Bank of Italy in its Supervisory Instructions for banking groups, which provide that «in the case in which representatives of the parent company hold positions within other group companies, any transactions which are effected by and between companies of the group do not in themselves constitute situations of conflicts of interests which are subject to the rules set forth by article 136 of the consolidated banking law». Bank of Italy circular no. 229 of 21 April 1999, as subsequently amended, containing the *Istruzioni di Vigilanza per le banche*, tit. II, chap. 3, sect. II, para. 4. Legal academics sharing this position include Gambino, Responsabilità amministrativa nei gruppi societari, Milan 1993, p. 846.

36 The following judgements also reflect this position: Supreme Court, no. 1439/90, cit.; Supreme Court, 8 May 1991, no. 5123, in: Foro it., 1992, I, c. 817; Supreme Court, 13 February 1992, n. 1759, in: Società, 1992, p. 794 et seq.

37 Supreme Court, 11 March 1996, n. 2001, in: Foro it., 1996, I, c. 1222, which ruled out that the assignment of debts on a gratuitous basis by one company to another company belonging to the same group could be considered a donation. Along the same lines, see Supreme Court, 5 December 1998, n. 12 325, in: Giur. it., 1999, c. 2317. Legal academics who have supported the theory of «compensatory advantages» include Montalenti, Conflitto di interesse nei gruppi di società e teoria dei vantaggi compensativi, in: Giur. comm., 1995, I, p. 710 et seq.

The case law theory of «compensatory advantages» has, to a certain extent, been adopted by art. 2497, ICC, which regulates the liability of companies or entities which provide unitary direction for the shareholders of the subsidiaries and their creditors. The first paragraph provides for the conditions and limits of liability for negligent exercise of unitary direction and then states that «they shall not be held liable when the damages are lacking in light of the overall results of the direction and coordination activities or have been entirely eliminated, even by transactions specifically aimed at such elimination».

Naturally, it would be wrong to say that the new rules legitimise the sacrifice of the interest of the individual companies for the supposedly higher interests of the group. Nonetheless they suggest a more analytical approach to the issue of «damages» to the company – which, as we saw, is a requirement for the application of art. 2391 – which will have to be assessed – either before by the directors or after by the Court – while bearing in mind the «overall results» of the context of the activity in which each individual transaction takes place.

No doubt, this wording is intentionally generic and requires careful consideration by the board, in light of the new provisions of art. 2391, para. 1 and, especially, the disclosure and justification requirements. Such requirements are confirmed and further specified by art. 2497ter, which provides that «the decisions of companies which are subject to direction and coordination activities, when such activities influence such decisions, shall be justified in detail and include a precise indication of the reasons and the interests which influenced the decision. Such reasons and interests shall be accounted for in the report mentioned by art. 2428».

In fact, there can be no doubt that in all cases in which the board of directors of a group company has to decide on transactions which are in line with the «group policy», the provisions of art. 2391 will apply. However, in some cases, «minorities» may not be represented on the board of directors, as all the directors have been chosen by the parent company. In such cases, the only case in which the potential detrimental resolution may be annulled will be that in which an external shareholder manages to prove that it was «directly damaged» by it. Naturally, it may still claim compensation, even on the basis of the «new» liability action set forth by art. 2393bis.

VII. The liability arising from unitary management

Even though the ICC reform does not provide a systematic set of rules for corporate groups, it has tackled the most problematic issues, which may be summarised as follows:

(i) liability of the entity which exercises the management and coordination of companies;
(ii) reconciling the interests of the individual group companies, their «external» shareholders and the company creditors with the «group policy»;
(iii) transparency of the decision-making processes of the board of directors of the group companies;
(iv) disclosure of the membership of a corporate group;
(v) protection of shareholders in the event that a company enters or leaves the group.

With regard to the management of subsidiaries, art. 2497 states that «companies or entities which, while exercising management and coordination of companies, act in their own or another's business interests in breach of the principles of fair business and corporate management of these companies, are directly liable to their shareholders for any damage caused to the profitability or value of their stake in the company and to the company creditors for the loss suffered by the company capital». A few important conclusions may be drawn from the above mentioned provision. Such as:

(i) It is, in principle, lawful for the «holding company» (i. e., the entity which exercises the unitary management of the group) to interfere in the management of individual subsidiaries;
(ii) The holding company has a duty to exercise a fair unitary management. Therefore, the liability of the directors of the holding company and of the holding company itself for negligence «becomes» a contractual, rather than tortuous liability;
(iii) The directors of the subsidiaries have the power/duty to assess the fairness of the instructions received and to disregard any which do not comply with the principles of fair corporate or business management of the subsidiary.

The rules summarised above acknowledge the orientation developed, albeit not unanimously, by scholars and the Courts under the previous rules.[38] Recently, the Supreme Court has held that although the principle whereby the directors of a subsidiary may not sacrifice the interests of the company in the

38 In particular, the case law under the previous rules had already held that unitary management was in principle lawful [see (i) above]. Indeed, although the Courts constantly reasserted the fundamental principle of the «independence of the individual companies belonging to the group, as separate decision-making entities», they did not hesitate to recognise the worthiness of the interests arising from unitary management (pursuant to art. 1322, beginning of the first paragraph, ICC), due to the advantages which the individual subsidiaries may obtain from their membership of a corporate group, in terms of image, market reputation or ability to use common services and to have recourse to economy of scale. See Supreme Court, 26 February 1990, no. 1439, in: Giur. comm., 1991, II, p. 366 et seq., and, more recently, Supreme Court, 5 December 1998, no. 12 325, in: Giur. it., 1999, p. 2317.

name of an allegedly superior group interest remains unchanged, the concept of damages should be assessed differently in the event that the company belongs to a corporate group, in fact, in this case the individual company «often has advantages which compensate any detriment caused by other transactions, due to the fact that it is part of a larger group which was created to meet the objective need to coordinate and rationalise the business activity» (so-called theory of «compensatory advantages»).[39]

The «compensatory advantages» theory, which as we said above was subjected to penetrating criticisms by legal authors[40], has now been implicitly confirmed by the new art. 2634, ICC (on «disloyal financial management»), which punishes directors, general managers and receivors who have interest in conflict with the company interests and who, in order to obtain an unfair profit or another advantage, transfer or take part in activities aimed at transferring company assets, thus intentionally bringing about an «economic loss» to the company, with from three to six months imprisonment. The third paragraph of this article states that «in any case the profit of the affiliated company or the group is not unfair if it is compensated by advantages, whether actually obtained or reasonably foreseeable, arising from the affiliation or from the membership of the group».

The rule set forth in the new art. 2634, ICC[41] is a clear confirmation of an academic theory which, in its most «extreme» form, deems even the so-called

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39 See the Supreme Court decision dated 11 March 1996, no. 2001, in: Foro it., 1996, I, p. 1222, which excluded that the gratuitous assignment of credits from one company to another company of the same group could be interpreted as a donation. See also Supreme Court, 5 December 1998, no. 12 325, in: Giur. it., 1999, p. 2317, and Milan Court of Appeal, 30 March 2001, in: Banca Borsa Titoli di Credito, 2002, II, p. 200 et seq., in particular p. 216–217. The «compensatory advantages» theory was supported by Montalenti (note 37), p. 710 et seq., and in: Operazioni infragruppo e vantaggi compensativi: l'evoluzione giurisprudenziale, comment to Supreme Court no. 12 325/98, in: Giur. it., 1999, p. 2318 et seq.

40 See Denozza, Rules vs. Standards nella disciplina dei gruppi: l'inefficienza delle compensazioni «virtuali», in: Giur. comm., 2000, I, p. 327 et seq.

41 The rules contain some ambiguities, when (para. 3) provides that the affiliate's or the group's *profit* (and not the *damage*) shall be compensated by the *advantages* which arise from being part of the group. In order to give a meaning to this provision, we must assume that the legislator intended to exclude that the profit is unfair, if the damage caused to another group company by the transaction that produced the profit (for another affiliate or the group as a whole but not to the holding company) is compensated by the advantages to the company. See Abriani, Gruppi di società e criterio dei vantaggi compensativi nella riforma del diritto societario, in: Giur. comm., 2002, I, p. 618–619. A literal interpretation would lead to the affiliate's or the group's profit not being considered unfair if the transaction brought about or was capable of bringing about advantages to the company which suffered the damage. Therefore, a large profit would not be unfair it were compensated by a modest advantage to another company which was *seriously damaged* by the transaction. See, although this is a criticism, Sacchi, Conclusioni, at the: Tavola rotonda sui vantaggi compensativi nei gruppi, in: Giur. comm., 2002, I, p. 635.

hypothetical compensations lawful, i. e. compensating a current loss with advantages which have not as yet materialised, but which are only likely to happen. When applied as a criterion for the assessment of the directors' conduct, this theory provides clear guidelines for the Court, which shall assess whether the compensatory advantages exist from an economical and functional point of view rather than on the basis of a quantity evaluation. The assessment shall be carried out *ex post*, but on the basis of facts which were known at the time of the decision of the group transaction, in accordance with the well-known theory of the «posthumous prognosis».[42]

Confirmation of the aforementioned conclusions may be found in the last part of the new art. 2497, first paragraph, ICC, which excludes any liability arising from unitary management «when the loss is negligible when considered against the overall results of the management and coordination activity or when completed removed by specific transactions».

In this respect it should be pointed out that recently the Italian Supreme Court stated that as far as civil liability is concerned, the doctrine of the «compensatory advantages» requires that the advantages which compensate any detriment caused by other transactions to a subsidiary must be effective and not merely hypothetical.[43]

42 See Mucciarelli, Il ruolo dei «vantaggi compensativi» nell'economia del delitto di infedeltà patrimoniale degli amministratori, in: Giur. comm., 2002, I, p. 634.

43 See Supreme Court, 24 August 2004, no. 16 707, in: Giur. it., 2005, p. 69 et seq., at 71.