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The bylaw clause that breaks decision-making deadlocks in companies



Contents

Overview

**The deadlock
in corporate
management: an
overview**

Expert's opinion

**How to
overcome a
management
deadlock**

Focus on

**The case of a
limited liability
company
operating in the
manufacturing
sector**

Contacts

Overview

A management deadlock occurs when disagreements among multiple directors prevent the company from making decisions – a situation that is particularly common in companies with equal ownership, family-owned companies, and joint ventures. In the worst cases, the deadlock can even lead to the dissolution of the company due to its inability to operate. To prevent this, the law allows, for limited liability companies (S.r.l.) and partnerships, the possibility to include a clause in the articles of association that entrusts one or more third parties with the resolution of management disputes, pursuant to Article 838-quinquies of the Code of Civil Procedure, introduced by the Cartabia Reform. This option, however, is still rarely used and characterized by certain controversial aspects, including its legal nature, the limited statutory autonomy, and its effects on the liability of directors. In this article, we will analyse the provision, from the inclusion of the clause in the articles of association, to the selection of the third party, up to the binding effects of the third party's decision.

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Expert's opinion

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A management deadlock is the paralysis that arises when the people holding the management power are unable to reach a decision. It is not a mere disagreement – which is a normal part of any company's life – but a structural impasse that prevents the management from deciding one way or the other.

HOW TO OVERCOME A MANAGEMENT DEADLOCK

WHAT IS A MANAGEMENT DEADLOCK AND WHEN IS THERE A REAL RISK THAT IT MIGHT OCCUR?

A management deadlock is the paralysis that arises when the people holding the management power are unable to reach a decision. It is not a mere disagreement – which is a normal part of any company's life – but a structural impasse that prevents the management from deciding one way or the other. The risk is concentrated in certain recurring scenarios. Consider, for example, companies in which two shareholders or two groups hold equal stakes, where the 50-50 split of the capital leaves no room for a majority. These situations are typical of family-owned companies and joint ventures and in these cases a deadlock, if left unmanaged, can even lead to the company's dissolution due to its inability to operate.

ARTICLE 838-QUINQUIES OF THE CODE OF CIVIL PROCEDURE PROVIDES FOR A SOLUTION TO THIS PROBLEM. WHAT DOES IT PROVIDE, AND WHY IS IT ADVISABLE TO INCLUDE IT IN THE ARTICLES OF ASSOCIATION RATHER THAN IN A SHAREHOLDERS' AGREEMENT?

The law allows for the inclusion in the articles of association of a clause that defers the resolution of management disputes to one or more third parties. Essentially, shareholders decide that, should the management become deadlocked, an external third party will resolve the impasse with a binding decision.

The key strength lies precisely the inclusion of a clause in the articles of association, which gives it actual legal effect – that is, it is binding on the company and its corporate bodies – whereas a shareholders' agreement is binding only on the shareholders who sign it and, as a rule, cannot be enforced against the company or the directors where the dispute arises. The provision in the articles of association, therefore, directly affects the organization and remains in effect regardless of changes in the company's membership.

WHO CAN BE ENTRUSTED WITH THIS DECISION, AND HOW SHOULD THE THIRD PARTY BE ELECTED?

The law simply refers to this party as a “third party” and does not specify any requirements, leaving the matter entirely to the discretion of the articles of association. The essential quality is impartiality – meaning substantially that the directors who gave rise to the dispute cannot make the decision – while there is nothing that prevents from appointing a trusted professional or even a legal entity, such as a consulting or auditing firm.

Since the third party is called upon to make a substantive decision regarding management, it is appropriate that they have technical and entrepreneurial expertise in relation with the activity in question. The clause may either name the third party directly – providing for a replacement mechanism in the event of refusal – or delegate the selection to a designating authority, such as the president of the notarial council or the court, while specifying the criteria.

Should a committee be chosen, it is preferable to have an odd number of members to avoid deadlock among the decisionmakers.

WHAT IS THE LEGAL EFFECT OF THE THIRD PARTY'S DECISION? ARE THE DIRECTORS REQUIRED TO COMPLY WITH IT?

The decision is binding, and this binding nature results in liability for any director who fails to comply with it. However, it is important to clarify that the third party assumes responsibility only for the decision-making phase, while implementation remains on the directors, who retain the authority to act on behalf of the company. They are therefore subject to a duty to implement the decision, which is however subject to a specific limitation: if the decision is detrimental to the company, the directors may and must refuse to implement it, or else face liability. In short, they must safeguard legitimacy before the decision takes effect.

The decision may be challenged in court within the (narrow) limits set forth in Article 1349, paragraph 2, of the Italian Civil Code – that is, only by proving the third party's bad faith – and the articles of association may provide for an additional internal level of appeal before a panel. In any case, the court does not overrule the management's decision but may only annul it.

IN PRACTICAL TERMS, HOW DO YOU DRAFT AN EFFECTIVE CLAUSE? AND WHAT KINDS OF DISPUTES ARE EXCLUDED?

A good clause is one that fills in the gaps in the law. It is advisable to define what is meant by a deadlock, specify which issues may be referred, identify who has the authority to initiate the procedure, and set timeframes that are necessarily short, consistent with the need for business continuity. Another crucial decision regards choosing between a “weak” clause, which limits the third party to selecting one of the directors' proposals, and a “strong” clause, which allows the third party to fully replace the directors and decide on related matters.

Certain matters, however, remain under the exclusive authority of the directors. These concern, in particular, the establishment of organizational, administrative, and accounting structures pursuant to Article 2086 of the Civil Code, and decisions for which the Code requires a collegial approach, such as the preparation of draft financial statements or draft merger and demerger plans. It is prudent for the clause to expressly exclude them from delegation.

Focus on

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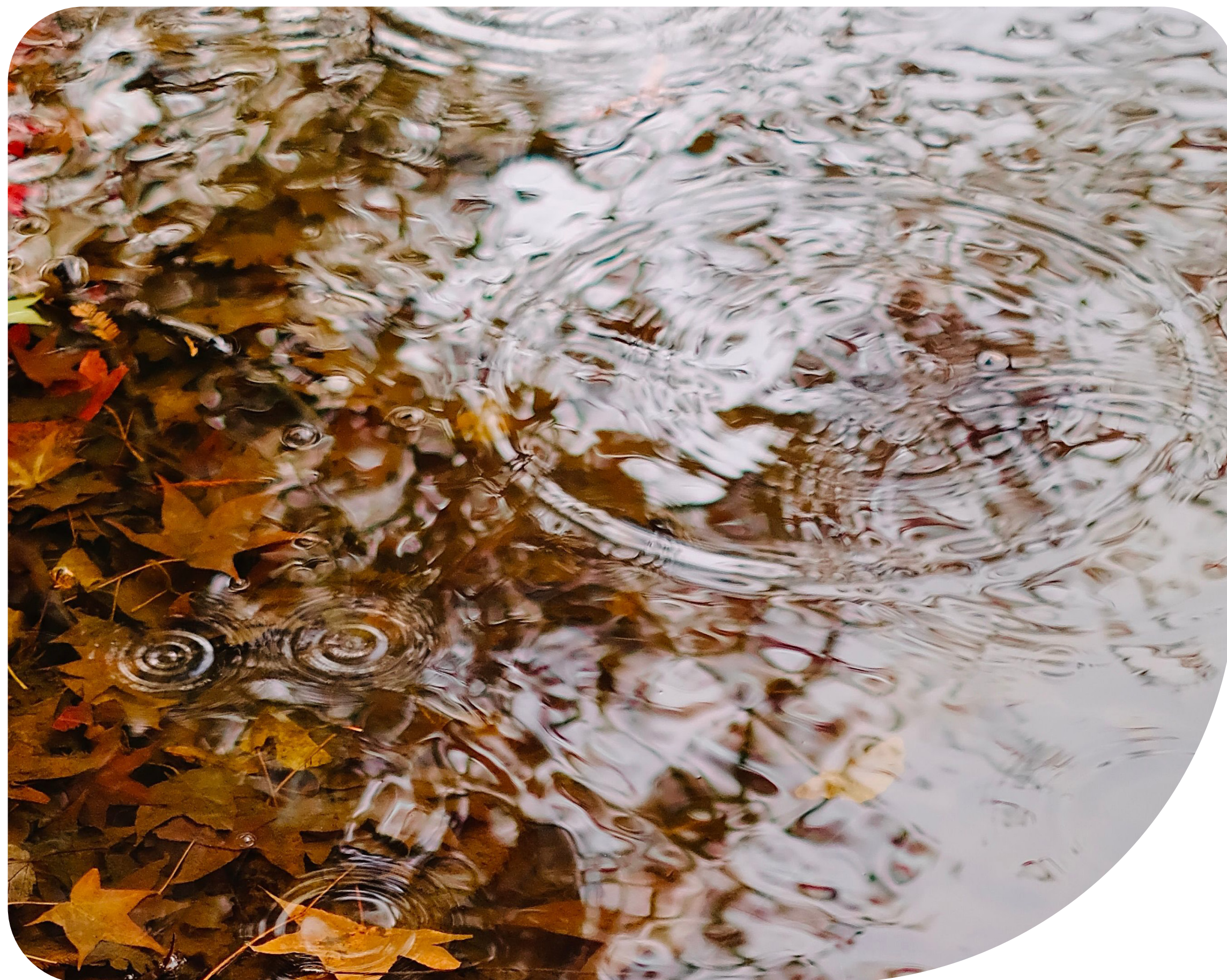
[OVERVIEW](#) | [EXPERT'S OPINION](#) | [FOCUS ON](#) | [CONTACTS](#)

CASE STUDY

The Case of a limited liability company operating in the manufacturing sector

The following case is hypothetical and is presented for illustrative purposes. It helps demonstrating, through a plausible scenario, how a provision within the articles of association drafted in advance can transform a paralyzing conflict into a decision. Let's imagine a limited liability company operating in the manufacturing sector – a solid, well-established business – whose capital is divided equally between two shareholders who are also the sole directors. As long as their paths align, equality works, because every choice stems from mutual agreement; difficulties, however, arise when their views diverge on an important decision.

For example, an opportunity arises to purchase an adjacent warehouse and double production capacity. One director considers it a must and pushes for the investment, while the other fears the financial exposure and prefers to consolidate by distributing profits. Neither of them has a majority, and neither is backing down.



The result is a deadlock, not merely a disagreement. The transaction requires a management decision that is lacking; the seller sets a deadline for accepting the offer, and that deadline passes without a response. The opportunity is lost, tensions rise, and the conflict even spills over into the shareholders' meeting, which reflects the same fifty-fifty split. From this point on, any significant decision risks stalling, and the worst-case scenario looms on the horizon: the dissolution of the company due to its inability to operate. This is the phenomenon that industry insiders call a “deadlock” – a stalemate that particularly affects joint ventures, family-owned companies, and partnerships.

What could have prevented all this? Not a separate agreement between the shareholders, which would have still been weak because a shareholders' agreement is binding only on those who sign it and, as a rule, is not enforceable against either the company or the board where the dispute arises. The answer lies in the articles of association. If the articles of association had contained a clause drafted in accordance with Article 838-quinquies of the Code of Civil Procedure, which specifically allows limited liability companies and partnerships to refer disputes regarding management to a third party for resolution, the situation would have taken a completely different turn.

In fact, when a deadlock occurs, one of the directors appeals to the provision and requests the intervention of a third party. The selection of this third party is not left to chance, because the articles of association have already established the procedure for their appointment, entrusting it to a neutral appointing authority (for example, the president of the relevant professional association), providing that the selected individual must be an expert with managerial and entrepreneurial expertise. This is the first important element of the solution – impartiality – since neither of the two directors involved in the conflict can make the decision.

The process consists of three distinct stages. In the preliminary phase, directors provide the third party with a complete dossier, including investment figures, financial sustainability, and the proposed options, because an informed decision requires that decision-maker be aware of all the relevant factors. The third party becomes involved during the decision-making phase, and this is where the difference between a vague clause and a well-drafted one becomes apparent. If the articles of association grant broad powers, the third party is not forced to choose strictly between purchasing and forgoing the property but may devise a third option – such as acquiring the warehouse through a lease with a gradual repayment plan – that balances growth and prudence. During the implementation phase, the responsibility passes back to the directors, who still have the authority to act on behalf of the company and carry out the decision.

Two crucial issues remain to be clarified, i.e.: liability and remedies. Referral to a higher authority does not absolve directors of liability; they remain liable if they have mishandled the matter or if they carry out a decision that is clearly harmful – a decision they, in fact, have a duty to reject. In this sense, they must safeguard legitimacy first. At the same time, for discretionary decisions made in an informed manner and in good faith, the “business judgment rule” applies, which protects a diligent director even when the financial results prove disappointing. Furthermore, if a third party’s decision appears to be flawed, it can be challenged in court only by proving bad faith, and the articles of association may provide for an internal appeal process before a panel even before the matter reaches court.

It must be clarified that the entrusted third party cannot replace directors in all matters.



Certain matters remain within their exclusive jurisdiction, such as the establishment of the organizational, administrative, and accounting structures required by Article 2086 of the Italian Civil Code, and decisions for which the Civil Code mandates a collegial decision-making process, such as the draft financial statements or proposed mergers and demergers. A well-drafted clause expressly excludes these matters from delegation.

The scenario described so far has a possible variation that closely affects family-owned businesses. When ownership passes from the founders to their descendants, equality among family branches may lead to a deadlock, because the source of division is not just the specific transaction, but often differing visions for the business. In these contexts, the clause can be tailored to facilitate generational transition, entrusting the resolution of disputes to a trusted third party chosen by the family or – if relationships permit it – even to the founders themselves, who are called upon to uphold the spirit of the venture. The clause thus not only becomes a remedy for paralysis but also safeguards continuity, aimed at protecting the value built up over time from a conflict that, if left unchecked, would eventually destroy it.

The analysis of this case is helpful to understand that the clause does not eliminate conflict – which is an inherent part of any shared enterprise – but it prevents that conflict from turning into paralysis. It must be tailored to the company and its internal dynamics, and the right time to include it is not when a conflict is already underway, but rather when relations are still harmonious and everyone is thinking clearly about the future. That is when, with just a few lines in the articles of association, you can create safeguard the company against deadlock.



Contacts

Our professionals are available to answer any questions or provide further clarification.



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We combine
global scale with
local insight