Cajola & Associati
Law offices - founded in 1966

LEGAL INFORMATION NEWSLETTER

No. 2 March, 2011

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.

Overview About the Statutory Regulation of Limited Liability Companies (S.R.L. - *Società a Responsabilità Limitata*)

Civil Code, Articles 2462-2483
Act N° 366/01
Legislative Decree N° 6/03

INTRODUCTION – This form of business association enjoys a great degree of internal flexibility in terms of management and control that makes it attractive to closely held enterprises. The stockholders are free to develop their organizational structure and to some extent their own management rules and principles.

GENERAL RULES – A minimum stock capital of € 10,000 is required to incorporate a *società a responsabilità limitata*.

Stockholders are not personally liable for debt of the Limited Liability Company, unless the following circumstances concur altogether:

- Sole Stockholder Company
- Insolvency of the company
- Stock contributions have not been entirely paid in, rules concerning payment of the stock or rules regarding duty of legal publicity have not been observed.

Occurring the above circumstances, the stockholder is personally liable for debts of the company.

FORMATION – Filing articles of organization of limited liability company drafted in the form of public deed before a public notary is mandatory.

Besides usual information (name of company, name of stockholders, stated capital etc.), the articles of organization must include information about its management, including powers of attorney and eventual attributions of powers among its stockholders.

It is further required to report the municipalities where the registered office and secondary offices are located.

Incorporated business associations are now allowed to be stockholders of a Limited Liability Company.

CONTRIBUTIONS - Contribution of a stockholder may be cash, property and services as long as a contribution may be economically valuated.

Upon execution of the articles of organization, stockholders must deposit at least 25% of their contribution with a bank institution (if there is a sole stockholder, he must deposit forthwith its contribution as a whole).

Contributions through insurance bill or bank guarantee for an amount equal to the capital contribution are now allowed.

In order to estimate a contribution (e.g. contribution of services), an auditor's or an auditing company's report is required.

The auditor or the auditing company remain liable to stockholders, creditors and third parties for statements in the report.

An estimating report is also required in case the company purchases credits or goods for an amount equal to 10% of the stated capital within two years from company's filing with the Companies Registry.

In this case directors and sellers are liable for eventual damages to stockholders, creditors or third parties.

Should a stockholder fail to make his required capital contribution within the required term:

- Directors invite the stockholder to comply within 30 days
- Upon expiration of the above term, directors may alternatively (1) sell the stock of the insolvent stockholder to the other stockholders proportionally to the stake of stock they own;

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

(2) in case stockholders do not buy the stock of the insolvent stockholder, the stock may be sold through auction; (3) if the auction fails, directors may oust the stockholder keeping his contribution for subscription to the benefit of the company, and if they do so they have to redeem and cancel his stock, reducing the stated capital of the company accordingly.

FINANCING BETWEEN STOCKHOLDERS AND THE COMPANY – A distinction has to be made between credit financing and capital financing (e.g. loans bearing no interest, or no repayment term, which are substantially capital contribution).

The following statutory definition classifies capital contribution: financing that stockholders granted during a period of time when, considering the kind of business activity that the company carries on, there is an excessive unbalance between company's debt and its asset capital (undercapitalization) or whenever a capital contribution would be reasonable.

In this case, repayment of stockholder financing to the company is subject to prior repayment of other creditors and, if made the year before the company filed for bankruptcy shall be repaid.

The balance sheet shall report eventual loans made by the Company to its stockholders.

STOCK OF THE COMPANY - The stake of a stockholder is a quota that cannot be:

- Represented by shares
- Object of investment soliciting.

Unless otherwise provided in the Bylaws rights of stockholders are proportional to the stock they own.

ASSIGNMENT OF STOCK INTEREST - Stockholders (or their heirs) get rights of appraisal if assignment of the stock has been conditioned to:

- Acceptance by management, stockholders, or third parties
- Particular conditions or limitations preventing inheritance.

Appraisal rights cannot be exercised for two years from the date of formation of the company

Upon its record in the Shareholders' book, the assignment of capital stock is enforceable against the company.

When the deed of assignment of the stock (with authenticated signature):

- Has been filed with the Companies Registry; and
- After 30 days of its filing it has been recorded in the Shareholders' book upon request of either the seller or the buyer,

the assignment is enforceable against third parties.

Even if the same stake has been sold several times, the first in good faith that records the assignment with the Companies Registry gets good title to its property, no matter when the assignment has been made.

If the stake of a sole stockholder is assigned, the assignment record must be filed with the Companies Registry within 30 days from its entry in the Stockholders' book, along with a statement by the sole stockholder about her/his personal particulars.

If other stockholders join the company, a specific mention must be filed with the Companies Registry.
Any attachment or distraint of stock is enforced through:

- formal notice to the debtor and to the company; and
- its record with the Companies Registry.

STOCKHOLDER WITHDRAWAL - The certificate of limited liability company set forth when and how a stockholder may withdraw from the company.

The stockholder may withdraw at any time when she/he has dissented to anyone of the following company's resolutions:

- Modification of corporate purpose
- Modification of the form of business association (e.g. from limited liability company to corporation).
- Revocation of winding up procedure
- Merger or de-merger
- Transfer of the registered office of the company abroad
- Abolition of one or more causes for withdrawing that the company's Certificate sets forth
- Undertaking of company's action that involves a substantial modification of the company's purpose as stated in the company's articles of organization
- Relevant modification of the rights of stockholders, regarding distribution of dividends or management and control.

The withdrawal cannot be exercised, and if exercised has no effect, in two cases:

- If the resolution that give rise to the right of appraisal has been revoked

- If a resolution for winding up of the company has been adopted.

The value of the stock must be calculated proportionally with the fraction of the stated capital owned and must be determined on the market value of the stake when the appraisal right has been exercised.

In case of disagreement between the parties, the value of the stake must be determined by an expert appointed by the Tribunal.

Repayment has to be made within six months from notice to the company about withdrawal.

Withdrawal may be exercised through (a) purchase of the stake by other stockholders proportionally to the stock owned; (b) purchase by a third party chosen by agreement of the stockholders (c) repayment from company's reserves available or through reduction of the stated capital.

If the company is not able to repay the stockholder, the company must wind up. As above said, the value of the stock must be determined on its market value at the time the withdrawal has been exercised.

An estimate of the corporate assets has to be made, through a method that takes into account the following factors:

- Future perspectives for the company
- As to whether repayment determines or not the winding up of the company
- Eventual termination of business activity.

MANAGEMENT OF THE COMPANY - The Law Reform establishes a great degree of internal flexibility in terms of management and control.

Bylaws provide management rules for the company. Unless Bylaws provide otherwise, Directors must be stockholders as well. Limitations to their power to act set forth in the articles of organization are not enforceable against third parties, unless there is evidence that they acted intentionally for damaging the interest of the corporation.

The articles of organization may contain a provision that the management office is taken by a:

a) Single Director
b) Board of Directors, whose members exercise their actions jointly. In this case statutory rules regulating management of partnerships apply to Limited Liability Companies.

Therefore:

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

c) Board of Directors, whose members may act individually.

In this case:

- Each Director may exercise her/his office individually
- 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 Directors as a whole.

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 organization of Limited Liability Company 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).

The statutory provisions of consultancy and of written consent imply that an action is undertaken by a single Director and that resolutions are adopted without need of a meeting of the Board of Directors.

CONFLICT OF INTEREST – In case of Director's conflict of interest, it is possible:

- To claim that agreements undertaken by the Director in conflict with third parties are void, if the third party was aware or might be aware of the conflict
- For Directors to challenge those resolutions passed with the determinant vote of the Director in conflict of interest, within three months from the date the resolution was adopted.

Rights of third parties in good faith arising from business operations where a Director was in conflict of interest cannot be challenged.

Whenever Directors do not comply with their duties, they are jointly and severally liable to the company for damages occurred. Those Directors, who provide evidence about their dissent to the decision of the company or about lack of negligence or fault are not liable.

Shareholders who do not act as Directors shall be maintained informed about the business of the company. They have the right to inspect, even through

their professionals, company's books and documents relating to the management.

CLAIM AGAINST A DIRECTOR – Such a claim may be raised by single shareholders. The claim may be settled or withdrew, if shareholders representing 2/3 of the stated capital agree to do so and those of them representing 1/10 of the stated capital do not object to.

The claim against Director do not prevent shareholders or third parties damaged by the company's action from claiming themselves damages.

Approval of the annual financial reports do not clear Directors and Auditors from their responsibility.

Those shareholders who have intentionally decided or authorized company's actions that harmed the company, its shareholders or third parties, share joint and several liability with Directors and Auditors responsible for such actions.

ACCOUNTING SUPERVISION - An external Auditor and the internal Board of Auditors exercise accounting supervision. Civil Code Article 2477 provides that election of the Board of Auditors is mandatory whenever:

- The stated capital of the company is in the amount equal or superior to the minimum amount (€120,000.00) of stated capital required for corporations (S.P.A.)
- Thresholds* set forth in Civil Code, Article 2435bis, allowing a company to file simplified annual financial reports are exceeded for two consecutive years.

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.

COMPANY'S BOOKKEEPING AND ANNUAL BALANCE SHEET - The Notary must certify each book. Besides the accounting book which are required by law, the following books are mandatory:

- Stockholders' Book
- Book of Stockholders' Decisions (reporting minutes of the meetings, stockholders' resolutions on matter of their competence or raised by Directors or by stockholders representing 1/3 of the stated capital, and decisions adopted through consultation or written consent by directors)
- Book of Directors' Decisions
- Book of Decisions of the Board of Auditors or the Auditor

Rules of the Civil Code regulating balance sheet reporting duties of corporations (S.P.A.) apply to Limited Liability Companies as well. Shareholders approve the balance sheet and decide about dividend distribution. Only earnings achieved by the company may be distributed as dividends.

Directors must file copy of the balance sheet along with the Shareholders' list with the companies Registry within 30 days from the date of approval of the balance sheet.

COMPANY'S RESOLUTIONS - Powers and attributions of stockholders are set forth in Bylaws. Stockholders shall decide on issues brought to their attention by one or more directors or by 1/3 of shareholders, and on the following matters:

- Balance sheet approval and dividend distribution
- Election of Directors
- Election of Board of Auditors and/or external Auditor
- Amendments to articles of organization
- Resolutions concerning substantial modification to the corporate purpose or concerning relevant modification to the rights of stockholders.

There are not a specific formalities for adoption of a company's decision. However, there must be a writing wherein the will of stockholders, the matter subjected to decision and consent of stockholders are certified.

The written decision must be reported in the Book of Stockholders' Decisions.

This rule evidences that decisions over company's operations do not have necessarily to be adopted by a collective body as long as the above requirements are met.

QUORUM – In order to adopt company's resolutions a quorum of 50% of the stock must be represented (Civil Code, Article 2479).

Shareholder actions must be approved by the majority of the stock represented at the meeting, save for those actions concerning:

- Substantial modification to the corporate purpose
- Relevant modification to the rights of stockholders.

The above actions must be approved by 50% at least of the stock of the company.

It is important to remark that extraordinary meetings are not required anymore for Limited Liability Companies.

The articles of organization of Limited Liability Company sets forth rules for the call of stockholders' meetings, with the formalities necessary to ensure information about the arguments subject to discussions (fax and e-mails are proper means of transmission).

In absence of specific provisions on the matter, the call must be delivered via registered letter with receipt sent to stockholders at least 8 days before the date set for the meeting.

No formalities are required when the entire stock is represented at the meeting and all the Directors and Auditors are either present or informed and no one objects that the discussion over the matter should not take place (Civil Code, Article 2479bis).

INVALIDITY OF RESOLUTIONS - As above said, stockholders' decisions may be adopted out of the meeting of Stockholders. The Reform Law requires that company's decisions must be reported in the Book of Stockholders' Decisions.

The same distinction between void and voidable resolutions of Corporations (S.P.A.) that provisions of Civil Code Articles 2377-79ter, applies to Limited Liability Companies.

(1)The following company's decisions may be challenged within 3 months from their reporting in the book of Stockholders' Decisions by dissenting stockholders, Directors and Auditors:

- Decisions adopted inconsistent with the Law or the company's certificate
- Decisions adopted with the determinant vote of those stockholders having, on their own or on behalf of third parties, an interest in conflict with the interest of the company, if those decisions may harm the company.

(2) Whoever interested may challenge the following decisions within three years from their reporting in the Book of Stockholders' Decisions:

- Decisions on impossible or illicit matters
- Uninformed decisions adopted.

(3) Those resolutions amending the company's purpose or on impossible or illicit matters may be challenged at any time.

Rights of third parties in good faith arising from enforcement of company's decisions or resolutions cannot be challenged.

AMENDMENT OF THE ARTICLES OF ORGANIZATION – Amendments to the Articles of organization may be effectuated through resolution of the stockholders' meeting and a notary must draft the minutes of the meeting.

In case of stated capital increase, however, Articles of organization may provide that the decision relating to the increase may be adopted by the Board of Directors.

The minutes of their decision must be drafted by a notary. It is important to notice that the capital increase cannot be effectuated until stock contributions due are not entirely paid in.

If the capital increase requires new contributions, stockholders get an option of subscription over the new stock quotes issued proportional to the amount of stock they own. If stockholders exercise the option, they must deposit 25% at least of the stock price upon subscription.

Articles of organization may exclude the option right, therefore allowing that stock quotes are offered to third parties.

Whenever the stockholder does not agree, for whatever reason, to the admission of new stockholders in the company he may exercise appraisal rights.

As far as it concerns diminution of stated capital, the Limited Liability Company is not required anymore to provide a reason for the capital diminution, save for the circumstance of diminution of stated capital for losses, where the statutory regulation has been substantially maintained unchanged.

ISSUANCE OF DEBT SECURITIES - The possibility of issuing debt security may be set forth in the Articles of organization. In particular the Articles of organization may regulate:

- The company's power competent in adopting such decisions
- Limits
- Formalities
- Quorum required for passing resolutions.

In any case limits, formalities, terms and conditions of the borrowing must be included in the decision of issuance that has to be filed, by Directors, with the Companies Registry. Outstanding securities can only be traded by professional investors subjected to prudential control according to special regulations, like banks or S.I.M. (companies of authorized security dealers).

Professional investors dealing in debt securities guarantee for the solvency of the company if they decide to transfer the securities to third parties, different from professional investors or stockholders of the same company.

Article contributed by Riccardo G. Cajola