

ZIWEI XU

The Asset Lock Under the Regular Operation of Social Enterprises in Italy

Abstract

Italian law establishes the legal status of social enterprises by providing the accreditation of entities that satisfy the requirements to be a social enterprise. Due to the variety of legal forms of social enterprises, the specifics of the asset lock rule may vary in the course of their regular operation. The reform of the third sector, which explicitly includes social enterprises, adds complexity to this issue. In this context, the question of how the asset lock can be used to ensure that there is no drift away from the social purpose of the social enterprise is of paramount concern. This paper will explore four main types of participants in these entities, which are directors, shareholders (or members), third parties, and the controller. To this end, the operation of the asset lock will be dissected by discussing and analyzing the constraints on directors' remuneration, the principle of the non-distribution of profit motive, restrictions on transactions with third parties in social enterprises, and regulation by the controller during which period of operation, as well as by comparing from a theoretical point of view which of the legal forms of social enterprises would be more conducive to serving the interests of the community and the public interest.

KEYWORDS: asset lock, social enterprises, remuneration, non-distribution, constraints.

ZIWEI XU, doctoral researcher, Université du Luxembourg,
ORCID – 009-0006-1991-5093, e-mail: ziwei.xu@uni.lu

Under existing Italian legislation, social enterprises are bound by specific restrictions on the distribution of profits arising from their business to shareholders/members, directors, and others.^[1] Social enterprises are not driven by the profit, that is, these organizations should use any profits for the performance of their statutory activities or the increase of their assets^[2], save in exceptional cases (legal entities of Book V of the Civil Code)^[3]. Accordingly, this paper will present an analysis of the concrete situations of the asset lock in social enterprises during their regular operations, depending on the critical four actors involved, namely, directors, shareholders or members, third parties, and the controller.

1 | Directors

1.1. Remuneration of directors

Italian law provides that the remuneration of directors in social enterprises in the form of companies or cooperatives may not be disproportionate to the activities carried out and responsibilities assumed, or in any case, higher than the emoluments of entities operating in identical or similar sectors and conditions^[4]. It is necessary to note that this constraint does not apply in all cases.

In the event of a company registered as a social enterprise, given the variety of governance models of a joint-stock company (s.p.a.), comprising the traditional, dual, and monistic models^[5], the board of directors or the sole director may be present under the traditional model (the default model) and the monistic model (specified in bylaws) exclusively. In both models, as in the mechanisms for determining directors' remuneration in companies, the remuneration of such directors in social enterprises is

¹ Antonio Fici, 2020, European Social Enterprise Law After the „Social Business Initiative” Communication of 2011: A Comparative Analysis from the Perspective of Worker and Social Cooperatives, CECOP, Brussels.

² Art. 3 para. 1, law no.112/2017.

³ Art. 3 para. 2, law no.112/2017.

⁴ Art. 3 para. 2 a), law no.112/2017.

⁵ Alessandro de Nicola, Marco Carone, „Chapter 5. Directors”, [in:] *Italian Company Law* (EGEA, 2014), 107-121.

decided by the general meeting of shareholders, provided that the amount is subject to the previously mentioned limits. These constraints and regulations on remuneration apply to social enterprises in the form of limited liability companies (s.r.l.) as well.

However, not all shareholders are social impact investors; for those who are not, what matters most is their pecuniary interest, i.e., the best interests of those who are significantly affected by the company's conduct^[6]. The greater the percentage of shares held by these shareholders, the greater their "voice" at the assembly general meeting. In this case, there is a risk that the directors' remuneration adopted by the general meeting of shareholders may exceed the ceiling stipulated in the social enterprise. Should this occur, it would constitute a violation of the partial prohibition of profit distribution. However, the absence of statutory sanctions for such an action may be left to the hope that external controllers or internal auditors will discover it soon.

Unlike social enterprises in the company form, social cooperatives have the tripartite system, that is, it must have a general assembly, a board of directors, and a supervisory body^[7]. In this case, the appointment and removal of directors by the meeting of the members and fixing their remuneration in case it is not specified in the cooperative's statutes^[8].

Italian social cooperatives are required to have a membership that consists of at least 70% of various types of stakeholders^[9]. Additionally, members of disadvantaged groups must comprise at least 30% of the cooperative's employees^[10]. This ensures that the social cooperatives' members are socially engaged. In such entities, the remuneration of directors, as determined by the general assembly of members, may be less prone to exceed the cap imposed by legislation on social enterprises. Consequently, social cooperatives are significantly more conducive to „social lock-in" than

⁶ Tamara C. Belinfanti, „15- Social Lock-In and the Cooperative Form", [in:] *The Cambridge Handbook of Social Enterprise Law*, ed. Benjamin Means, Joseph W. Yockey (Cambridge: Cambridge University Press, 2018), 256-274.

⁷ European Commission (2020) Social enterprises and their ecosystems in Europe. Updated country report: Italy. Author: Carlo Borzaga. Luxembourg: Publications Office of the European Union.

⁸ Art. 2542 para. 1 & art. 2363 para. 1 no. 2) & 3), Italian Civil Code.

⁹ European Commission (2020) Social enterprises and their ecosystems in Europe. Updated country report: Italy. Author: Carlo Borzaga. Luxembourg: Publications Office of the European Union.

¹⁰ Art. 4 para. 2, law no. 381/1991.

social enterprises in the company form^[11] with regard to determining and disciplining directors' salaries. They are in a superior position to pursue the general interests of the community and human promotion, as well as the social integration of citizens.

In the case of social enterprises in the foundation/association form, directors (trustees) therein cannot be paid remuneration but may be compensated for expenses. Two types of organizations though require special attention, voluntary organizations (ODVs) and amateur sports associations (ASDs). ODVs are prohibited from granting office allowances to persons holding elective office (including directors), except members of supervisory bodies who meet the professional requirements outlined in Article 2397 of the Civil Code^[12]. Non-profit ASDs may pay compensation to member executives, provided that the individual's annual compensation does not exceed the maximum compensation allowed for the chairman of the audit committee of the s.p.a.^[13].

1.2. Directors' duties related to handling assets

Although the social enterprise law does not specifically define responsibilities for directors, considering the social mission of these businesses, directors should conduct for social benefits. In accordance with the legal structure of the social enterprise, the duties of the directors may be nuanced.

In the case of social enterprises operating as corporations, directors, in carrying out their powers (managerial, executive, and representative), must also adhere to fiduciary duties. Directors are responsible for governing the company in accordance with both the law and the company's articles of association, and they are expected to conduct themselves with

¹¹ Belinfanti, „15- Social Lock-In and the Cooperative Form”, n. 6. In this paper, Tamara provides an explanation of „social lock-in”, i.e., it is a feature that the cooperative model is attuned to securing the social mission of the cooperatives from the hands of investors.

¹² Ministero del Lavoro e delle Politiche Sociali, note no. 6214 of 09/07/2020. <https://www.lavoro.gov.it/documenti-e-norme/normative/Documents/2020/Nota-n-6214-del-09072020-riscontro-quesiti-in-materia-di-CTS.pdf>.

¹³ Revenue Agency, response no. 452 of 10/20/2019. <https://www.agenziaentrate.gov.it/portale/documents/20143/2059938/Risposta+n.+452+del+2019.pdf/a29ed54e-coc8-7ad2-fc97-640d194c9d1d>.

the utmost care^[14]. In these enterprises, directors shall be liable for breaching the duty of care. For example, where high-risk transactions are entered into and directors fail to adequately assess the circumstances of these dealings, resulting in losses to the company, which may indirectly decrease the revenue of the social enterprise. It may also affect social activities and to some extent hinder the pursuit of social objectives.

In contrast, a director who has an interest in a matter to be decided by the board of directors that does not necessarily conflict with the interests of such entities (i.e., specific social objects set out in the statutes) is required to fulfill a disclosure obligation^[15]. Any resolution that could be detrimental to the social mission of a social enterprise, particularly when there is a conflict of interest, can be challenged by the other directors and the board of statutory auditors^[16]. Should the director with the preceding interest be the managing director, he/she must renounce this transaction and submit the relevant decision to the board of directors^[17].

Furthermore, the general nature of the representative power granted to directors by the memorandum of association or shareholders' resolution means that, even if there are limitations on this power set out in the enterprise's charter or imposed by the relevant authorities (even though these restrictions have been made public), this limit may not be enforced against third parties unless it is proven that they have deliberately harmed the interests of the company^[18]. The provision was originally introduced with the objective of safeguarding the market order and the interests of third parties with benevolent interests. In the case of social enterprises, the scope of the company's interests should encompass activities that benefit the community and the pursuit of the public interest. Therefore, if a third party intentionally damages the general interest of a social enterprise to gain economic advantage by entering into a contract with a director who has a restricted powers of representation in the company, this restriction is enforceable against the counterparty to this transaction. In practice, however, this is not easy for the company to demonstrate the subjective intent and the results of the damage as well as a causal relationship between them.

¹⁴ Art. 2420ter, Italian Civil Code.

¹⁵ Art. 2391 para. 1, Italian Civil Code.

¹⁶ Art. 2391 para. 3, Italian Civil Code.

¹⁷ Art. 2391 para. 1, Italian Civil Code.

¹⁸ Art. 2384, Italian Civil Code.

Directors in social cooperatives are bound by a fiduciary duty of care, loyalty, and obedience to these cooperatives, similar to those of a company director in many respects^[19]. It is not permitted for board members to be an unlimited partner in a competing company, to engage in a competing business on their own behalf or on behalf of a third party, or to serve as a director or managing director in a competing company, except in instances where such activities have been authorized by a members' meeting^[20]. Such directors are required to disclose any interest they may have in the cooperative's business. In such cases, the board is obliged to consider the rationale for and the convenience of the business when deciding whether to proceed^[21]. This is based on the premise that such business contributes, directly or indirectly, to the realization of social objectives.

It is also required that directors perform their duties with due diligence, in accordance with the nature of their activities and specific qualifications. In the event of contravention of this obligation^[22], they shall be held liable, including for damages caused by the failure of social cooperatives to carry out their duties and for damages resulting from negligent actions of individual members and third parties. In the event of a dissenting member of the board, said member is obliged to immediately note their dissent in the register of meetings and resolutions and notify the chairman of the supervisory board thereof prior to being exempt from liability^[23]. In cases of a particularly serious nature, the director may also be dismissed by the general meeting.

In conclusion, social cooperatives are more effective than company-type social enterprises in advancing the collective interests of the community, particularly with regard to the compensation of social enterprise directors and their duties. Firstly, the remuneration of directors is determined by the general meeting, with the social nature of members in social cooperatives orientated towards the protection of social goals when considering this issue. This is in contrast to the profit-seeking attitude of shareholders. Consequently, the remuneration of directors in social cooperatives is

¹⁹ Charles T. Autry, Roland F. Hall, *The Law of Cooperatives* (American Bar Association, Section of Business Law, 2009), 62-65.

²⁰ Art. 2390 para. 1, Italian Civil Code.

²¹ Art. 2391 para. 1 & 2, Italian Civil Code. This director must inform other directors and the Statutory Audit Committee of any interest that he or she may have; where he or she is a Managing Director, he or she would also have to abstain from executing that transaction and notify the Statutory Audit Committee.

²² Art. 2392 para. 1, Italian Civil Code.

²³ Art. 2392 para. 3, Italian Civil Code.

conducive to the realization of social benefits. Directors in social enterprises that take the form of associations or foundations are typically compensated only in very specific instances. Furthermore, the duties of directors in social cooperatives bear some resemblance to those in company-type social enterprises. However, directors in social cooperatives are more likely to „inherit” a greater degree of „sociality” from their members. Consequently, social cooperatives may be more inclined to pursue social objectives in the execution of their directors’ duties and obligations.

2 | Shareholders/members

2.1 The non-distribution constraint to shareholders/members

It is prohibited to distribute profits to shareholders or members of social enterprises under Italian law^[24]. The diversity of legal forms available for social enterprises – that is to say, all private entities, with the exception of a few exceptional cases^[25], that meet certain criteria – offers them the opportunity to acquire the status of social enterprise^[26]. In this context, the asset lock does not constitute a total prohibition on profit distribution. While social enterprises registered as companies or cooperatives are permitted to issue dividends to their shareholders or members^[27], other legal forms of social enterprises, such as foundations or associations, religious entities, and so on, which may be registered as social enterprises, are not allowed to distribute profits to their members.

In the case of social enterprises incorporated under Book V of the Civil Code, there are certain restrictions on the distribution of dividends. The distribution of profits is initially determined by the general meeting^[28] and social enterprises in the form of the company are limited to the terms of profit allocation. The distribution of profits is initially determined by the general meeting. Social enterprises in the form of a company are

²⁴ Art. 3 para. 1, law no.112/2017.

²⁵ Art. 1 para. 2 & 3, law no.112/2017.

²⁶ Art. 1 para. 1, law no.112/2017.

²⁷ Art. 3 para. 3 a), law no.112/2017.

²⁸ Art. 2433 para. 1, Italian Civil Code.

restricted to the terms of profit allocation. These entities may allocate to their shareholders an annual share of profits, which shall be below 50% of the total annual profits (minus the accumulated losses of previous years). Furthermore, each shareholder may not receive dividends exceeding the maximum interest rate of the postal bond increased by 2.5 points on the paid-in capital^[29]. It should be noted, however, that social enterprises in company form are not always required to distribute profits. Such social enterprises are also subject to the rules that govern the operation of Italian companies, whether limited liability companies (s.r.l.) or joint-stock companies (s.p.a.). In the event that the share capital is in a deficit^[30], it may not be allocated profits until the share capital has been replenished by an amount equal to the deficit. Furthermore, at least 1/20 of net profits must be set aside in a legal reserve until this reserve reaches 20% of the share capital^[31]. Once the statutory reserve has been allocated, any remaining profits can be distributed to other specific reserves, as outlined in the company's statutes. A social enterprise in this form may only proceed to distribute its profits once it has complied with these two provisions.

Furthermore, joint-stock companies (s.p.a.) frequently possess the ability to reasonably forecast their profits several months before the conclusion of the financial year. Consequently, it is not uncommon for the advanced payment of dividends to be distributed to shareholders based on these projections^[32]. In such a case, shareholders may not be able to claim dividends paid in good faith by the company^[33]. This scenario is likely to have a negative impact on the social enterprise. To be precise, such social enterprises, while meeting the two conditions of early payment of dividends and bona fide receipt of dividends by shareholders, may still be constrained by the distribution of profits. This portion of the assets would otherwise flow into the shareholders' pockets, albeit in a reduced amount as compared to that of a joint-stock company. Consequently, this could result in such assets being used to feed the profit-seeking mentality of shareholders rather than being invested in activities that benefit the community, which could jeopardize the social purpose of the social enterprise.

²⁹ Art. 3 para. 3 a), law no.112/2017.

³⁰ Art. 2433 para. 3, Italian Civil Code.

³¹ Art. 2430 & 2463, Italian Civil Code.

³² de Nicola, Carone, „Chapter 14. Financial Statements”, n. 5, 159-169.

³³ Art. 2433 para. 4, Italian Civil Code.

The distribution of dividends to members of social cooperatives is likewise subject to the relevant provisions on social enterprises, as previously stated. It is important to note that this should be read in conjunction with Article 2514 of the Civil Code^[34]. This implies that, concerning the distribution of profits, reserves, and residual assets, social cooperatives are treated as if they were prevalent mutual cooperatives^[35]. In practice, cooperatives, including social cooperatives and prevalent mutual cooperatives, are required to allocate at least 30 % of their annual profits to their statutory reserves^[36], while 3% of their annual profits must also be allocated to the mutual funds^[37]. With regard to the distribution of the remaining profits, the statutes are required to stipulate the manner and maximum percentage of dividends that can be allocated to members. These dividends can only be paid out when the ratio between net assets and liabilities is greater than one-quarter^[38]. It is unclear whether all reserves in prevalent mutual cooperatives are indivisible, comprising reserves not declared indivisible by their charters, or only those statutory reserves under article 2545quater, paragraph 1, as well as voluntary reserves that are indivisible per the cooperatives' articles of association^[39].

It should also be noted that Italian law is not explicit in regards to refunds to members of social cooperatives^[40]. However, given that social cooperatives serve the general interest of the community, it seems that the distribution of cooperative refunds to members is incompatible with their status as non-mutual cooperatives^[41]. This solution may prevent members of social cooperatives from benefiting financially from the activities carried out by these entities, ensuring that no public resources are misused^[42].

In the case of social enterprises in the association/foundation form, there is either an absence of a profit motive for social enterprises^[43] or,

³⁴ Art. 3 para. 1, law no. 381/1991.

³⁵ Antonio Fici, „Chapter 9. Italian”, [in:] *Principles of European Cooperative Law: Commentaries and National Reports*, Gemma Fajardo, Antonio Fici, Hagen Henry, David Hiez, Hans-H. Münkner, Ian Snaith (Cambridge: Intersentia, 2017), 347-408.

³⁶ Art. 2545quater, para. 1, Italian Civil Code.

³⁷ Art. 2545quater, para. 2, Italian Civil Code.

³⁸ Art. 2545quinquies, Italian Civil Code.

³⁹ Fici, „Chapter 9. Italian”, n. 35.

⁴⁰ David Hiez, „General Interest Cooperatives: A Challenge for Cooperative Law” *International Journal of Cooperative Law*, No. 1 (2018): 93-108.

⁴¹ Fici, „Chapter 9. Italian”, n. 35.

⁴² Ibidem.

⁴³ Art. 3 para. 2, law no.112/2017.

as nonprofit organizations per se^[44], even belong to the third sector^[45], they are not permitted to allocate profits to members. These restrictions are, in essence, an absolute prohibition on the profit distribution therein. Thus, to ensure and preserve this objective, the profits of an association or foundation registered as a social enterprise must be used to carry out legal activities that advance civic, solidarity, and social welfare purposes^[46].

In practice, the constraint of profit distribution by a social enterprises may be breached indirectly, namely, by conduct which, without any reason, is particularly advantageous to shareholders or members^[47]. For instance, a social enterprise may provide shareholders or members with goods or services at a price that is better than the market rate^[48]. Alternatively, it may pay them salaries that are 40 percent higher than the rates set forth in the collective agreement for similar qualifications, except in cases where acquiring a specific skill is necessary to perform an activity of general interest^[49].

In conclusion, concerning these restrictions on the distribution of profits, social enterprises in the form of associations or foundations are more stringent in this regard than those in the form of companies and cooperatives. This ensures that all profits would be directed toward social objectives. In contrast, while the majority of profits in companies and cooperatives are also used to benefit the community, a small portion may be distributed as dividends to shareholders or members or used as compensation in specific cases. This practice may indirectly undermine the achievement of social objectives.

⁴⁴ Henry Hansmann, *The Ownership of Enterprise*. Cambridge, Mass.-London: Harvard University Press, 2000. <https://doi-org.proxy.bnl.lu/10.4159/9780674038301>.

⁴⁵ Art. 8, para. 2, law no. 117/2017.

⁴⁶ Art. 8, para. 1, law no. 117/2017.

⁴⁷ Antonio Fici, „The Social Enterprise in Cooperative Form, Cooperativismo e Economía Social” *CES*, No. 39 (2016-2017): 31-53.

⁴⁸ Art. 3 para. 3 e), law no.112/2017.

⁴⁹ Art. 3 para. 3 b), law no.112/2017.

2.2. Restrictions of interest on debentures (in relation to the shareholders/ members)

Italian law does not prohibit social enterprises from issuing debt financial instruments, including convertible debentures, provided that the remuneration amount does not exceed two points of the maximum limit set for distributing dividends to shareholders by social enterprises in company form^[50]. Otherwise, this would constitute an indirect allocation of profits, which would be detrimental to achieving social targets.

The method and content of conversion of convertible debentures is dependent on the legal form of the social enterprise. In the case of social enterprises in company form, the company constitution may grant the directors the right to issue convertible debentures^[51]. Existing shareholders or bondholders of this enterprise may subscribe to them, but there is a potential risk. In practice, shareholders' subscription rights to debentures are not prohibited by legislation on social enterprises. The law stipulates that the maximum return to them is higher than the maximum dividend to shareholders^[52], which may encourage shareholders to subscribe for convertible bonds in order to pursue their financial interests.

The shareholders' extraordinary meeting is responsible for determining the conversion ratio and the manner of conversion of convertible debentures, etc.^[53]. It is therefore less likely that these shareholders would be social impact investors if the resolution of the meeting decides that these convertible debentures may be converted into voting shares under certain circumstances^[54]. In such cases, an increase in the share capital of social enterprises^[55] may result in a shift in control towards shareholders with a profit orientation, rather than those with a pro-social focus. This could potentially impact the achievement of the social mission of the enterprise.

⁵⁰ Art. 3 para. 3 c), law no.112/2017.

⁵¹ Art. 2420ter, Italian Civil Code.

⁵² Art. 3 para. 3 c), law no.112/2017.

⁵³ Art. 2420bis, para. 1, Italian Civil Code.

⁵⁴ An exception to this is the trigger clause for convertible bonds, which relates to threats to social targets.

⁵⁵ Alessandro de Nicola, Marco Carone, „Chapter 6. Debentures”, [in:] *Italian Company Law* (EGEA, 2014), n.5, 79-85. The company shall concurrently resolve the increase of the share capital by an amount corresponding to the shares to be allocated by way of conversion.

In the case of social cooperatives, the issuance of convertible debentures is slightly distinct from that of social enterprises in company form. In accordance with Law No. 448/1998, social cooperatives are permitted to issue convertible bonds^[56], which is a key aspect of their financial structure. Conversely, cooperatives governed by the rules of limited liability companies (s.r.l.) only offer subscription instruments without administrative rights to qualified investors. Each member is entitled to one vote^[57], regardless of the share value or volume of stocks held. Additionally, bondholders may become members of the cooperative upon conversion of convertible bonds, thereby acquiring voting rights.

It is unclear if the term „administration rights” refers solely to the management rights of the board of directors^[58], or if it encompasses the principle of autonomy through the democratic principle of realization of members’ self-governance, self-control, and self-responsibility^[59]. It is likely that a way can be found to read the document in such a way that an additional covenant can be made in the conversion agreement that the bondholders are not entitled to the right to vote or to participate after conversion, nor are they allowed to become board members^[60]. Thus, the issuance of convertible bonds would have a minimal impact on the achievement of societal objectives for members of social cooperatives. However, the return to bondholders remains within the maximum limit set forth in the law on social enterprises.

In the case of social enterprises in the association/foundation form, they may not be financed through an approach of issuing convertible debentures, as is permitted for the previous two legal forms of social enterprises. However, they may issue social bonds and obtain funds in this way^[61] as these entities belong to the Italian third sector. It is not necessary to convert

⁵⁶ Reference: Sara Meloni, „Financial Instruments in Italian Co-Operative Companies” *SSRN* (2013). <https://ssrn.com/abstract=2246443>.

⁵⁷ Art. 2538, para. 2, Italian Civil Code.

⁵⁸ Hagen Henry, *Guidelines for Cooperative Legislation* (Geneva: International Labour Office, 2012) 86-89.

⁵⁹ *Ibidem*, n.58, 51-63.

⁶⁰ While bondholders may desire voting rights in social cooperatives following conversion, they must first become members. Only members within cooperatives have voting rights, and the rule of „one member, one vote” applies. To become a member, an individual must meet the qualifications for membership.

⁶¹ Art. 77 para. 1, law no. 117/2017.

these debentures in this context, as such securities are distinguished from convertible bonds^[62].

In conclusion, the issuance of convertible bonds may have some unfavorable effects on the pursuit of social enterprise objectives. Shareholders or members of both social enterprises in company form and social cooperatives may purchase such bonds. However, the interest ceiling on debt instruments is higher than that on dividends. Furthermore, given the profit-driven nature of shareholders, social enterprises in company form are more disadvantageous than social cooperatives in terms of pursuing and realizing social objectives. Furthermore, the purchase of these bonds is slightly more restrictive in a social cooperative than in a company form of social enterprise. This may indirectly contribute to the pursuit of the general interest of the community by limiting members' ability to purchase such bonds.

2.3. The repurchase of shares from shareholders/members

In Italy, the repurchase of shares by social enterprises from their shareholders or members is subject to different regulations depending on the type of entity involved. This section will provide an analysis of the issuance and redemption of shares in social enterprises based on various legal forms of Italian social enterprises.

In the case of companies with the status of social enterprises, the social enterprise law does not impose any specific restrictions on this issue. However, redeemable shares are effectively shares with a put option against the company, which has the same effect as a clause in the company's bylaws that allows ordinary shareholders to withdraw at will. Therefore, the issuance of these shares and the corresponding restrictions on the right to withdraw arbitrarily are permitted^[63]. As shareholders can exit freely only in unlisted companies with no definite term^[64], redeemable shares (put options) can be issued exclusively in such companies. With regard to redeemable shares, it should be noted that shares used as call options are not subject to this restriction. Furthermore, they can also be used as

⁶² Art. 77 para. 2, law no. 117/2017.

⁶³ Alessandro de Nicola, Marco Carone, „Chapter 3. Joint-stock companies: general remarks”, [in:] *Italian Company Law* (EGEA, 2014), n.5, 25-30.

⁶⁴ Art. 2437, para. 3, Italian Civil Code.

a poison pill to prevent hostile takeovers^[65] and to deter social enterprises from deviating from their social purpose.

With regard to the redemption of shares, withdrawing shareholders are entitled to request that their shares be purchased by other shareholders or third parties (as will be discussed in the next section) or by the company itself. These shareholders are, in principle, required to sell their shares for a price that is not less than the redemption value^[66]. It is important to ensure that this does not contravene the constraints on the distribution of profits. For example, if shareholders sell their shares to other shareholders or to the company for a price significantly lower than the market value of the shares, this could result in an indirect distribution of profits. In this case, if the shares are sold to other shareholders, it will not affect the voting rights of the shareholders because these shares are only entitled to dividends^[67]. However, if the company's articles of association stipulate that redeemable shares are entitled to vote at the shareholders' general meeting, it could impact the realization of social welfare objectives. This would depend on whether the transferee shareholders are social impact investors. If so, it could help protect social welfare objectives. Otherwise, it could hinder the realization of societal aims.

In the case of social cooperatives, the repurchase of members' shares is subject to certain limitations. These include restrictions on the transfer of shares to a third party or to the cooperative itself. The repurchase of shares by the cooperative is subject to the following conditions: firstly, it must be authorised by the board^[68], secondly, members' shares must be transferred in full, not partially^[69]; and thirdly, members may be withdrawn in accordance with the provisions of the law or the bylaws^[70]. Furthermore, the repurchase of cooperative members' shares is limited to the amount paid by the members at the time of subscription.

It is evident that the restrictions on the withdrawal of cooperative members and the transfer of shares, which were initially implemented to protect the interests of existing members of cooperative^[71] have served precisely

⁶⁵ de Nicola, Carone, „Chapter 3. Joint-stock companies: general remarks”, n.63.

⁶⁶ Idem, „Chapter 16. Amendments to company's constitution”, n.5, 181-194.

⁶⁷ Art. 2353, Italian Civil Code.

⁶⁸ Art. 2530, para. 1, Italian Civil Code.

⁶⁹ Art. 2532, para. 1, Italian Civil Code.

⁷⁰ Ibidem.

⁷¹ Antonio Fici, „Capitolo 12-Autonomia statutaria e recesso del socio nelle società cooperative”, [in:] *Imprese cooperative e sociali: Evoluzione normativa, profili*

to safeguard the societal purposes of the enterprise. In particular, the withdrawal limit mitigates potential risks in pursuing the enterprise's objectives due to the incentive uncertainty of new members, while the share transfer limit effectively precludes the possibility of an indirect distribution of profits. This discipline demonstrates the superiority of the cooperative form of social enterprise over the corporate form of social enterprise in terms of the protection of its social goals.

3 | Third parties

3.1. The transactions with third parties

It is not permitted for social enterprises to purchase goods or services at a price higher than the normal price without sufficient economic grounds^[72], regardless of the legal form under which they are operating. It is unclear whether the term „normal price” in this context refers to the market price of goods. However, it can serve as a reference point for evaluating such prices. Social enterprises may also engage in trade with third sectors beyond social enterprises at prices below the aforementioned normal prices. Furthermore, the law permits gratuitous donations to these entities, provided that they are not founders, partners, or companies controlled by social enterprises^[73]. In this non-commercial context, the movement of funds^[74], may be eligible for tax benefits. From this perspective, the free appropriation of assets to the third sector is, in effect, the equivalent of promoting social objectives by social enterprises.

sistematici e questioni applicative (Turin: G. Giappichelli Editore, 2012), 229. In this chapter, Professor Fici explained the asymmetry between membership and withdrawal demonstrating how it can be effectively understood from the perspective of the social function of cooperatives. The admission of new members is a means for cooperatives to disseminate the benefits they are capable of generating, whereas the exercise of withdrawal may represent a conduct by which members may pursue their individual interests rather than the common benefits of the cooperative.

⁷² Art. 3 para. 2 e), law no.112/2017.

⁷³ Art. 3 para. 3 b), law no.112/2017.

⁷⁴ Antonio Fici, „Social Enterprises and Social Cooperatives in the New Italian Legal Framework for Third Sector Organizations”, [in:] *Perspectives on Cooperative Law*, ed. Willy Tadjudje, Ifigenia Douvitsa (Singapore: Springer, 2022), 77-88.

This is the flow of funds from social enterprises to the third sector for the promotion of specific social welfare projects. While these projects may not be in the service of the social objectives defined in the statutes of the social enterprises concerned, they are another means of preserving the broader sense of social purpose.

3.2. The transfer of shares to third parties

The transfer of shares in social enterprises is subject to varying restrictions depending on the legal form involved. As social enterprises in the form of associations/foundations and religious institutions primarily rely on funding sources such as public financial support and donations from other entities, the issuance of shares is not a viable means of raising funds. Consequently, this section will not address such social enterprises but will focus on the transfer of shares in social enterprises in the form of companies and cooperatives to third parties.

In the case of social enterprises operating as a company, the transfer of shares to a third party represents a means for shareholders to exit their investment. The transfer of shareholders' shares is relatively free^[75], but it is essential to be aware that shareholders may not transfer their shares to a third party on more favorable conditions than those in the market^[76], as this may breach the restrictions of the non-profit distribution. In such cases, an exception may be made if the transferee is an entity of the third sector or if the purpose of the transferee is to pursue an objective of general interest^[77].

Another scenario in which the transfer of shares to a third party occurs is when a company redeems its shares. This is typically done to ensure that the departing shareholder disposes of his or her shares for a price that is not less than the redemption value. Italian law stipulates that, in the event that the other shareholders in a company do not purchase all or part of the withdrawing shareholder's shares, the directors may then sell those shares to third parties. Alternatively, should the shares be listed, they are placed on the relevant regulated market by way of an offer^[78]. In this case, it is less

⁷⁵ Alessandro de Nicola, Marco Carone, „Chapter 5- Share capital, shares and capital maintenance”, [in:] *Italian Company Law* (EGEA, 2014), n.5, 49-78.

⁷⁶ Art. 3 para. 2 e), law no.112/2017. In this case, the goods that shareholders provide are shares.

⁷⁷ Art. 3 para. 3 b), law no.112/2017.

⁷⁸ Art. 2437-quarter, Italian Civil Code.

likely that the risk of breaching the mechanism for limiting the distribution of profits from social enterprises is reflected in the price of the transfer of the shares. However, there is a risk that the new stockholder, who may not be a social impact investor or proponent, may use their right to vote at the shareholders' meeting to affect the result of resolutions concerning social activities. This could have an adverse impact on the community's benefits and the achievement of social well-being.

In the case of social cooperatives, the transfer of shares and the withdrawal of members are two distinct but related processes. It is important to note that members have the right to withdraw from a cooperative only under circumstances permitted by law or by the cooperative's bylaws^[79]. This means that members cannot withdraw freely and unconditionally, even if the variability of the cooperative's capital cannot be interpreted as a technical scheme designed to facilitate the exit of members^[80]. In instances where withdrawal is impermissible, social cooperative members may be locked inside it, and thus unlimitedly exposed to opportunistic behaviors by directors and majority members^[81]. If the transfer of shares is prohibited in the statutes, then shares in cooperatives cannot be transferred to third parties. Furthermore, the right to withdraw cannot be exercised before a period of two years has elapsed since the member joined the entity^[82].

In the event that the law or the constitution of the social cooperative permits the withdrawal of members, a declaration of such withdrawal must be communicated to the cooperative. Following a review by the directors^[83] the member may be exited from the company. In the event that the board of directors authorizes the transferability of members' shares^[84], the cooperative reserves the right to accept or reject this authorization. The decision will be communicated to the member within 60 days of receipt of their notification of the proposed transfer of shares^[85].

⁷⁹ Art. 2532, para. 1, Italian Civil Code.

⁸⁰ Antonio Fici, „Capitolo 12. Autonomia statutaria e recesso del socio nelle società cooperative”, [in:] *Imprese cooperative e sociali: Evoluzione normativa, profili sistematici e questioni applicative* (Turin: G. Giapichelli Editore 2012), 213-261.

⁸¹ Antonio Fici, „Chapter 1- An Introduction to Cooperative Law”, [in:] *International Handbook of Cooperative Law*, ed. Dante Cracogna, Antonio Fici, Hagen Henry (Berlin-Heidelberg: Springer, 2013), 3-62.

⁸² Art. 2530, para. 6, Italian Civil Code.

⁸³ Art. 2532, para. 2, Italian Civil Code.

⁸⁴ Art. 2530, para. 1, Italian Civil Code.

⁸⁵ Art. 2530, para. 3, Italian Civil Code.

Should the social cooperative elect to repurchase members' shares, this would constitute a buyback of shares. In the event that the cooperative remains silent beyond the aforementioned period, members are free to transfer their shares to a third party. The cooperative is then obliged to register any buyers who meet the requirements to qualify for membership in its register of members^[86]. The transfer of members' shares in a social cooperative cannot exceed the price of the normal value. Otherwise, there is a violation of the rule restricting the distribution of profits (indirect distribution). However, the legislation has yet to define the standard price for shares in cooperatives. In the event that cooperatives decline this authority, namely, decide not to purchase members' shares, members may choose to appeal the refusal to the court^[87].

However, in the event of a prohibition on share transfer as outlined in the social cooperative's bylaws, a member may notify the cooperative at least 90 days in advance of their intention to withdraw^[88]. The shares may not be transferred to a third party, and the member is entitled to the return of that party's contribution^[89]. If the law prohibits the transfer of shares in a cooperative, members are free to withdraw after a period of two years. In this instance, the shares are also not transferable to third parties, and members are entitled to demand the return of their contributions^[90].

In transactions between social enterprises and third parties, the specific organizational form has minimal impact on the protection of the social mission. This is true even when the third party is part of a third-sector organization, provided that the arm's-length limit is not exceeded. In such cases, the social goals of the social enterprise remain safeguarded. With regard to the transfer of shares in a social enterprise to a third party, social cooperatives are subject to greater constraints than social enterprises in company form. Furthermore, the withdrawal of members is more limited than the exit of shareholders. The relative freedom of shareholders to transfer their shares presents potential challenges to the pursuit of social goals for social enterprises in company form. This is particularly relevant when the new shareholders are not social impact investors.

⁸⁶ Art. 2530, para. 4, Italian Civil Code.

⁸⁷ Art. 2530, para. 5, Italian Civil Code.

⁸⁸ Art. 2530, para. 6, Italian Civil Code.

⁸⁹ Antonio Fici, „Chapter 1- An Introduction to Cooperative Law”, [in:] *International Handbook of Cooperative Law*, ed. Dante Cracogna, Antonio Fici, Hagen Henry (Berlin-Heidelberg: Springer, 2013), 3-62.

⁹⁰ Art. 2530, para. 6, Italian Civil Code.

4 | Controller

4.1. Internal control bodies: auditors

The articles of association of a social enterprise may stipulate the appointment of one or more auditors^[91], who must be selected from among the registered statutory auditors^[92]. The auditor(s) may conduct inspections and audits at any time^[93], including during the winding-up process. Directors may therefore be required to provide information pertaining to business processes or specific affairs, and social enterprises may also be requested to do so^[94]. Furthermore, if the social enterprise exceeds two of the limits^[95] in two consecutive financial years^[96], it shall undergo a statutory audit by the auditor(s), or an auditing firm registered in a special register, or auditors registered in the special register of statutory auditors^[97].

These auditors are primarily responsible for two key areas. It is the responsibility of the auditors to monitor compliance with applicable laws and regulations, the company's own statutes, and the principles of proper management. In addition, they must assess the adequacy of the organizational, administrative, and accounting structures and their actual functioning^[98]. On the other hand, they are also supposed to watch over the entity's observance of the social objectives, in particular the constraints on non-profit distribution, the discipline of the salaries of directors and self-employed staff, the transfer of shareholdings and withdrawal of shareholders/members, the restrictions on transaction with third parties, and the way in which workers, users, and other stakeholders are involved in the activities of the social enterprise, etc. Besides, the auditors have to certify that the social report is prepared in compliance with the code adopted by the Decree of the Ministry of Labor and Social Policy^[99]. The social balance

⁹¹ Art. 10 para. 1, law no.112/2017.

⁹² Art. 2397, para. 2, Italian Civil Code.

⁹³ Art. 10 para. 4, law no.112/2017.

⁹⁴ *Ibid.*

⁹⁵ Limits: 1) total balance sheet assets: 4,400,000 €; 2) revenues from sales and services: 8,800,000 €; 3) average number of employees employed during the financial year: 50.

⁹⁶ Art. 10 para. 5, law no.112/2017; art. 2435-bis para. 1, Italian Civil Code.

⁹⁷ Art. 10 para. 5, law no.112/2017.

⁹⁸ Art. 10 para. 2, law no.112/2017.

⁹⁹ Art. 10 para. 3 & art. 9 para. 2, law no.112/2017.

sheet should be published online, and the results of mayor's supervision shall be confirmed^[100].

In addition, given the peculiarities of the legal form of the incorporation of a social enterprise, the governance system of a joint-stock company (s.p.a.), if the traditional model is used, the body that carries out the duties of internal control also contains the board of statutory auditors. However, the company's financial statements must be audited by an external auditor or the board of statutory auditors. In the case of a p.a., the body responsible for internal control is the board of supervisors. When a s.p.a. employs the monistic model, its regulatory body is the internal control committee, which is appointed by the board of directors from among its members^[101]. In social cooperatives, in addition to the former monitoring body for social enterprises (statutory auditors), there is also the supervisory board. Members of this board must not have a conflict of interest with the social cooperative^[102].

4.2. External control bodies: Ministry of Labor and Social Policies (MLSP) and Ministry of Economic Development (MED)

The MLSP monitors social enterprises (non-cooperative forms)^[103]. The Ministry entrusts to the National Labor Inspectorate the monitoring function to verify the compliance of social enterprises with the compliance of Legislative Decree 112/2017^[104]. A decree of the MLSP regulates the form, content, and methodology of inspection activities of social enterprises^[105].

The controlling activities for social enterprises in the form of non-cooperative social enterprises are divided into ordinary inspections (available to be carried out by selected associations) and extraordinary inspections (the inspection function is always entrusted to the Inspectorate)^[106]. Both types of inspections are subject to reporting forms approved by a decree of the MLSP, and the results of the controlling activities must be reported

¹⁰⁰ Ibid.

¹⁰¹ de Nicola, Carone, „Chapter 5- Directors”, n.5, 107-121.

¹⁰² Art. 2399, Italian Civil Code.

¹⁰³ Art. 15 para. 1, law no.112/2017

¹⁰⁴ Art. 15 para. 2, law no.112/2017

¹⁰⁵ Art. 15 para. 4, law no.112/2017

¹⁰⁶ Art. 3, Decreto Ministeriale del 29 marzo 2022.

exclusively in a model report approved by the same decree^[107]. Social enterprises are subject to ordinary inspections at least once a year.^[108] In the case of social enterprises in the form of associations, the responsibility for carrying out ordinary inspections falls upon inspectors appointed by the associations themselves^[109]. The objective of the ordinary inspection is to verify that the social enterprise is effectively pursuing the objectives of citizenship, solidarity, and social responsibility, that it is in compliance with the limitations and conditions pertaining to the principle of non-profitability, and that it is adhering to the provisions concerning the involvement of workers and other stakeholders in the governance of the company^[110]. The ordinary inspection may yield one of five results^[111].

When it is necessary to enter into in-depth investigation of the findings of the control carried out, for the sake of sample checks, following the submission of a complaint by a shareholder or interested party, or upon notification by the public administration, the MLSP shall order a special inspection^[112]. This inspection aims to check whether the social enterprise is in compliance with all relevant legislative, regulatory, and legal provisions, whether the entity is functioning properly, and whether its activities are being carried out in accordance with the relevant standards^[113]. Based on

¹⁰⁷ Art. 4, Decreto Ministeriale del 29 marzo 2022.

¹⁰⁸ Art. 10 para. 1, Decreto Ministeriale del 29 marzo 2022.

¹⁰⁹ Art. 10 para. 3, Decreto Ministeriale del 29 marzo 2022.

¹¹⁰ Art. 12 para. 1, Decreto Ministeriale del 29 marzo 2022.

¹¹¹ Art. 14, Decreto Ministeriale del 29 marzo 2022. They are: i) If no irregularities are found, the ordinary inspection ends with the signing of an inconclusive inspection report. ii) In case a remediable irregularity is discovered in the inspection, the inspector issues a warning to the administrative body of the social enterprise, assigning a time limit of between 30 and 90 days for regularization. After the designated period has elapsed, the inspector shall verify this and confirm it in the relevant report. iii) In the event of non-compliance or even partial compliance, the inspector formally makes a reasoned, non-binding recommendation through an appropriate report. In the event that the lack of control is attributed to the non-existence of the entity, the inspector shall propose the adoption of provisions providing for the loss of SE status. In the event that violations that cannot be remedied are detected during the inspection, the inspector shall formally make a reasoned recommendation for the approval of provisions providing for the loss of SE status by means of an appropriate report. Based on this information, the Ministry may request a judicial assessment of the insolvency status of the enterprise. If the enterprise meets the requirements, the Ministry may then proceed with the administrative compulsory liquidation of the social enterprise.

¹¹² Art. 17 para. 1, Decreto Ministeriale del 29 marzo 2022.

¹¹³ Art. 18 para. 1, Decreto Ministeriale del 29 marzo 2022.

the results of the special inspection, the Ministry determines the measures to be suggested^[114].

The external control of social cooperatives is conducted by the MED in agreement with the MLSP,^[115] There are two kinds of inspections: cooperative audits and special inspections. The reporting patterns of these dual inspections are authorized by a decree of the MED. Social cooperatives are subject to cooperative audits in accordance with the frequency and methods set forth in the Ministerial Decree^[116], and the review of cooperatives has to be carried out every two years, and the cooperative scrutiny is conducted by the Ministry via the auditor appointed by it^[117]. Associations are bound to audit the social cooperatives falling under their umbrella, including those institutions whose resources have been dissolved^[118]. The purpose of the inspection of social cooperatives is the same as that of the inspection of social enterprises (non-cooperative forms)^[119]. The Ministry may also order special checks of social cooperatives^[120]. The cooperative examination is based on the need to conduct a comprehensive analysis of a selected sample and to order a special inspection when deemed appropriate.

Furthermore, the monitoring body may appoint a temporary commissioner, who may also serve as the legal representative, in the event that inspection activities are impeded or if the social enterprise fails to regulate illegal acts within a reasonable timeframe. This may occur in the context of a social enterprise operating as a cooperative or a non-cooperative entity^[121]. In the event of a breach that cannot be remedied or is not redressed, the Minister may order the removal of the social enterprise's status^[122].

In general, the internal regulation and external controls of social enterprises are not yet sufficiently robust with regard to asset lock protection. The law allows internal auditors of social enterprises to conduct inspections at any time. However, it does not stipulate penalties for negligence or failure of regulators to exercise this power. Furthermore, external controllers of social enterprises are responsible for conducting both ordinary and special inspections to regulate the specifics of social activities and

¹¹⁴ Art. 20 para. 1, Decreto Ministeriale del 29 marzo 2022.

¹¹⁵ Art. 15 para. 5, law no.112/2017.

¹¹⁶ Art. 2 para. 1, law no. 220/2002.

¹¹⁷ Art. 2 para. 2 & 3, law no. 220/2002.

¹¹⁸ Art. 2 para. 6, law no. 220/2002.

¹¹⁹ Art. 15 para. 5, law no.112/2017.

¹²⁰ Art. 8 para. 1, law no. 220/2002.

¹²¹ Art. 8 para. 7, law no. 220/2002.

¹²² Art. 8 para. 8, law no. 220/2002.

the pursuit of social objectives. However, there is a lack of clarity regarding the sanctions for not effectively exercising this role of surveillance. Furthermore, the stipulations regarding special inspections are somewhat vague, which presents certain challenges in conducting these inspections.

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