# On the liability of de facto Directors towards the company and Shareholders

1. – The de facto director has managerial functions in a joint stock corporation, i.e. he takes decisions and acts in a managerial capacity in the name and on behalf of the company, without having being vested by a legally existing resolution on the basis of the law or the Memorandum of Association.

The category of non-existent resolutions, in addition to the broadly invalid ones (i.e. null and void or annullable) has now been admitted for some time by dominant case law both legitimately and on merit (1).

This same category is now also accepted by the prevalent legal literature (2), except for some critical voices which made themselves heard in the past (3).

The non-existent resolution is so defined!when an element making up the procedural model fact situation forming the resolution is absent, such as not to allow the start or cause the interruption of the necessary legal stages from the beginning to the end, with the result of determining an apparent model fact situation which cannot be subsumed into the juridical ca-

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From « Il Diritto Fallimentare e delle Società Commerciali » 2000, Part 1 - Literature

(1) The category of non-existence is now pacifically admitted: see Court of Civil Cassation, 14.1.1993 no. 403: Court of Civil Cassation 4.12.1990 no. 11609; Court of Civil Cassation 15.3.1980 no. 1768; Court of Civil Cassation, 1.4.1982 no. 2009; Court of Civil Cassation 11.3.1977 no. 989; Court of Civil Cassation 4.3.1963 no. 511. For a review of the decisions on merits: QUINTARELLI, *Le deliberazioni assembleari inesistenti di società per azioni*, in *Giur. comm.*, 1984, I, 1158 ff.

(2) In legal literature; L. FARENGA, « *La deliberazione di società come atto a struttura procedimentale e la teoria giuridica della inesistenza* » and bibliographies mentioned; RIMARCHI, Invalidità delle deliberazioni di assemblea di società per azioni, Milan 1957, p. 451 and ff.; GIANNATTASIO, Ancora *sulla inesistenza giuridica delle deliberazioni assembleari, Giust. civ.*, 1966, I, p. 490; ASCARELLI, *Inesistenza e nullità*, in *Riv. dir. proc.*, 1846, p. 61; RAGUSA-MAGGIORE, *La responsabilità degli amministratori*, Milan, 1969, 81; BORGIOLI, in Giur. comm. 1981, II, 699; FERRARA-CORSI, *Gli imprenditori*, Milano 1987, p. 489; G. COTTINO, *Diritto Commerciale*, I, Padua, 1993.

(3) FERRI, *Le società* in *Trattato di diritto civile* by Vassalli, Turin, 1987, p. 635 and ff.; MIGNOLI, *In tema di nullità e annullabilità delle delibere assembleari, in Riv. Società* 1948, I, 432; COTTINO, *Diritto commerciale*, I, 1987, p. 429.

tegory of resolutions due to structural and functional inadequacy, with respect to the model fact situation » (4).

The case in our case law is that referable to a resolution of a Shareholders' meeting but it could also be for any other joint resolution, as is the case of the appointment of the Executive Committee, by the Board of Directors.

Resolutions « passed by a body without the power to resolve » (5), « those adopted by a Shareholders' Meeting called by a non-legitimized body » (6) or by a « Board of Directors not correctly called » (7) or « by a Meeting meeting in a venue other than that shown in the notice of call » (8), or « where there was not a quorum » (9) or « where there has not been a vote » (10) or « if the quorum prescribed for voting has not been reached » (11) of « where the votes have been expressed in a non-homogeneous way » (12) or « in the event that minutes of the meeting have not been drawn up » (13) and so on and so forth have been deemed cases of non-existent resolutions.

A non-existent resolution appointing Directors has a chain reaction on the non-existence of the subsequent Shareholders' Meetings and resolutions that are called by the de facto but not rightfully entitled Directors, producing a « domino » effect.

The case in which the procedural model fact situation is affected by some defect which entails the nullity or the annulment of the Meeting's resolution is different with respect to the previous category.

In this latter case, as the annulment has its effects only *ex nunc*, the Director has to be considered *de jure* until the annulment.

The case in which the appointment of the Director is to be deemed null and void under article 2379 Civil Code is also different, because it forms the object of a pronouncement of ascertainment which operates *ex tunc.*

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(4) In this sense amongst the many: Court of Civil Cassation, 14.1.1993; Court of Civil Cassation 4.12.1990 no. 11609; Court of Cassation 15.3.1986 no. 1768 in *Giur. comm.* 1987, II, p. 83 and ff.; FERRO-LUZZI in *Contratti associative*, Milan 1976, p. 134 ff. amongst many others.

(5) Court of Civil Cassation, 1.10.1960 no. 2542 in *Giur. it.* 1961, I, 1 section 420.

(6) Court of Appeal, Brescia, 1.12.1965 in *Giust. Civ*, 1966, p. 1208.

(7) Court of Appeal, Milan, 23.7.1957 in *Rep. giur. it.* 1958, Società p. 90; Court of Rome, 13.7.1990 in *Riv. dir. comm.*, 1991, II, 197.

(8) Court of Civil Cassation, 14.1.1993, no. 403 in *Riv. dir. comm.*, 1993, II, 202.

(9) Court of Civil Cassation 13.1.1987 no. 133 in *Giur. it.*. 1987,, I, 1, 1724; Court of Milan, 24.9.1990 in *Riv. dir. comm..*, 1991, II, 243.

(10) Court of Civil Cassation 1.10.1960 no. 2542 in *Giur. it.*, 1961, I,1, 420.

(11) Court of Civil Cassation 20.4.1961 no. 511, Dir. fall., 1961. II, 783; Court of Cassation, 4.1.1966 no. 45 *Foro it.*, 1967, I, section 827; Court of Perugia, 22.4.1983 in *Società* 1984, 1335.

(12) Such is the case where the Meeting is to express votes in favour by raising hands and votes against and abstentions by ballot paper.

(13) Court of Civil Cassation 26.6.1956 no. 2286 in *Riv. dir. comm.*, 1958, II. p. 4.

In any case, the non-existent resolution of a Shareholders' Meeting cannot be an object of validation.

A different de factor director with respect to that shown above is that where the decisions are taken by an extraneous person who interferes with the management, with the tolerance of, in lieu of or in collaboration with the *de jure* Director.

2. – The de facto Director is equivalent in Italian criminal case law to the rightful director and therefore is fully subject to the prohibitions and penalties provided by criminal law for the acts committed by both (14).

A different solution would lead to considering that the criminally illicit activity by the de facto director is not an offence due to the absence of investiture in the position, unlike that existing in the rightful director and therefore the former would be unjustly exonerated of any criminal liability.

The dominant case law subjects the de factor director to criminal law in its substantial content and correctly deems that in criminal law, the liability is based on the effective management of the company which prevails over the formal one of taking on the office.

The individual model fact situations of offences are configured by criminal law, not according to the title, under which the activity of director is exercise but « according to the factual observation that the activity is concretely exercised ».

The same applies to the hypotheses of corporate and bankruptcy crimes, such as bankruptcy, false company misrepresentation, conflict of interests and so on and so forth.

The damaged company can take legal action against the Director, for the various corporate and bankruptcy crimes, including without a prior resolution of the Shareholders' Meeting to take the liability action against the de facto director.

The shareholder can also take legal action both in subrogation of the company and on his own account, as individually damaged as the pursuit of tortious liability for tort is guaranteed by article 2395 Civil Code.

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(14) Court of Criminal Cassation, 14th May 1993, defendant Delle Fave; Court of Criminal Cassation 29th December 1972, defendant Zito in Giust. pen., 1973. II, 591; Court of Criminal Cassation 5th December 1966, defendant Savoldo in Dir. fall., 1967, II, 974; Criminal Cassation 8th May 1964, defendant Esposito in Rep. Foro it., 1965, entry *Società* no. 220, 223, Criminal Cassation 1st July 1963, defendant De Angelis in Rep. Foro it., 1954, 246. In legal literature: ANTOLESI, *Manuale di diritto penale. I reati fallimentari*, Milan 1959, p. 109; ZUCCALA, *Il delitto di false comunicazioni sociale*, Padua 1954, p. 53, CONTI-BRUTI-LIBERATI, Il diritto penale nelle società commerciali, Milan 1971, p. 110; C. PEDRAZZI, *Gestione di impresa e responsabilità penale*, in *Società* 1962, p. 220; F. MONELLI, *La responsabilità dell'amministratore di fatto* in *Giur. comm.* 1984, p. 107; M. ABBIANI, *Gli amministratori di fatto delle società di capitali*, Milan, 1988. p. 200 and ff.

3. – Legal literature and case law also subject the de factor director to the civil tortious liability provided for the rightful director with motivations similar to criminal liability.

They have resource to the motivation that otherwise the de facto director would enjoy a protection of interests, contrary to the legal system for acts of negligent and wilful mismanagement he has performed, whilst those of the shareholder an the third party creditor would be without protection.

Legal literature and case law have attracted attention above all to damage caused by the de facto director for tortious liability.

However, the problem has not been covered by literature and case law in its unity with regard top damage from contractual and tortious liability.

The current opinions, according to the author of these lines, appear inadequate with respect to a problem that requires a detailed and articulated analysis of its multiform aspects.

A further problem is the legitimization of the damaged subject to take action against the de facto director.

Let us start with the tortious civil liability of the rightful director from which we will draw an analogy for a contribution to solving the problem of the application to the de facto director.

The criminal offence, caused by the aforementioned director, as stated, gives rise to tortious liability for civil damage suffered by the company and the shareholder.

The individual exercise by the shareholder of the action under article 2395 Civil Code to pursue the compensation of damage he has directly suffered, which are not the reflection of that caused to the company's capital by tortious liability is also generally admitted (15).

The author of these lines deems this interpretation excessively reductive, for a dual set of reasons.

First of all the limitation of the action by the shareholder under article 2395 Civil Code, only to the damage caused by the director for tortious liability does not appear justified.

It is generally argued by the legislative formula that refers to the shareholder who is « directly damaged » by the acts of the director therefore the indemnifiable damage is limited to direct damage and the reflected damage by the corporate capital is excluded and in short the damage suffered by the corporate share of the individual shareholder, even if caused by a wilful and negligent activity.

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(15) Court of Cassation 19.12.1985, no. 6493; Court of Civil Cassation 2.6.1989 in Giur. it. 1989, I, 1, Court of Civil Cassation 3.11.1983, no. 6469 in *Dir. fall.*, 1984, II, p. 250,: Court of Cassation 28.3.1996, no. 2850 in Società 1996, 1397; Court of Civil Cassation 4.4.1997, no. 2934; Court of Civil Cassation 3.7.1998 no. 6519. In this sense, there is also FERRI, *Le società*, Turin, 1985, p. 686; G. MINERVINI, *Gli amministratori di S.p.A.*, Padua 1969.

This interpretation reduces the individual action that can be accomplished under article 2395 Civil Code to an absolutely marginal conjecture.

To the writer, it does not appear justified by the term « direct damage » used by article 2395 Civil Code.

The formula is limited to stating that between the wilful conduct and negligent conduct of the director and the damage there must be a relationship of direct causation, as it is in articles 1223 and 2056 Civil Code, i.e. indicating a relationship of logical univocity, whilst the immediate term expresses that of a historical consequentiality (16).

It does not appear to the writer that from the adjective « direct » an argument can be drawn to reduce the sphere of the different types of shareholder's indemnifiable damage. only to those extraneous to his corporate share, whilst this is also a direct consequence, which comes under article 2403 Civil Code.

This does not mean that great caution must not be used to ascertain the tortious liability of a rightful director, who is assisted by a presumption of legitimacy of his work.

As I have said, it is questionable whether the damage suffered by the individual shareholder in his share in the corporate capital is not protected, although it is a reflection of that on the corporate capital, following the mismanagement, which represent tortious crime by the rightful director.

The interpretation referred, on the one side, is lacking because it would lead to excluding from tortious liability of the director, the damage suffered by the corporate share, also in the case in which the illicit conduct is a crime.

However, it is not questionable that the shareholder can assert his right to compensation for the specific damage which is suffered by his individual share, although a reflection of that suffered by the company.

The above concerned the rightful director.

The question regarding the tortious liability of the de facto rather than the rightful director appears much wider and at the same time different.

The de factor director is not assisted by the presumption of legitimacy of his work which cannot therefore be said to be finalized to pursuing the interest of the company and he must indemnify the company and the shareholders, following his negligent or wilful tortious behaviour.

The fact that he is a de factor director and the rightful director is absent means that the damage resulting from his conduct to the corporate capital and to the individual shareholding would be condemned otherwise not to be both indemnified, due to the absence of the legitimate company

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(16) G. VALCAVI, *Intorno al rapporto di causalità nel torto civile* in *Riv. dir. civ*, 1995, II, 481; Id., *Sulla causalità giuridica nella responsabilità civile* in « *Danno e responsabilità* » 1998, p. 1007 and ff.

body that must provide for this on the one hand and the erroneous interpretation that would aim to exclude the shareholding from the sphere of article 2395 Civil Code on the other.

The shareholder therefore has the right to directly take action against the de facto director under article 2395 Civil Code for the damage he has suffered by the negligent or wilful acts that generate tortious liability of the rightful directors and, a fortiori, of de facto directors, although depending on that suffered by the company to its capital.

It also has to be admitted that from individual action does not exclude the further aim of taking action for the damage caused by the de factor doctor to the company's capital, at least in subrogation of the same.

4. – Let us now go on to outlining a synthetic picture of the non-tortious civil liability of the directors of a joint stock company with regard to shareholders and creditors.

As far as the rightful directors are concerned, the discipline concerning them is laid down by article 2392 Civil Code which prescribes that they must fulfil the duties improvised by the law and by the Deed of Incorporation with the diligence of the principal which is the same ordinary diligence of a reasonable and prudent man and establishes that they must jointly respond for any damage caused.

The legal picture is also specified by article 1711 for which the consequences of acts which lie outside the limits of the appointment remain the responsibility of the principal and by article 1712 for which they must, in every case « without delay communicate the performance to the principal ».

The rightful directors, within the discretionary sphere of the decisions reserved to them, have a freedom in decision-making which may not be censured by a judge.

Their liability for damage obeys an objective paradigm where the Shareholders have to prove the wilful action or grave negligence. whilst the defendant directors have to produce the counter-proof of normality.

Liability for damage, deriving from a contract is limited to that ordinarily foreseeable, in accordance with article 1225 Civil Code.

An action of liability may only be taken by a resolution of the company's Shareholders' Meeting in accordance with article 2393 Civil Code or by article 2409 Code of Civil Procedure.

A dominant orientation in legal literature (17) and in case law (18) however although opposed by a minority opinion, excludes that the individual shareholder can carry out an action for negligence and damage under arti-

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(17) RAGUSA MAGGIORE, *La responsabilità degli amministratori*, cit. p. 93; MINERVINI *Gli amministratori* p. 363 ff.; COTTINO, *op. cit.*, I, p. 676.

(18) Court of Cassation 3.8.1988, no. 4817; Court of Cassation 6.1.1982 no. 14; Court of

cle 2395 Civil Code by way of contractual liability with regard to the damage he has suffered to his company share (19).

Let us now examine the different discipline of the liability of the de factor directors which is extraneous to the infringement of the *neminem ledere* principle, and compare it with contractual liability under article 2392 Civil Code of the rightful directors.

The author of these lines deems that contractual liability of the de factor directors to the company and shareholders is not configurable, by analogy with that of the rightful directors but only non-contractual liability is, although not coinciding and different from tortious liability which is reduced to the simple infringement of the prohibition of *neminem ledere*.

The de factor director is not bound to the company by an organic relationship and it cannot be surmised that he has the rights and obligations of the principal, with respect to which he has to answer for contractual liability.

This is inferred from article 1711 Civil Code, which contemplates that the consequences of acts, which lie outside the limits of the appointment, remain the responsibility of the principal, so as to answer for them on his own account.

A fortiori, the same conclusion must be reached where there is not even an appointment, as is the case of the de factor directors who are therefore not vested by a legally existing Shareholders' resolution.

Contractual liability of the de facto director is therefore not configurable from the point of view of the so-called de facto contractual relationship which « would assume a juridical significant, leaving aside the existence of the corresponding contractual model fact situation ».

We do not agree with the existence of a category of this kind because this assumption is based on a petition of principle and is absolutely general.

Recently there has been an attempt to overcome the obstacle of the lack of investiture of the de facto director in the position, with reference to the final part of article 1173 Civil Code, the contents of which have been strained by an inadmissible addition which was extraneous to the legislator.

The rule indicates amongst the sources of the obligations alongside the agreements and the illicit behaviour « any other fact suitable to producing them in conformity with the legal system » and it is argued that this would legitimize a claimed general category of de facto contractual relationships.

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Cassation 16.11.1977 no. 5011; Court of Cassation 7.2.1974 no. 327; Court of Milan, 31.1.1983 in *Società*, 1984, 323: Court of Milan, 28.1.1980 in *Gur. com.*, 1981, II, p. 699.

(19) FRÈ, Società per azioni, p. 503 and ff.; MONELLI *Gli amministratori di società*, 1984m 323; Court of Milan 28.1.1980 in *Giur. Com.*, 1981, II, p. 699.

This appears inadmissible because the wording of article 1173 Civil Code, in the absence of a specific rule of the legal system, does not allow an opinion of this kind.

More recently, an isolated decision of legitimacy, with which we disagree (20), has referred to the institution of the management of others' business to try and justify the liability of the de factor director from a contractual pint of view. but the analogy is wrong.

The equivalence between the management of others' business and the relationship of the de facto director is inadmissible because the *utilis gestio* requires the impossibility of the *dominus* to provide for his interests and his non-awareness of the acts of the manager.

It concerns the case where the activity of the manager has as its object one or more individual operations, whilst this is not the case of the de facto director, whose activity is characterized not by individual acts of interference in the management but must continue for a significant period of time, with repeated acts typical of those of a company director being carried out (21).

The straining of the limits of a special and residual institution, such as *utilitas gestio* to draw the general justification of an entire category that lies outside the indicated institution must be rejected.

A conclusion of this kind is in contrast with the specific discipline of the institution of useful management.

Indeed, the *utilitas gestor* – admitted that he has been such – answers on his own account for his acts and obligations, where he acts against the prohibition of the party concerned, pursuant to article 2031, section 2, Civil Code.

We must therefore consider that the de facto director, acting without an appointment, acts against the consent of the company and the shareholders concerned, because the consent and the authorization must be expressed, according to the rules of the Memorandum of Association and the law, which are conditions for the existence of the procedural model fact situation and the resolutions and not arbitrarily supposed.

Surmising, moreover, an explicit prohibition of the parties concerned, with the consequences under article 2031, section 2, Civil Code, it could be sufficient for the shareholder, acting in subrogation of the company or not, to address a simple invitation to the de facto director to desist operating or a legal claim for legal ascertainment, which must be taken as events of ordinary occurrence.

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(20) Court of Civil Cassation 6.3.1999, no. 1925, President Cantillo, Reporting Judge Marziale, *Diritto e pratica della società* in *Il Sole 24 Ore* 8.11.1999 no. 20 with a note by A. Manzini

(21) A. MANZINI, Comment on the decision of the Court of Civil Cassation 6.3.1999 no. 1925 in *Diritto e pratica delle società*, cit. p. 47 and ff.

From this, we can also infer that the reference to the *utilis gestio* does not justify the profile of contractual responsibility between the company and the de facto director.

The quality of falsus procurator is more suitable for the de facto director, and a very recent decision attributes to the former the responsibility for damage from non-contractual liability although not reductively tortious.

The damage that is not indemnifiable within the limits of the foreseeability under article 1225 Civil Code derives from the exclusion of the contractual liability between de facto directors, company, shareholders and creditors concerned.

The fact that the de facto director does not enjoy a discretionary sphere of activity depends on this, on the basis of the paradigm of normality that would allow presuming the correctness, save the reverse burden of proof by the company and shareholders.

The trial judge can also censure this if carried out within the limits of normality.

Concluding, we deem that it is not possible to extend the contractual liability under articles 2392, 1710 and 1225 Civil Code to the de facto directors by analogy with rightful directors.

The opposite opinion, that infers the contractual liability of the de factor director from the *utilis gestio* or *the fictio* of a presumed appointment, similar to that of the rightful director, moreover ignoring article 1708 and its implications, is resolved in denying and contradicting the autonomous category of non-existent resolutions, with respect to those that are only invalid held by the dominant opinion and ends up by exonerating the de factor director from the extensive consequences of compensation of his acts.

5. – Let us now examine the logic and the amplitude of the civil liability of the de facto director with respect to the company, the Shareholders and the creditors.

Article 1708 Civil Code, as stated, places under the responsibility of the director of a company the consequences of his action when this lies outside the limits of the appointment.

By analogy, article 2031, section 2, Civil Code, refers to the *utilis gestio* to answer for his conduct, despite the prohibition of the party concerned.

It ahs been seen that these rules a fortiori justify the principle according to which the director who acts without a legally existing appointment must answer unlimitedly for the consequences of his decisions or acts.

This principle is an expression of the general rule that whoever acts, does so at his own risk.

This applies unconditionally to the de facto director.

An approach of this kind is the only one that respects the system that discourages initiatives of arbitrary replacement by subjects who are not le-

gitimized, who are in conflict with the current discipline inspired by the respect of rigorous legality and the interests of the investors, as is the case of a company with shares listed on the markets that are governed by rules protecting the rights of the minority, with public institutions of supervision, such as the Consob (Italian Securities Commission).

The conclusions reached that the de factor director acts at his own risk is also a rule balancing interests which sees, on the one hand, the obligation of the company to support the consequences of the acts of its de facto directors due to the principle of appearance which protects those who contacts with them in good faith and on the other, the right of the to take action against the de facto director for the consequences for which he is responsible.

The latter must, in every case, guarantee the company and the shareholders from losses and obligations, i.e. a profitable result and not a simple obligation of means, as the rightful director.

The erroneousness of the opinion that shapes the civil liability of the de factor responsibility on the mould of the contractual liability of the rightful directors is that it supposes the *fictio* of an appointment in advance, without taking into account that for the latter, where they operate outside the limits of the appointments, for indemnity a ratification of the party concerned under article 2932 Civil Code is necessary, which is not even deemed conjecturable for the de facto directors, according to the general principles.

The equivalence between the de facto and the rightful director cannot be based, a fortiori, on the orientation of criminal case law, because the criminal liability protects the public interest in preventing social alarm and punishing the culprit.

Lastly, the opinion that deems that the de factor director underlies the contractual liability under article 2392 Civil Code is denied by case law which deems that the responsibility of the *falsus procurat*or is tortious (22).

6. – Let us now see who can take action to obtain a pronouncement of liability of the de factor director and the formalities that have to be observed.

The company and its shareholders *utendo iuribus* are certainly legitimized.

A Shareholders' resolution the take the action of liability as provided for by articles 2393 and 2409 section 4 is not necessary in the case that the acts of mismanagement are performed by the rightful director.

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(22) For tortious liability of the *falsus procurator*: Court of Civil Cassation 19.9.2000, no. 12969; Court of Civil Cassation 16.1.1997, no. 6488.

The need for this resolution is closely linked with the presumption of legitimacy of the action of the latter, whilst this is not so for the de facto director.

This is inferred from the wording of article 2392, section 3, for which the shareholders' resolution has as effect the immediate revocation of the rightful director, whilst this has no meaning if referred to the de factor director.

The shareholders are legitimized to provide individually against the de facto director, who is liable, including with recourse to the protection as per article 2395 Civil Code.

This rule has a broad meaning and uses the interest of the shareholder to achieve the purpose of protecting the interest of the company in protecting the legality of its acts.

The subrogation function is *in re ipsa*, without the shareholder having to have recourse to the formal declaration of acting in subrogation.

In this sense, the author recalls a far-off decision of the Court of Law of Milan of 15th October 1987 (President Baldi – Reporting Judge Quadraro, published in *Giur. It.*, 1988, I, 2, 418) that perspicaciously stated that « a non-existent resolution can even be impugned by each shareholder individually who is interested in protecting the legality of the company acts ».

An admirable editorial note added: « if a juridical act or fact does not exist, it is not part of the system. It is not *tamquam non esset*, but simply *non est*. It is the general interest of the system and therefore of all, including in pursuance of art. 100 Code of Civil Procedure to remove the deceitful appearance avoiding that a simple reflection is exchanged for a reality which, precisely, does not exist, so that everybody and any shareholder should be legitimized to take action and only the intention of pure chicane could represent a limit to the initiative in this sense ».

Stating otherwise, as is the case of those who confuse de facto directors with rightful directors, the premises of the « non-existence of shareholders' resolutions » would be denied and superfluous and would end up by being identified simply with those that are simply annullable,

The subversion of the principle of law, that a non-existent resolution is not susceptible of being remedied in any way, would be illegitimately superseded by the aphorism *what is done is done!*