LEGAL INFORMATION NEWSLETTER

Nr. 6 December, 2009

We are pleased to provide you with the new issue of our legal information newsletter.

Topical legal questions are discussed and those related to issues that you might encounter.

We hope that you will find it of interest.

We would welcome any comment you might have.

AN OVERVIEW OF THE PROCESS OF FORMATION AND OPERATION OF BUSINESS ENTITIES IN ITALY

Legislative Decree N° 6/2003

INTRODUCTION – Since January 1, 2004, Italy has enacted new rules for company formation, start up, organization and administration.[1]

This reform has brought Italian company law into line with that of other most advanced countries, introducing simplifications and greater flexibility for corporate decision-making.

The new rules have replaced those that had been in place for 60 years.

The key element of the reform is self-regulation that allows companies vast powers to establish specific rules in their by-laws and articles of incorporation, without too many strict, pre-defined mandatory requirements.

Other examples of flexibility can be found in the many financial tools available as well as in the different corporate governance forms.

TYPES OF BUSINESS ENTITIES – Prospective foreign investors wanting to set up a business in Italy with a more permanent presence other than establishing a mere representative office or a branch may decide to incorporate a company.

By considering doing so, they will need to choose the most suitable organizational structure in accordance with the nature of their businesses.
Foreign investors are free to adopt any of the forms of business entities available to Italian citizens.

The type of entity chosen will largely depend on the strategy to be adopted, as well as on management, financial and taxation considerations.

Types of business associations may be classified in two categories created by the law, depending on the circumstance that they are organized on a stock capital basis ("*società di capitali*" or capital companies) or on a personal basis ("*società di persone*" or partnerships).

The difference between the two categories is that only the capital companies are regarded as having a legal entity entirely separate and distinct from the individuals who compose it, with the capacity of continuous existence or succession and having as capacity that of taking holding and conveying property.

A capital company's liability is normally limited to its assets and the stock or quota holders are protected against personal liability in connection with the business of the company.

There is an exception to the above distinction that is represented by a rarely used business association structure, the so called "*società in accomandita per azioni*" or Partnership Limited by Shares that is a form of company organized on a stock capital basis, where two category of shareholders exist:

Those who enjoy the shield of corporate privilege of this business association and do not respond on a personal basis for the obligations of the limited share partnership ("*soci accomandanti*") and those who are instead entrusted with the management of the company and are as well personally liable for the obligations ("*soci accomandatari*"). The main types of business associations provided for in the Civil Code are the following.

CAPITAL COMPANIES – Only the Corporation (S*ocietà per Azioni*) and the limited liability company (S*ocietà a Responsabilità Limitata*) possess full and separate legal identity.

Cajola & Associati
Via G. Rossini, 5
20122 Milan – Italy
Phone: +390276003305
Fax: +3902780177
E-mail: law@cajola.com
Web site : www.cajola.com

[1] Legislative Decree No. 6/2003

Foreign investors usually choose one of these two structures to minimise potential liability exposure. *Società per Azioni* and *Società a Responsabilità Limitata* may be deemed respectively close to the public and private companies in United Kingdom, as well as to the corporation and limited liability companies in the United States of America.

LIMITED LIABILITY COMPANY (*"Società a Responsabilità Limitata – S.r.l."*) – Small or medium-sized enterprises may adopt the Limited liability company form to run their businesses in Italy.

This form of business association - with a minimum capital contribution required of € 10,000[2] - enjoys a great degree of internal flexibility in terms of management and control that makes it attractive to closely held enterprises.

This flexibility leaves the stockholders free to develop their organizational structure and to some extent their own management rules and principles.

Stockholders are not personally liable for debts of a limited liability company, unless the following circumstances concur altogether:

1. Sole Stockholder Company
2. Insolvency of the company
3. Stock contributions have not been fully paid in, rules concerning payment of the stock or rules regarding duty of legal publicity have not been observed.[3]

In the above circumstances, the stockholder is personally liable for debt of the company.

The contribution of a stockholder may be cash, property and services as long as a contribution can be financially evaluated. Participation of a member is a quota that cannot be represented by shares.

CORPORATION ("*Società per Azioni – S.p.a.")* –
In a corporation, the capital holdings of members are represented by shares. The corporation has the same major features as the corporate form in most other countries.

A corporation is governed by the shareholders at the general meeting, by the directors and the board of statutory auditors. Its statutory regulation provides that circulation of corporate capital is a relevant factor in order to classify:

1. Companies without outstanding shares held by public investors (closely held corporations)
2. Companies with outstanding shares held by public investors, namely, companies issuing stock shares that are traded on regulated markets or circulating in the market on a relevant scale, that means circulating among Italian issuers with net capital not less than € 5 million and with a number of shareholders or bondholders greater than 200). Specific rules are provided for these public companies.[4]

There is a minimum capital contribution required of € 120,000.[5]

PARTNERSHIP LIMITED BY SHARES ("*Società in Accomandita per Azioni – S.a.p.a.")* – Very rarely used[6], this structure has the same features of limited partnerships and stock companies.

Their share capital consists of stocks and shareholders are divided into two groups: general partners, who manage the company and have unlimited, collective and contingent liability; and limited partners, whose exposure to debt is limited to the shares each underwrote, and who cannot carry out management activities within the company.

In case of plurality of directors, the appointment of a new director is subject to the approval of the other directors.[7]

PARNTERSHIPS – Partnerships are not legal entities distinct from its members, although they may acquire property and assume obligations in their own trade name. They are:

[1] Simple Society ("Società semplice")
Rarely used, the main feature of this business structure would be used for the exclusive purpose of non-commercial economic activities, such as for instance the management of small real estate property or agricultural activities.

[2] General Partnership *("Società in Nome Collettivo")*
The partners have unlimited liability for the partnership's obligations.[8] A general partnership may not have a corporate partner.

An SNC may transact business, acquire, hold property, sued and be sued in its own trade name.

It must operate under a business name that includes the name of one or more or the partners and indicates the partnership relationship. No minimum level of capital contribution is required, and contributions may be in the form of cash, property or services.

[2] Civile code, Article 2463.
[3] Civile code, Articles 2462 and 2464.
[4] Civil code, Article 2325bis and TUF.
[5] Civil code, Article 2327.
[6] Save for a noteworthy exception, that is "Giovanni Agnelli & C. S.a.p.a.", the holding company of "Fiat Group".
[7] Civil code, Article 2457.
[8] Civil code, Article 2291.

The consent of all partners is required for the transfer of a partnership interest.

Partnership profits and losses are distributed in proportion to each partner's contribution, unless otherwise stated in the partnership agreement.

Any stipulation in the partnership agreement limiting the extent of a partner's losses is void.

[3] Limited Partnership *("Società in Accomandita Semplice")*
A limited partnership must be composed of at least one partner with unlimited liability and at least one partner with liability limited to the extent of the partner's capital contribution.[9]

The partner with limited liability may not participate in a partnership management.

Several court decisions have held that a corporation may not be a partner in a partnership management.

A trade name of the partnership must include the name of at least one general partner and indicate that is a limited partnership.

Unless stated differently in the partnership agreement, the interest of a partner may be transferred only by the votes of partners representing a majority of the partnership's capital.

In general, provisions relating to general partnerships apply to limited partnerships as well.

[H] Joint Ventures
Several forms of joint ventures may operate in Italy.

Examples range from participating (unincorporated) associations to consortia for special purposes to the most flexible forms of temporary co-operation among enterprises joined by contract to carry out projects or deliver services.

The form involving temporary co-operation was recognized by a domestic statutory regulation that permits a non-equity unincorporated group of contractors to tender for public works through a group leader.

Members of joint ventures remain independently responsible for taxation, legal requirements and corporate obligations.

FORMATION OF CORPORATIONS AND LIMITED LIABILITY COMPANIES – Any name can be used as a name for a corporation or a limited liability company, even a name derived from fantasy, as long as the name includes the wording "Spa" for corporations and "Srl" for limited liability companies.

Particulars of those who subscribe the shares must be available to the public and kept up-to-date by registering issuance and subscriptions in the shareholders' book and communicating them to the Companies' Registry within 30 days.

Full name and address of the shareholders, the number of subscribed shares, their value and type shall be reported in the shareholders' book.

CORPORATE GOVERNANCE – The management of the company is exclusively the responsibility of the directors, who act as necessary to achieve the corporate purpose.

In a corporation, the management of the company can be entrusted to non-members while only members can manage a limited liability company, unless the articles of incorporation provide otherwise.[10]

In general, if the by-laws make no provision for the number of directors, but indicate only the minimum and maximum number, the number of them is determined by the shareholders' meeting.

When the by-laws or the shareholders' meeting provide for it, the board of directors may delegate its functions to an executive committee formed by its members.

Power of representation of Directors is of general character.

The limitations of the power of representation that the by-laws set forth, even when published, are not enforceable against third parties, unless it is proved that the third person acted intentionally to the detriment of the company.[11]

In limited liability companies, the by-laws may contain a provision that management is undertaken by a:

1. Sole Director
2. Board of directors, whose members exercise their actions jointly. In this case statutory rules regulating management of partnerships apply to limited liability companies.[12]

Therefore:

a. Unanimous consent of all the directors is required for company's actions
b. Single directors cannot carry out any action on their own, except when there is necessity to avoid damage to the company.

[9] Civil code, Article 2313.

[10] Civil code, Article 2475.
[11] Civil code, Article 2384.
[12] Civil code, Articles 2257 and 2258.

3. Board of directors, whose members may act individually. In this latter case:

a. Each director may exercise her/his office individually

b. The power to manage the company belongs to any stockholder with unlimited liability.

Certain company's actions (annual financial reports drafting, merger or de-merger plan and capital increase plan drafting) may only be exercised by the directors altogether, by way of majority quorum or the different quorum that the by-laws of the company may set forth.[13]

In limited liability companies, even if directors exercise their activity jointly, it cannot be said that the Board is a collective body.

In fact there may be a provision in the articles of incorporation of limited liability companies establishing that directors' resolutions must be adopted by way of written consultation or by way of express written consent (even via fax or e-mail if bearing signature).

GOVERNANCE IN CORPORATIONS – In corporations, different models of corporate governance may be adopted. By-laws may regulate more freely the internal organization of the board competent for management, its functioning, the circulation of information among its members and the members of the board of Auditors. If by-laws do not provide otherwise the model of corporate governance and control applied is still represented by the traditional system.

[1] Traditional System
The reference model is the traditional system (general shareholders' meeting, board of directors, executive committee, board of auditors and external auditing when required by law).

Under the new system, the accounting control previously attributed to the board of auditors is now attributed to an external auditor or an auditing company.

A provision of the civil code establishes that the office term for appointed directors is the same office term set of directors appointed by the time of their election.[14] In case of conflict of interest, the executive director shall refrain from undertaking operations and shall empower the board of directors for their enforcement.

If a resolution would have not been approved without the vote of the director in conflict of interest, such resolution may be challenged within 90 days, and, during this period of time operations, carried out with bona fide third parties are valid.

Directors and members of the board of auditors *"…must act with the same professionalism and diligence required by the nature of the action undertaken".*[15]

Such standard does not require directors to be necessarily experts on accounting, finance and any other sector of management and governance of the enterprise, rather it means that their decisions shall be informed and pondered, based on knowledge and on a calculated risk, and not on irresponsible and negligent improvisation.

[2] Dualistic System (German Tradition) - It may be established on by-laws that governance of the company is exercised by the management board, which is appointed by the supervisory board (with the exception of the first election resulting from the certificate of incorporation).

Management board can assign specific executive powers to one or more of its members.

Rules regulating relationship between board of Directors and the executive committee, and directors in general apply to this corporate model.

Management board cannot remain in office for more than three consecutive fiscal years. It may be however be confirmed and removed for "good cause" by the supervisory board.

The supervisory board, which exercises general supervision over activity of the company, is elected by the general shareholders' meeting (with the exception of the first election resulting from the certificate of incorporation).

Its membership has to be no less than three. Their office lasts three fiscal years.

The supervisory board exercises supervision over:

1. Compliance with legal and accounting rules and regulations
2. Corporate operations, reporting any unlawful act.

Moreover, once a year the board reports to the management board.

[3] Monistic System (British Tradition)
By-laws may set forth that a board of directors have the duty of corporate management, but a committee appointed internally will be appointed for the purpose of supervising the management.

[13] Civil code, Article 2473.
[14] Civil code, Article 2386.
[15] Civil code, Article 2704.

This system of governance must be explicitly set out in by-laws.

There is a close connection between the board of directors and the committee for supervision of the management, in fact only those who have been previously elected members of the board of directors may serve as members of the committee.

The board of directors set the number of members for the committee (not less than three, if the company solicits investment at large).

REGISTERED OFFICE – The articles of incorporation must just indicate the municipality where the registered office of the company is located.

However, information about its exact registered address must be given to the Companies' Register, as a service address.

AUDITORS IN CORPORATIONS – Only one out of the three or five of the effective members (and one of the supplemental members) of the internal board of auditors must be an auditor member of the roll of auditors; other members may be chosen among members of other professional categories or among professors in juridical or economical sciences.

According to the statutory provision of the civil code[16], the board of auditors exercises a control of law and By-laws regulation compliance and over principles of fair management. In other words its duty is to exercise administrative and legal control, while duty of control over accountancy, which characterized the activity of the board, has been eliminated.

Among other duties, members of the board of auditors have also to certify that a bond issuance does not override legal limitation.[17]

Supervision over accounting has to be exercised by an external auditor, who cannot be member of the board of auditors.

His/her appointment may be mentioned in the certificate of incorporation or he/she may be elected by the general shareholders' meeting.

The auditor is elected by the general shareholders' meeting, takes his/her office for three years and may be removed only for "good cause". His/her activity of control consists in:

1. Drafting a specific auditing report
2. Communicating to the supervisory board about the existence of any fact deemed to be blamed.

The auditors are required to:

1. Verify quarterly during the fiscal year regularity of accounting and fairness of accounting methods applied
2. Express with specific report an opinion over the annual balance sheet and the consolidated balance sheet
3. Document the activity carried out on a specific book as provided by statutory regulation on mandatory bookkeeping.

The auditing activity is in conflict with the office of member of the supervisory board of:

1. The company
2. Controlling/controlled companies

and with other activities listed in the relevant provisions of civil code.[18]

AUDITORS IN LIMITED LIABILITY COMPANIES - In a limited liability company, an external auditor and the internal board of auditors exercise accounting supervision.

Election of the board of auditors is mandatory whenever:

1.The stated capital of the company is in the amount equal or superior to the minimum amount (€120,000) of stated capital required for corporations
2. Thresholds set forth in civil code, article 2435bis, allowing a company to file simplified annual financial reports are exceeded for two consecutive years.[19]

If the above thresholds have not been exceeded for two consecutive fiscal years the company is not compelled to maintain the board of auditors.

Rules of the civil code regulating election and functioning of the board of auditors of corporations apply to limited liability companies as well.

PROCESS FOR FORMATION OF CORPORATIONS - The articles of incorporations must be executed in the form of public deed through the assistance of a public notary.

Among other information, the articles of incorporation shall state the trade name of the company, the particulars about shareholders, the municipality where the registered office of the corporation is located, the corporate purpose and the amount of stated capital.
The minimum amount required has been raised to € 120,000.

[16] Civil code, Article 2403.
[17] Civil code, Article 2412.
[18] Civil code, Articles 2399 and 2409*quinques*.
[19] Civil code, Article 2477.

The rules of corporate governance adopted, number of directors and their powers, specifying who has the capacity of legally representing the company and the duration of the company must be recorded as well.

As a condition of the incorporation, shareholders must subscribe the entire stated capital. Shareholders shall pay upon subscription at least 25% of the stated capita (if there is a sole shareholder, deposit of the stated capital as a whole is required).

The term for restitution to the company of the percentage deposited in the bank for subscription of the shares has been reduced to 90 days.

If the shares have not been entirely paid in, it is not possible for the company to increase its stated capital.

As a further condition for the incorporation, it is necessary to obtain the relevant governmental authorizations that the specific business purpose of the corporation may require.

For instance, in order to exercise their business activities banking and insurance corporations must be previously authorized to operate in those areas of business.

Once the articles of incorporation have been executed and the above conditions fulfilled, the law requires the public notary to file within 20 days this document coupled with the by-laws with the Companies' Register, along with the documentation evidencing the payment of the 25% of the stated capital, the eventual sworn auditing report about the appraisal value of credits and assets conferred as capital contribution and the eventual governmental authorizations required.

It is duty of the notary to verify that requirements imposed by the law for the application to the Companies' Register are observed.

SOLE SHAREHOLDER CORPORATION - A unilateral certificate is necessary for its incorporation.

The sole shareholder has to pay the entire stated capital.

The same rule applies whenever a shareholder of a corporation with more than a single shareholder takes over the other shareholders' stock not yet paid in (in this case the sole shareholder gets 30 days for compliance).
In case of concurrent capital increase the outstanding amount must be corresponded forthwith.
The rule requiring disclosure about ownership by a sole shareholder on company's literature and letterheads, which has been enforced for limited liability companies, does not apply to corporations.

Contracts entered by the company and the sole shareholder and operations to the benefit of the latter are not enforceable against creditors, unless there is mention of them on either the board of directors' meeting book or a writing with date certain and precedent to eventual distraint.

The sole shareholder remains liable up to an amount equal to the capital subscribed and paid in, with the following exceptions:

1.Insolvency of the company
2.Stated capital not entirely paid in
3. Publicity requirement not fulfilled.

PROCESS FOR FORMATION OF LIMITED LIABILITY COMPANIES – As well as for corporations, the articles of incorporations must be executed in the form of public deed through the assistance of a public notary.

The articles of incorporation shall state - among other information - the trade name of the company, the particulars about shareholders, the municipality where the registered office of the corporation is located, the corporate purpose and the amount of stated capital. the following information. The minimum amount required is € 10,000.

The rules of corporate governance adopted, number of directors and their powers, shall be stated as well.

The same rules concerning the entire subscription of the stated capital, the payment of the 25% of the stated capital and the eventual contributions in kind apply.

Differently from corporations' contribution of a quota-holder may be also intellectual property and labor services as long as the contribution may be economically appraised.

As far as the enrolment in the Companies' Register is concerned, the same provisions described above for a corporation apply to limited liability companies.

Article contributed by Riccardo G. Cajola