

THE CRIMINAL LIABILITY OF DIRECTORS AND OFFICERS IN INSOLVENCY PROCEEDINGS UNDER ITALIAN LAW

Under Italian Civil law, directors are required to act in the best interest of the company, with a degree of diligence reflecting the specific knowledge and skills required by their office and within the powers granted to them by law and by the company's By-laws for the achievement of the company's object.

A very broad listing of the directors' duties specifically mentioned in the Italian Civil Code would include compliance with:

(i) the rules provided for the preservation of the equity and assets of the company and indirectly the rights of creditors, the duty of controlling any contribution in kind to the equity of the company, the prohibition to distribute fictitious dividends or dividends not resulting from duly approved financials (interim dividends), the prohibition from giving advances or loans out of the company funds to acquire shares of the company, the prohibition from making transactions on shares of the company or controlling or associated companies, the prohibition from making loans and giving guarantees in favor of the directors (and accepting such loans and guarantees); a prompt action whenever the equity capital is reduced below certain levels because of losses; a prompt application to the Tribunal for an insolvency proceedings in case the company becomes insolvent;

(ii) calling of shareholders' meetings when required by the law or the By-laws (consenting to the inspections of the committee of statutory auditors, if appointed, and supplying to them true and complete information);

(iii) the requirement that the company maintains true and complete accounting books and records, complies with the payment of taxes, social security contributions, tax withholdings from employees' salaries, etc.; preparation of yearly financials that truly and completely reflect the financial and economic situation of the company.

Directors (as well as shadow and the *de-facto* directors) are jointly and severally liable vis-à-vis the company, the shareholders, and third parties in general for damages suffered by each of them as a direct result of the directors' negligence in fulfilling their fiduciary duties.

In particular, according to Article 2392 of the Italian Civil Code, company's directors may be held liable towards the company in case they negligently fail to manage the company's affairs or if, being aware of prejudicial acts, they refrain from preventing them from occurring or reducing their negative consequences.

Pursuant to Article 2396 of the Italian Civil Code, companies' officers are subject to the same liability regime applicable to directors.

Under Italian criminal law, directors and officers may also be personally prosecuted¹ for those bankruptcy crimes committed prior to or during the bankruptcy procedure. It is noteworthy that many of the bankrupt crimes envisaged for the bankrupt entrepreneur are also applicable to the company's directors and officers (i.e. fraudulent bankruptcy acts, straight bankruptcy, abusive recourse to credit, denounce of non-existing credits).

Article 223, paragraph 1, of Italian Criminal Law 16 March 1942 No. 267, envisaging the so called fraudulent² bankruptcy, sets forth that directors and officers of bankrupt companies are

¹ Under Italian law, criminal liability is generally individual (Article 27 of Italian Constitution). Exceptions apply in respect of Italian Decree 231/2001 concerning criminal liability of the companies for crimes committed by its officers/employees, when such crimes are committed to the benefit of the company.

punished with imprisonment from three to ten years if they have committed one of the facts provided for by Article 216³ (which targets the entrepreneur's fraudulent bankruptcy), and listed hereinbelow:

- 1) diversion, concealment, dissimulation, destruction or dissipation of all or part of the company's assets as well as either the registration or acknowledgment of non-existent liabilities for the purpose of harming creditors;
- 2) removal, destruction or falsification, in whole or in part, with the intent of obtaining an undue profit or of harming the company's creditors, the company's books and other accounting records or keeping them as to make it impossible to reconstruct the entrepreneur's assets and business transactions⁴.

Directors and officers are also subject to criminal liability in case they remove, destroy or falsify the company's books or other accounting records in the course of bankruptcy proceedings.

In addition to the above, directors and officers are forbidden from paying some of the creditors or by creating fictitious titles of preference, for the purpose of favoring some creditors and of harming others⁵.

The penalty provided for by Article 216, paragraph 1, applies to the above mentioned individuals in case:

- 1) they have committed any of the acts contemplated in Articles 2621, 2622, 2626, 2627, 2628, 2929, 2632, 2633 and 2634 of the Italian Civil Code⁶;
- 2) they have caused by fraud or by the effects of fraudulent transactions the bankruptcy of the company.

Article 224, paragraph 1, of Italian Criminal Law 16 March 1942 No. 267 envisaging the so called straight bankruptcy, establishes that directors and officers of bankrupt companies are punished by imprisonment from six months to two years if they have committed one of the facts provided for by Article 217 (which targets the entrepreneur's straight bankruptcy), i.e. if they:

² "Fraudulent" under Italian law is any conduct which aims at deceiving third parties through misrepresentation of facts (Italian Court of Cassation, Sec. V, April 14, 1980).

³ Article 216 (Fraudulent bankruptcy). A entrepreneur is punished by imprisonment from three to ten years if declared to be bankrupt, when he:

- 1) has distracted, hidden, dissimulated, destroyed or dissipated all or part of his assets or, with the intent of damaging his creditors, has alleged or acknowledged the existence of non-existing debts;
- 2) has removed, destroyed or falsified, wholly or in part, with the intent of obtaining an undue profit or of harming his creditors, the company's books and other accounting records or has kept them as to make it impossible to reconstruct the entrepreneur's assets.

The same penalty applies to the bankrupt entrepreneur, who has committed one of the actions listed in the above paragraph 1), or in case he removes, destroys or falsifies the accounting records during the bankruptcy proceeding.

The bankrupt entrepreneur is punished by imprisonment from one to five years if, prior to or during the bankruptcy proceeding, for the purpose of favouring some creditors and of damaging others, makes payments or creates fictitious titles of preference.

Except for the case of accessory penalties provided for by chapter III, title II, book 1 of the criminal code, the application of the above penalties determines the disqualification of the bankrupt entrepreneur from the carrying out of a trading activity and from the exercise of management activities within a trading company.

⁴ These samples of misconduct are called "fraudulent bankruptcy on assets".

⁵ The so called "preferential bankruptcy".

⁶ Articles 2621, 2622, 2626, 2627, 2628, 2929, 2632, 2633 and 2634 of the Italian Civil Code respectively targets the following acts: false corporate communications; false corporate communications causing loss to shareholders or creditors; illegal return of contribution of capital; illicit distribution of profits and reserves; fraudulent transactions on securities; transactions detrimental to creditors; fictitious formation of corporate capital; undue distribution of corporate assets by the liquidators; misappropriation of company assets.

- 1) have destroyed much of the company's patrimony by means of chancy or manifestly imprudent transactions;
- 2) have carried out serious imprudent transactions in order to delay the bankruptcy declaration;
- 3) have aggravated the company's serious economic condition failing to file a voluntary bankruptcy petition, or with other negligent acts;
- 4) did not comply with the obligations undertaken in a former agreement with creditors.

Pursuant to Article 218 of Italian Criminal Law 16 March 1942 No. 267, directors and officers that make abusive recourse to credit or continue to do that, outside of what is provided for by the above articles, by dissimulating the company's crisis or the insolvency status of the company, are punished with imprisonment from six months to three years.

The same penalty is applicable to directors and officers of insolvent companies that have committed the crimes provided for by this article.

Finally, directors and officers are punished by imprisonment from six to eighteen months in case they, *inter alia*, insert in the creditors' list non-existing creditors or fail to declare inventory goods.

An essential precondition of the criminal liability of directors and officers in fraudulent bankruptcy, apart from the existence of a connection between the acts carried out by these individual and the reduction of creditors' interest (*actus reus*), is the so called "dolo generico" (generic fraud, *mens rea*). Said "dolo generico" consists in the "conscious will to give to the company's assets a different destination from the company's corporate purposes and to carry out activities able to harm the creditors of the company"⁷.

In case of preferential bankruptcy, the psychological element of this crime is represented by the so called "dolo specifico" (specific fraud), i.e. the pursuing of the result envisaged by the relevant provisions of law (favouring some creditors and harming others).

The straight bankruptcy can be charged to directors and officers that have committed this crime both with fraud (*dolo*) and with negligence (*colpa*).

The civil liability of directors and officers, as above outlined, is a contractual liability (towards the company) or an extra-contractual one (towards creditors and third parties). These types of liabilities are established by law for the purpose of protecting the integrity of the legal relationships existing among the above individuals, the company and the company's creditors.

On the contrary, the criminal liabilities of directors and officers are envisaged for the purpose of ensuring the regular unfolding of the bankruptcy procedure and, according to a minor case law approach, with the aim to safeguard the recovery of value from debtors' assets in favour of creditors, to protect the public interest of the market to obtaining correct information on companies' assets and enhancing the control of corporate governance.

A number of corporate crimes⁸ also entail the company's "administrative/criminal" responsibility pursuant to Legislative Decree No. 231, dated June 8, 2001.

⁷ Italian Court of Cassation, Sec. V, October 6, 1999 No. 12897.

⁸ Corporate crimes that may result in a criminal liability for the company are:

- False corporate communications (2621 e 2622 Civil code)
- False information in prospectuses (2623 Civil Code)
- False information in reporting or in communications of the auditing firms (2624 Civil Code)
- Obstructing/Impeding controls (2625 Civil Code)
- Fictitious formation of corporate capital (2632 Civil Code)
- Undue restitution of equity contributions (2626 Civil code)
- Illegal distribution of profits or reserves (2627 Civil code)

Inspired by the 1997 OECD Convention on fighting bribery of foreign government officials, Italian 231/2001 Decree has introduced a regulatory framework for administrative/criminal liability of companies in case of crimes⁹ committed, in Italy or abroad, in the interest or to the benefit of the company, by its directors and/or employees.

In the event of a criminal offence committed by such persons, a trial against him/her will take place - who will be punished according to the Italian Criminal Code - as well as a trial against the company (represented, before the Criminal Court, by its legal representative).

The sanctions for the company in case of violation of Italian 231/2001 Decree provisions are: pecuniary sanctions (which may be extremely severe); injunctive sanctions (such as, amongst others, prohibition of the exercise of the business activity, suspension or revocation of the authorizations, licenses or concessions, prohibition to negotiate with public administrations, exclusion of facilities, loans, contributions, prohibition to advertise goods or services); confiscation and publication of the Court decision.

The above sanctions may also be applied as a *protective measure* during the investigation period, with the serious consequence of paralysing the company's activities. More severe sanctions for repeat offenders are also applied.

Since 231/2001 sanctions are triggered by criminal violations, no insurance coverage may be possible to avoid any consequence of the lack of compliance.

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- Unlawful operations on the shares or quotas of the company or of the holding company (2628 Civil code)
 - Operations to the detriment of creditors (2629 Civil Code)
 - Undue division of the corporate assets by the liquidators (2633 Civil code)
 - Unlawful influence in the shareholders meeting (2636)
 - Rigging the market (2637)
 - Failure to communicate the conflict of interest (2629bis)
 - Preventing the regulatory authorities from carrying out their functions (2638)
 - Market abuse and insider trading

⁹ The crimes listed in the Decree are: bribery, **corporate crimes**, criminal offences related to financial aids, loans, grants, from public institutions, computer fraud against the State or a public institution, market abuse, insider trading, money laundering, forgery, crimes related to terrorism, crimes against the individuals, computer crimes, crimes related to privacy, industrial injuries, accidents at work and others.