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Effects of the Cancellation of Italian Companies from the Companies' Register and the Succession of the Shareholders[1]

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During the last three years, the Italian Court of Cassation made several important rulings — the last one on May 30, 2013 — which clarify the consequences of the cancellation of a company from the Companies' Register (*Registro delle Imprese*), which is one of the most contradictory topics arising from the reform of Italian corporate law entered into force on January 1, 2004. As the reform provided for the immediate termination of the company following the cancellation from the Companies' Register, the situation of company's owing debts at the date of the cancellation was unclear, as was that of any realized credits or further assets belonging to the company discovered after the cancellation.

In particular, the Court of Cassation ruled on the following controversial matters:

- Liability for the debts of the company still owing after the liquidation of the company (in case the value of the company's assets was not sufficient for the payment of all the creditors);
- The destiny of any capital gains emerged or discovered after the cancellation of the company or of any residual assets not entirely liquidated nor distributed before the cancellation;
- The consequences of the cancellation with respect to pending proceedings;
- The legitimate rights of former shareholders with respect to credits belonging to the extinguished company;
- The declaration of bankruptcy of the extinguished company.

I. Background

The cancellation of the company from the Companies' Register occurs in the following cases:

- Post wind up and liquidation of the company;[2]
- ex officio, when the company does not file liquidation financial statements for three consecutive years.

Prior to the corporate law reform,[3] the cancellation of a company from the Companies' Register did not imply termination of the company until any and all pending proceedings and relationships against the company had been defined. In the previous regime the resolution of certain issues, which typically arose subsequent to the liquidation of the company, was relatively simple. This included issues such as the collection of credits vis-à-vis the company; the situation regarding the credits and assets of the company; the rights of the company still existing after that time, being then overlooked (the so-called "non-liquidated residues") or discovered only later (the so-called "contingencies"); and the progression of court proceedings involving the company. In all of these cases the issue was resolved by considering the company was still existing, irrespective of the completion of the liquidation process and the cancellation of the company from the Companies' Register, which was to the benefit of the company's creditors, who were not obliged to sue a plurality of shareholders.

Following the reform of 2003, the cancellation of the company from the Companies' Register involves, without any doubt, the extinction of the entity, irrespective of the existence of proceedings and/or relationships still pending. In the case of residual debts of the company, the creditors are entitled to sue (i) the shareholders of the extinguished company, who are liable within the limits of the amount received as an outcome of the liquidation procedure; and/or (ii) the liquidator, in case the failure to pay the remaining debts of the company is due to liquidators' fault.

Section 2495 of the Civil Code ("CC")[4] aims to protect the certainty of the legal relationships, identifying the exact moment when the company ceases to exist, but created serious practical issues, making possible fraudulent initiatives of the shareholders or of the liquidator, who may facilitate the extinction of the company without a previous attempt to satisfy all the creditors (according to the general principle regulating the liquidation procedure, any payment to the shareholders can only be made after the entire payment of the company's debts). The creditors would be forced to follow the shareholders with subsequent difficulties related to the research of their identity and address or to the ascertainment of the portion of corporate assets distributed to each one of them (in the limit of which the single shareholder is liable for the remaining corporate debts). Moreover, in the case of "non-liquidated residues" or contingencies discovered after the liquidation – not expressly regulated by reformed Section 2495 of the CC — the company's creditors have the same position of the creditors of the single shareholder, with subsequent decrease of their chances of obtaining a satisfactory outcome.

A. The principles stated by the Court.

1. <u>The liability for the remaining company debts</u>

The Joint Sections of the Court of Cassation (decisions of March 12, 2013, nos. 6070, 6071, and 6072), making reference to the consequences of the extinction of a company, clarified that subsequent to the cancellation from the Companies' Register any and all obligations undertaken by the company are transferred to the company's shareholders, who are liable within the limits of the amounts received following the liquidation procedure, or without any limit in the (exceptional) case of shareholders having an unlimited liability for corporate debts.[5]

2. <u>The transfer to the shareholders of the rights and credits still existing after the termination of the company</u>

As to credits and/or assets still existing after the liquidation and termination of the company, whether overlooked or discovered later, the Court of Cassation stated that the rights and assets of the company are transferred to shareholders in a communion regime. Shareholders are jointly entitled to property rights and any other existing rights of the company not included in the final financial statements filed when the company is liquidated (*bilancio di liquidazione*).

However, the above-mentioned rule does not apply to:

- claims which are not yet ascertained as a full right suitable to be included in the liquidation financial statements (*e.g.*, a claim for breach of contract or for a damage compensation), even if already brought in court; and

- non-liquidated credits;

in connection with the liquidator, which should have commenced or concluded (if already pending at the time of the liquidation) a court action aimed to obtain the ascertainment of the relevant right and/or the liquidation of the credit. As a matter of fact, the decision of the liquidator to complete the liquidation procedure and cancel the company from the Companies' Register notwithstanding the chance to have certain demand ascertained in Court as a full right, or to have a credit properly liquidated, has to be intended as a waiver of the same. Therefore, the shareholders are not entitled to commence a legal action on the basis of these demands or non-liquidated credits.

3. Procedural effects of the extinction of the company

Finally, the Joint Sections of the Court of Cassation pointed out that the termination of the company prevents the company from commencing legal action, as well as from being summoned in a court proceeding. Once the company is extinguished, it may not be a party to any legal proceedings.

Therefore, when termination of a company occurs while a court case is pending, the same has to be interrupted (similarly to what happens in case of death of a person) and then could be continued against the shareholders.

However, where termination of the company has not been declared over the course of the first degree proceeding (*e.g.*, because the company's lawyers have not informed the Court of the termination or this information is not otherwise obtained), the same could be prosecuted, notwithstanding the termination of the party. However, this *fictio iuris* is limited to the first degree proceeding; in fact, the relevant judgment could not be challenged by or against the extinguished company. This means that the appeal proceedings could be commenced only by or against the shareholders of the extinguished company.

4. The specific provision for the declaration of bankruptcy

The Court of Cassation clarifies that the only exception to the general principle according to which the company, once extinguished, cannot be party to any proceedings, concerns the procedure for the declaration of bankruptcy. As a matter of fact, Article 10 of Law no. 267/1943 (the "Bankruptcy Law") provides that a company may still be declared bankrupt during the first year subsequent to cancellation from the Companies' Register. This means that in case the Court declares the company bankrupt within one year from the date of cancellation from the Companies' Register, the extinguished company will be part of the entire bankruptcy procedure, again on the basis of a *fictio iuris*. This rule applies only when the bankruptcy is officially declared within the above-mentioned one year term, as the mere commencement of the relevant procedure is not sufficient within this term.

By means of a further decision on May 30, 2013, the Court of Cassation clarified the issue of the representation of the extinguished company in the procedure for the declaration of bankruptcy: the extinguished company participate to the bankruptcy procedure in person of its former liquidator and with no need to sue the shareholders directly.

II. Conclusions

The Court of Cassation, through the above-mentioned decisions, clarified the practical consequences of the new wording of Article 2495 of the CC, concerning the cancellation of a company from the Companies' Register. The scenario, resulting from the provisions of the law and the interpretation of the Court of Cassation, in a nutshell, is the following:

- shareholders are liable, within certain strict limits, for the remaining debts of the company and therefore, the cancellation of the company may not involve, in principle, a prejudice to the creditors;
- the liquidator may be liable as well in case of negligent or fraudulent conduct during the liquidation process, which causes a prejudice to the company's creditors;
- the shareholders succeed to the extinguished company also with respect to the possible remaining rights and/or assets;
- as to the procedural consequences of the cancellation from the Companies' Register, the extinguished company could not be part of any proceeding, which has to be commenced or continued *vis-à-vis* the shareholders; and
- the extinguished company can be declared bankrupt within one year from the cancellation from the Companies' Register and the relevant procedure has to be commenced *vis-à-vis* the liquidator.

The decision to give priority to the protection of the principle of certainty of legal relationships (clarifying definitively the moment when a company ceases to be party to any legal relationship) may not be free of charge, and a price could be paid in this respect by the creditors.

In fact, it should not be excluded that the new regulation may actually involve certain difficulties in the collection of the credits still existing after the liquidation of the company, it being necessary to claim the payment from each one of the shareholders (searching for all the necessary information, such as their identity, address, the amount received during the liquidation, etc.). Some support comes, however, from merit courts, which allow the creditors to enforce the judgment obtained *vis-à-vis* the extinguished company directly against the shareholders (Court of Milan, ruling of March 8, 2011, no. 3142), derogating from the general rule pursuant to which a decision can be enforced only against the subjects specifically mentioned in the ruling. The attempt of the Supreme Court and of merit courts to balance, from time-to-time, the principle of certainty of legal relationships and the protection of the creditors is quite clear.

The most relevant clarification from the Court of Cassation concerns the situation of the assets, credits, and rights of a company still existing after its termination, whether they are overlooked or discovered later, in connection with which Article 2495 of the CC does not provide specific regulation. The general principle advanced by the Supreme Court implies that all the former shareholders are jointly entitled to these rights and assets. There is however no chance for shareholders to raise claims that the company (*rectius*, the liquidator) decided not to defend; the mere demands and non-liquidated credits have to be intended to be waived by the extinguished company, and therefore, may not be transferred to the shareholders.[6] This means, by way of example, that the shareholders are not entitled to commence or continue a legal action for the compensation of the damages caused by the breach of a contract entered into by and between the company and a third-party. The fact that a

company decides to be extinguished before having obtained a decision ascertaining its right to receive compensation, implies a waiver of the relevant claim, which may not revive through an autonomous initiative of the shareholders.

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1 For the purposes on this work, the term "shareholder" is not to be intended as limited to members of companies whose corporate capital is represented by shares (*società per azioni*), but, more broadly, it also refers to members of the other kind of companies, *e.g.* to the "quotaholders" of limited liability companies (*società a responsabilità limitata*), and to "partners" of associations or partnerships (*società di persone*).

2 The liquidation may be spontaneously decided by the shareholders' meeting, or in specific cases, set out by law (*e.g.,* when the shareholders' meeting is no longer able to operate or is continuously inactive, or when the company is no longer able to pursue its corporate objectives).

3 Legislative Decree no. 6/2003.

4 According to the Supreme Court decisions dated February 22, 2010 (nos. 4060, 4061, 4062), the reformed Article 2495 of the ICC also applies to associations and partnerships (*società di persone*).

5 The unlimited liability is typical of associations or partnerships (not having an autonomous corporate capital), whilst in case of limited liability companies (*Società a Responsabilità Limitata and Società per Azioni*), the unlimited liability is exceptionally applied to companies having a sole shareholder, who may be liable with all its personal assets when the company is declared bankrupt and (i) the existence of a sole shareholder was not properly advertised in the Companies' Register (this information requires a specific advertisement) (ii) or the shareholder has not entirely paid the amount due for the shares pursuant to the company's bylaws.

6 This principle, even if not clearly stated, had been already applied by the Supreme Court in 2010 (decision no. 16758), when the Court prevented the shareholders of a terminated company from commencing a legal action for the ascertainment of the simulated nature of the deed of termination of a contract entered into by a company. According to the Supreme Court, the fact that the liquidator decided to complete the liquidation and cancel the company from the Companies' Register, irrespective of the potential claim of the company, implies the waiver of the same and of any possible right connected thereto.