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Modernizing Italy's Corporate Governance Institutions: Mission Accomplished?

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This paper was prepared for the Bank of Italy conference "Corporate Governance in Italy: 10 Years After the Consolidated Law on Finance (TUF)" (Rome, 11 December 2008) For the sake of full disclosure: in the Fall and Winter 1997-98, the author was a junior official at the Bank of Italy and in that capacity was involved in the drafting of the Consolidated Law on Financial Intermediation, better known as the "Draghi Law" from the name of the then Director General of the Treasury Mario Draghi, Governor of the Bank of Italy at the time of the conference. The author next advised the Italian Ministry of the Economy and some Members of the Italian Parliament in connection with the general corporate law reform of 2001-04, with the so-called Law on Savings (the post-Parmalat reform), and with the implementation of Financial Services Action Plan Directives. In 2007 the author became (and still is) a Commissioner at Consob, the securities regulator in charge of implementing and enforcing the very provisions the Draghi Law and later reforms introduced. While the paper is written in the author's personal capacity with the ambition of providing one academic's assessment of Italian corporate governance reforms, the author wishes to apologize in advance with the reader should the past and/or present advisory and regulatory roles inadvertently taint the author's quest for objectivity. The author wishes to thank Enrico Baffi, Massimo Belcredi, Marcello Bianchi, Magda Bianco, Sabino Fortunato, Matteo Gargantini, Paolo Giudici, Renato Maviglia, Giovanna Nicodano, Salvatore Providenti, Paolo Santella, and Giovanni Siciliano for precious comments on earlier drafts, Francesca Tempestini for her assistance in retrieving data on the Italian share blocking system, and Rafael La Porta and Andrei Shleifer for giving him access to the questionnaire they and their co-authors designed to build the Anti-Self Dealing Index. Usual disclaimers apply. Last but not least, opinions expressed in this paper are exclusively the author's and of course do not necessarily reflect those of Consob.

Abstract

This essay takes stock of the corporate governance reform efforts Italian policymakers have engaged in since the beginning of the 1990s. After describing the reform process and its drivers (a concern for Italian equity markets' attractiveness in an increasingly competitive and global framework, scandals, and EC activism), the essay analyzes the main reforms to single out what has worked (i.e. had a practical positive impact on Italian listed companies' corporate governance) and what has not worked. After concluding that the corporate governance legal framework has greatly improved as a result of reforms, the essay identifies a number of areas in which further steps could be taken to protect investors against the risk of expropriation by corporate insiders. It is also argued, however, that the mother of all corporate governance reforms in Italy would be a change in legal and political culture; legal culture should change so as to put substance over form, function over doctrine. That would be a precondition to effective enforcement of corporate and securities laws. Political culture should change from one that deems it to be the norm for politicians to decide on the allocation of corporate control to one more respectful of property rights. Two modest, bottom-up proposals to help change legal culture in the long run are finally put forth.

Keywords: Corporate Governance Reform, Italian Corporate Law, Regulatory Competition, Minority shareholders, Private Enforcement, Public Enforcement, LLSV, Self-Dealing

JEL Classifications: G18, G32, G34, G38, K22

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1. Introduction

Corporate governance reform has been high on the agenda of policymakers in all countries and international fora since at least the 1990s. Italy has been no exception: efforts to modernize Italian corporate governance institutions have been constant and fruitful in the last twenty years or so—and they are far from over. This essay takes stock of such endeavor ten years after the landmark corporate governance reform known as the Draghi law[1] entered into force.

To do so, it first provides a brief overview of the key reforms in this area with a special focus on the Draghi law and its amendments, identifying three sometimes concurring and often connected drivers for their adoption: the need to make the Italian equity market more attractive to investors (domestic and international) by ensuring them greater protection against the risk of expropriation at a time of increasing capital mobility; the obligation to implement European Community (EC) directives (and regulations); the need to react to corporate scandals and especially to Parmalat's fraud (Section 2).

Next, a more detailed analysis is provided to highlight the successes and failures of the three main reforms of the last ten years (the Draghi reform, the corporate law reform of 2002-04, and the post-Parmalat Law on Savings). The purpose is to single out the provisions that proved effective in protecting investor interests and those that failed to do so (Section 3, 4, and 5). The ambition is to avoid an evaluation of the intrinsic merits of the various policy choices (good reforms versus bad ones), but rather to single out those that had a positive impact on real-life corporate governance in Italy and those that did not (whether because they had not impact at all or, possibly, because they had a negative impact). Drawing from previous sections' findings on successful and failing reforms, Section 6 finally sketches out what remains to be done in order to ensure an attracting institutional framework for outside equity investment in Italian issuers.

There can be no doubt that Italy's corporate governance framework has significantly improved in the last two decades and that the Draghi law was a turning point: by tackling many of the key corporate governance issues, policymakers succeeded in signaling their awareness of investors protection needs and in giving shareholders better governance tools to protect their interests. It is also true that crucial key issues, such as the regulation of self-dealing transactions, were neglected or inadequately addressed for too long. Further, far from all the policy responses proved effective, due especially to an insufficient, albeit increasing, attention to enforcement issues.

In addition to that, if one of the main worries of corporate law reformers was to fill the corporate governance gap with other developed countries and enhance competitiveness in attracting international investors, what Italy has done so far has proved not to be enough also for the simple reason that in the same period the countries it has been trying to catch up with made significant progress in the direction of better protecting investors' interests.

Finally, the institutional context in which corporate governance reforms were to operate has proved inadequate, undermining the effectiveness of otherwise useful measures. A highly ineffective courts system, a political culture still granting residual control rights over firms' assets to political elites rather than to private agents, an old-fashioned, equity market-unfriendly legal culture, and corporate governance problems at the level of supervisory

[1] Legislative Decree No. 58 of February 24, 1998 (hereinafter: Legislative Decree

agencies all help explain why it is too early to declare “Mission accomplished,” as Section 7 concludes.

2. Twenty Years of Corporate Governance Reforms: An Overview

A. Pre-Draghi Law Reforms. Italian policymakers’ efforts to improve corporate governance institutions started back in the late 1980s, when a number of Parliamentary initiatives were taken to fill the gap in financial markets regulation that had recently widened following reforms in other major European countries such as the UK and France. Three important reforms ensued: the modernization of investment services and stock exchange regulation in 1991, the ban on insider trading in the same year, and a new regulatory framework for takeover bids in 1992.[2]

In the same years, EC harmonization initiatives prompted the Government to introduce important new laws: after implementation of the Fourth and Seventh Company Law Directives on financial accounts in 1991,[3] periodic disclosure in listed as well as non-listed companies greatly improved,[4] while a review of ownership disclosure obligations to implement Directive 88/627/EEC paved the way for a more transparent market for corporate control,[5] and rules on securities offerings were refined to implement

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58/1998).

[2] See Law No. 1 of January 2, 1991; Law No. 157 of May 17, 1991 and Law No. 149 of February 18, 1992.

[3] See Legislative Decree No. 127 of April 9, 1991.

[4] See e.g. Giovanni E. Colombo, *Il Bilancio d’Esercizio*, *in* TRATTATO DELLE SOCIETÀ PER AZIONI 7*, 23, 47 (Giovanni E. Colombo & Giuseppe B. Portale eds., 1994) .

[5] See Legislative Decree No. 90 of January 27, 1992. Note that, because a 1974 law already required immediate disclosure to target companies of purchases of stakes higher than 2%, the 1992 law had little negative impact on hostile takeover activity in Italy.

Directive 89/298/EEC.[6] The Investment Services Directive (ISD) of 1993 required a further upgrade of the regulation on investment services and stock exchanges and, most importantly, provided the occasion for privatizing Borsa Italiana, the Italian Stock Exchange.[7]

In granting the Government legislative authority to implement the ISD, the perception that various, uncoordinated reform efforts had driven to a chaotic legislative framework led Parliament to also authorize the Government to consolidate and coordinate some of the statutes referred to above.

But the early 1990s were also crucial because it was at that time that the Government engaged in an ambitious privatization program based on private sales, IPOs, and, for state-controlled companies already listed on the stock exchange, sales of control blocks on the markets. The legislative basis of that program was a series of law decrees enacted by the Government between 1991 and 1994.[8]

For that program to be politically acceptable, economic democracy concerns had to be addressed, which the Government mainly did by trying to "design" a widely held ownership structure for (some of) the companies it privatized via IPOs and sales on the public markets, on the one hand, and by granting governance rights to minority shareholders, on the other.

Thus, sales of control blocks on the market were preceded by the introduction of voting caps. And, also reflecting an increasing awareness that to attract buyers for privatized companies better investor protection mechanisms were to be in place, the law decree on privatizations mandated the

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[6] See Legislative Decree No. 85 of January 25, 1992.

[7] The ISD (Directive 93/22/EEC) was enacted via the Legislative Decree No. 415 of July 23, 1996.

[8] Law Decree No. 386 of December 5, 1991, converted into Law No. 35 of January 29, 1992; Law Decree No. 333 of July 11, 1992, converted into Law No. 359 of August 8, 1992.

representation of minority shareholders on privatized companies' boards of directors (one fifth of the seats) and internal auditor boards (one seat) while addressing the issue of the cost of voting by mandating mail voting in such companies.[9]

The introduction of *special* corporate governance provisions for privatized companies attracted criticism from reform-minded corporate law scholars.[10] Intuitively, investor protection needs deserved no differential treatment depending on previous ownership patterns. However, the selective introduction of special protections for minority shareholders in privatized companies proved to be an ingenious way to experiment in this area without having to win the fierce resistance from incumbent controlling shareholders. Further, the apparent contrast between special-status privatized companies and other listed companies made it easier for reform-minded policymakers to foster their agenda of better shareholder protection across the board.

The 1990s were also the time when the European business and academic elites discovered, and became active in, the debate on corporate governance that had developed first in the US across the 1970s and 1980s, and then in the UK especially after the Maxwell scandal in 1991.[11] People became increasingly aware that Italian companies were bound ever more to compete with companies from other countries for equity finance and that poor investor protection mechanisms and institutions were a heavy competitive

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See especially Law Decree No. 332 of May 31, 1994, converted with amendments into Law No. 474 of July 30, 1994.

[9] See Art. 4 and 5, Law Decree 332/94, as amended.

[10] See especially G. Minervini, *Contro il Diritto Speciale delle Imprese Pubbliche "Privatizzate"*, 1994 RIVISTA DELLE SOCIETÀ 740, 745-7.

[11] See e.g. Brian R. Cheffins, *Trends in Corporate Governance: Going from London to Milan via Toronto*, 1999 DUKE J. COMP. & INT'L L. 5, especially at 16.

disadvantage:[12] British and North American money managers were understandably suspicious of a corporate governance system that anecdotal as well as empirical evidence showed to permit the dramatic expropriation of minority shareholders.[13]

Awareness of the corporate governance debate led Italian corporate law scholars to finally abandon the previously dominant paradigm according to which minority shareholders had no interest in being granted governance rights. Under that view, because minority shareholders' stake in corporations is purely financial and because they behave in a rationally apathetic way, they have no incentive to exercise governance rights other than for blackmail purposes. The only protection they can really take advantage from is via disclosure obligations and a securities regulator enforcing them.[14] This was the paradigm behind the creation of Consob (the Italian S.E.C.) in 1974.[15]

The increasing presence of institutional investors also in Italy and a better understanding of the value of voting rights if the hostile bid mechanism is available led Italian corporate law scholars, and first among them Disiano

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[12] See especially Disiano Preite, *Investitori Istituzionali e Riforma del Diritto delle Società per Azioni*, 1993 RIVISTA DELLE SOCIETÀ 476.

[13] See e.g. Luigi Zingales, *The Value of the Voting Right: A Study of the Milan Stock Exchange*, 7 REV. FIN. STUD. 125 (1994) (providing empirical as well as anecdotal evidence); Jonathan R. Macey, *Italian Corporate Governance: One American's Perspective*, 1998 COLUM. BUS. L. REV. 121, especially at 132 & 140 (anecdotal evidence). See also Andrei Shleifer & Robert. W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737, 742 (1997) (stating that "[i]n many countries today, the law protects investors better than it does in Russia, Korea, or Italy").

[14] See especially Giuseppe Ferri, *Potere e Responsabilità nell'Evoluzione della Società per Azioni*, 1956 RIVISTA DELLE SOCIETÀ 35; *id.*, *La Tutela dell'Azionista in una Prospettiva di Riforma*, 1961 RIVISTA DELLE SOCIETÀ 177.

[15] See critically ROBERTO WEIGMANN, CONCORRENZA E MERCATO AZIONARIO 13 (1978). Ferri's view prevailed in the policy arena upon the alternative view of Tullio Ascarelli, who had called for corporate law reforms granting minority shareholders better protection. See especially Tullio Ascarelli, *I Problemi delle Società per Azioni*, 1956 RIVISTA DELLE SOCIETÀ 3.

Preite,[16] to recognize that governance rights and shareholder remedies would help developing an otherwise stagnant equity market by reducing the scope for tunneling by insiders and thus attracting institutional investors.

B. The Draghi Law. The occasion for action in that direction, after the experiment with privatized companies, came with the measures implementing the ISD and the granting of authority for consolidation of financial market laws into a single act. The Government proposed, and the Parliament approved, a provision granting the Government the power to "amend the laws on listed corporations with specific regard to the board of internal auditors, minority shareholder rights, shareholder voting agreements and intra-group transactions, with a view to strengthen the protection of savings and minority shareholders."[17]

Legislative authority was at the same time broad and constitutionally shaky, because the Constitution proscribes vague and open delegation of legislative authority to the Government. Together with the fact that the law made no mention to the board of directors, the constitutional issue had a role in convincing lawmakers that it would be more prudent not to intervene on board's duties and organization in that reform round.

In broad outline, the Draghi Law streamlined the legal framework for securities offerings, takeover bids, disclosure obligations, and audit firms. Minority shareholders representing a minimum threshold (ranging from 1 percent to 10 percent of the outstanding shares) were granted governance rights and remedies previously either unavailable[18] or subject to higher

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[16] See Preite, *supra* note 12, See also Disiano Preite & Marco Magnani, *Linee di Riforma dell'Ordinamento Societario nella Prospettiva di un Nuovo Ruolo degli Investitori Istituzionali,* Temi di Discussione del Servizio Studi, Working Paper No. 244 (1994).

[17] Article 21, Para. 4, Law 52/1996.

[18] See Legislative Decree 58/1998, Articles 126(4) (two-thirds majority required in extraordinary meetings) and 129 (shareholder representing 5 percent of company's capital

ownership thresholds.[19] Disclosure on ownership structure was extended by requiring full disclosure of all shareholder agreements,[20] a technique often used in Italian companies to deviate from one-share-one-vote by cementing cross-shareholdings relationships. A "mini-breakthrough" rule was also introduced, declaring shareholder agreements by which parties restrict their own freedom to sell shares ineffective in the event of a takeover bid.[21] The lift of a 1974 ban on proxies came together with heavy regulation of proxy solicitation and a provision allowing mail voting on an opt-in basis.[22] As to audit functions, the Law completely reshaped the role, composition, and powers of the board of internal auditors, an internal body of the corporation in charge of audit functions: representation of minority shareholders within that board was (at least on paper) mandated, its powers and the powers of individual members strengthened, and its mission clarified by requiring it to focus on internal controls.[23] Further, a restyling of the legal regime of audit firms was implemented, by clarifying audit firms' tasks.[24] Finally, Consob's statutory objectives in supervising issuers were spelt out for the first time (investor protection and efficiency and transparency of the market for corporate control and of capital markets), its regulatory authority much broadened and its powers to request information, execute on-site inspections

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may sue directors derivatively). For current rules see, respectively Art. 2368 and 2369 (two-thirds majority) and Art. 2393-II Civil Code, as amended by Law 262/2005 (percentage required for derivative suit lowered to 2.5 percent of company's capital).

[19] See Legislative Decree 58/1998, Articles 125 (shareholders representing 10 percent of company's capital may request that a meeting be convened) and 128(2) (shareholders representing 5 percent of company's capital may file a complaint to the Court asking for the appointment of an inspector). For current rules see, respectively, Art. 2409 and 2367 Civil Code.

[20] Article 122 Legislative Decree 58/1998.

[21] Article 123, Para. 3, Legislative Decree 58/1998.

[22] Articles 127 and 136-144 Legislative Decree 58/1998.

[23] Articles 148, Para. 2, 149 and 150-151 Legislative Decree 58/1998.

[24] Articles 155-165 Legislative Decree 58/1998.

and impose *ad hoc* disclosure duties extended to a larger set of subjects (e.g., parties to shareholder agreements, blockholders).[25]

C. Post-Draghi Law Reforms. In the ten years following the enactment of the Draghi Law policymakers have been no less busy reforming corporate governance than in the 1990s. Three were the drivers of these more recent reforms.

First, there was the idea that after the modernization of corporate law rules for listed companies, a similar effort had to be put in updating the law of non-listed companies with a view both to align their regime to listed companies' whenever their shares were publicly held and to make Italian corporate law more competitive after the European Court of Justice rulings on pseudo-foreign corporations paved the way for regulatory competition within the EU.[26] Further, a more general corporate law reform would allow to tackle issues, like board duties, that the Draghi Law had omitted to deal with due to the shaky legislative authority pursuant to which it was enacted.[27] As an outcome, the Government enacted the general corporate law reform of 2002-2004[28] (known as the Vietti Reform after the name of the Undersecretary of Justice in charge of the process).

Second, the plethora of post-Financial Services Action Plan directives

[25] Articles 91, and 114-115 Legislative Decree 58/1998.

[26] See Case C-212/97, *Centros Ltd* v. *Erhvervs-og Selskabssyrelsen* [1999] E.C.R. I-1459; Case C-208/00, *Überseering BV* v. *Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-9919; Case C-167/01, *Kamel van Koophandel en Fabrieken voor Amsterdam* v. *Inspire Art Ltd* [2003] ECR I-10155; Case C-210/06, *Cartesio Oktató és Szolgáltató bt*, Judgment of 16 December 2008. In *Centros*, Mr. and Mrs. Bryde set up a company in the UK and tried to registered a secondary seat in Denmark, where the company would have exclusively conducted business.

[27] See Luca Enriques, *Scelte Pubbliche e Interessi Particolari nella Riforma delle Società di Capitali*, 2005 MERCATO CONCORRENZA REGOLE 145, 150-2 (but see also *id.* at 152-6 for a more cynical, interest group-based explanation of why the general corporate law reform of 2003-2004 was enacted).

[28] Legislative Decree No. 61 of April 11, 2002; Legislative Decree No. 6 of January 17, 2003; Legislative Decree No. 37 of February 6, 2004.

and regulations had to be implemented, namely the Prospectus Directive, the Transparency Directive, the International Financial Reporting Standards Regulation, the Takeover Bids Directive, and the Market Abuse Directive, which was done via a number of statutory acts.[29]

Finally, much like the US and other countries had enacted post-scandal reforms following Enron, WorldCom and similar scandals, the Cirio, Parmalat and the Banca Popolare di Lodi/ABN-AMRO/Antonveneta[30] scandals prompted the Italian Parliament to revise Italy's corporate governance framework. The so-called Law on Savings was the outcome.[31]

The Vietti Reform's scope is so wide as to make it impossible to outline its contents here. Section 4 will describe the provisions in that Reform that are most relevant for our purposes. Similarly, Section 5 will highlight the features in the Law on Savings that are worth considering for our assessment of corporate governance reforms in Italy.

3. Keeping up with the Shleifers: The Draghi Reform

There is no question that the Draghi Law was the tipping point for

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[29] See Law No. 306 of October 31, 2003 and Legislative Decree No. 38 of February 28, 2005 (exercising the regulatory options of Regulation (EC) No. 1606/2002); Law No. 62 of April 18, 2005 (enacting Directive 2003/6/CE and its implementing Level 2 Directives); Law No. 262 of December 28, 2005 and Legislative Decree No. 51 of March 28, 2007 (enacting Directive 2003/71/EC); Law No. 29 of January 25, 2006 and Legislative Decree No. 195 of November 6, 2007 (enacting Directive 2004/109/EC); Law No. 77 of June 20, 2007 and Legislative Decree No. 229 of November 19, 2007 (enacting Directive 2004/25/EC).

[30] On Cirio, see Marco Onado, *I Risparmiatori e la Cirio: Ovvero, Pelati alla Meta. Storie di Ordinaria Spoliazione di Azionisti e Obbligazionisti*, 5 MERCATO CONCORRENZA REGOLE 499 (2003); on Parmalat, see Francesco Benedetto & Simone Di Castri, *There is Something About Parmalat (on Directors and Gatekeepers)*, Working Paper (2005), *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=896940. On the Banca Popolare di Lodi/ABN AMRO/Antonveneta case see e.g. Elena Carletti, Philipp Hartmann & Steven Ongena, *The Economic Impact of Merger Control: What Is Special About Banking?* ECB Working Paper Series No. 786, 56 (2007), *at* http://www.ecb.int/pub/pdf/scpwps/ecbwp786.pdf.

corporate governance reform efforts in Italy, although, with the benefit of hindsight, perhaps more for the signal it sent to market players about the seriousness of Italian policymakers' intent to improve the corporate governance landscape than for what it achieved in terms of better investor protection. In other words, the Draghi Law was highly effective in performing the "signaling and credibility enhancement" function of laws that Professors Milhaupt and Pistor have identified as one of the essential roles law reforms can play in favoring financial development.[32] In fact, the new legal framework had a number of features that helped improve the perception of Italian corporate governance institutions at home and abroad.

First, the mere consolidation of a number of scattered and uncoordinated sets of rules made it easier for anyone to become familiar with Italy's capital markets regulation.

Second, a good number of idiosyncrasies until then characterizing the Italian regulatory framework were abandoned in favor of regulations more akin to those international market players were accustomed to. So, for instance, while an internal board of auditors was retained as a separate body within the company, its functions were streamlined to replicate those the audit committee performs in the US and the U.K.[33] And the takeovers regime was reshaped drawing inspiration from the U.K. model: first, a complete ban on defensive tactics (in force since 1992) was replaced by a rule requiring a shareholder meeting authorization to adopt them; second, a mandatory bid rule triggered by the crossing of a 30 percent threshold replaced a mandatory

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[31] See Law No. 262 of December 28, 2005 and Legislative Decree No. 303 of December 29, 2006.

[32] See CURTIS MILHAUPT & KATHARINA PISTOR, LAW AND CAPITALISM 34-5 (2008).

[33] See Guido A. Ferrarini, *Corporate Governance Changes in the 20th Century: A View from Italy*, *in* CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES, AND

partial bid rule triggered by the acquisition of control.[34] Third, by strengthening Consob's role in issuer regulation and supervision, it enhanced the supervisory agency's commitment and helped it become a well-respected key player in Italian capital markets.[35]

Third, a few highly symbolic provisions were enacted that signalled Italian policymakers' preference for an active market for corporate control, "mark[ing] an important change in the Italian system, which had traditionally favoured corporate control stability over contestability."[36] Chief among them were rules on shareholder agreements. Traditionally, dominant families and financial institutions have built blocks and cross-holdings in the major Italian listed companies to reciprocally reinforce control over them. Such coalitions were often formally cemented via shareholder agreements that granted parties rights of first refusal and allowed to coordinate voting in shareholder meetings. The Draghi Law weakened shareholder agreements as a tool to stabilize controlling coalitions, chiefly by imposing a maximum duration of three years and by introducing a "mini-breakthrough rule" allowing parties to shareholder agreements to freely tender their shares in a takeover by declaring any restriction on share sales in the shareholder agreement ineffective in the event of a takeover bid.[37] One year later, the hostile takeover of Telecom Italia by Olivetti was tangible proof of an active market for corporate control in

MARKETS IN EUROPE, JAPAN, AND THE US 31, 47 (Klaus J. Hopt, Eddy Wymeersch, Hideki Kanda & Harald Baum eds., 2005).

[34] Articles 104 and 106 Legislative Decree 58/1998. Articles 10 and 16 Law No. 149 of February 18, 1992.

[35] See Richard Deeg, *Change from Within: German and Italian Finance in the 1990s*, *in* BEYOND CONTINUITY: INSTITUTIONAL CHANGE IN ADVANCED POLITICAL ECONOMIES 169, 188 (Wolfgang Streeck & Kathleen Thelen eds., 2005).

[36] Ferrarini, *supra* note 33, at 47.

[37] Andrea Melis, *Corporate Governance Developments in Italy*, *in* HANDBOOK OF INTERNATIONAL CORPORATE GOVERNANCE. COUNTRY ANALYSES 45 (Christine A. Mallin ed., 2006). See also Article 123 Legislative Decree 58/1998.

Italy.[38]

Fourth, while not in the Draghi Law itself, the momentum following it and the privatization of the Italian stock exchange two years before were the drivers for the adoption of a corporate governance code in 1999. The code, while very cautious compared to that of other countries such as the UK,[39] focused boards' minds on how to adapt to a new environment in which corporate governance issues have a strong weight, and it has indeed led to better board practices, especially in the larger listed companies. And, quite aside from its impact on issuers, the very fact of having a corporate governance code in place was of relevance for the Italian stock market's international reputation.

Finally, and still in the signalling vein outlined above,[40] the Draghi Law greatly improved Italy's ranking in what was then the most revered corporate governance index available: the La Porta et al. Anti-director Rights Index.[41] As columns 2 and 4 in Table 1 show, if we measure the legal framework post-Draghi in the same way as the four authors had measured the pre-Draghi regime, Italy jumped from a miserable score of 1 to a score of 4.[42]

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[38] See e.g. Alexander Aganin & Paolo Volpin, *The History of Corporate Ownership in Italy*, *in* A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD 325, 357 (Randall K. Morck ed., 2005).

[39] See Luca Enriques, *Codici di* Corporate Governance*, Diritto Societario e Assetti Proprietari: Alcune Considerazioni Preliminari*, 22 BANCA IMPRESA SOCIETÀ 97, 100-2 (2003).

[40] Cf. Ferrarini, *supra* note 33, at 47 (casting doubt on the significance of the La Porta et al.'s index as a measure of shareholder protection).

[41] See Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, & Robert W. Vishny, *Law and Finance*, 106 J. POL. ECON. 1113, 1122 (1998).

[42] To be sure, if we recalculate their pre-Draghi score to correct for a couple of disputable (and arguably wrong) coding choices (see Luca Enriques, *Do Corporate Law Judges Matter? Some Evidence from Milan*, 3 EUR. BUS. ORG. L. REV. 765, 779 n.43 (2002) (arguing that proportional representation within the board was already allowed before the 1998 reform—and even mandated for privatized companies since 1994—and that the law already provided minority shareholders a judicial venue to challenge management's decisions

Table 1 – *Anti-directors Rights Index (pre- and post-Draghi Law)*

	pre-1998	1998
Proxy by mail allowed	0	1
Shares not blocked before meeting	0	0
Cumulative voting or proportional representation	0	0*
Oppressed minorities mechanism	0	1
Pre-emptive rights	1	1
Percentage of share capital to call an extraordinary shareholder meeting	0	1
Anti-director rights index	1	4

* Variable is "0" because the appointment of minorities representatives *within the internal board of auditors* is not relevant for Anti-directors Rights index purposes.

To be sure, if we look at the Revised Anti-directors Index as crafted ten years later by three of the original co-authors with Simeon Djankov to account for the broad range of criticism their original index raised,[43] the

under Art. 2409 Civil Code)) the effect of the Draghi Law is somewhat less impressive (from a pre-Draghi score of 3 to a post-Draghi score of 5).

[43] See Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes, & Andrei Shleifer, *The Law and Economics of Self-dealing*, 88 J. FIN. ECON. 430 (2008).

improvement is less significant (Table 2).[44] However, if what counts is the signaling effect of the corporate governance reform effort at the time of its enactment, then the Revised Index is irrelevant.

Table 2 – *Revised Anti-directors Rights Index (pre- and post-Draghi Law)*

	pre-1998	1998
Vote by mail	0	0
Shares not deposited	0	0
Cumulative voting	0	0*
Oppressed minority	0	1
Pre-emptive rights	1	1
Capital to call a meeting	0	1
Anti-director rights index	1	3

* The appointment of minority shareholders representtatives *to the internal board of auditors* is irrelevant according to the Index, which only considers appointment to the board of directors or the supervisory board.

Of course, it would be flatly wrong to play down the Draghi Law as just a public relations or a marketing exercise, however effective. A number of provisions in the Law itself and in Consob Regulation on Issuers enacted pursuant to it[45] did effectively improve minority shareholder protection. At the

[44] If we recalculate the index to account for the same coding mistakes highlighted in footnote 42, Italy's score goes from 2 (pre-1998) to 3 (post-Draghi).

[45] See Consob Regulation No. 11971 of May 14, 1999, as amended (Consob Regulation on Issuers).

same time, some other provisions in the Draghi Law proved less effective and still others plainly defective. In a decreasing order of effectiveness we can identify five key areas of the Draghi Law that are worth considering here: disclosure, governance rights, takeover law, internal controls, and enforcement.

1. Mandatory disclosure. The Draghi Law significantly improved mandatory disclosure for listed companies. First of all, disclosure of listed companies' ownership structures greatly improved, especially with regard to shareholder agreements. Such agreements have since then to be fully disclosed, which has given the market important information as to the degree of contestability of control in many Italian companies.

Second, the Draghi Law required Consob to revise and rethink its rules and schedules on issuer regulation in the new environment of heightened public concern for investor protection. This led to an overhaul of disclosure requirements for issuers, explicitly drawing inspiration from the U.S. and the UK disclosure regimes,[46] e.g. with regard to IPOs and material extraordinary transactions (such as mergers, new issues of shares, acquisitions and disposals) that can be (and often are) used to extract private benefits of control.[47]

Prior to then, disclosure was simply not required for acquisitions and disposals. As to mergers and new issues of shares, a simple count of the words used to describe the required information under the previous regime compared to the number of words used to describe it in the Annexes to Consob Regulation on Issuers indicates, however roughly, that disclosure on new

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[46] See CONSOB, TESTO UNICO DELLE DISPOSIZIONI IN MATERIA DI INTERMEDIAZIONE FINANZIARIA. QUESTIONI SOCIETARIE, II PARTE. DOCUMENTO DI CONSULTAZIONE (NOTE TECNICHE IN MATERIA DI INFORMAZIONE SOCIETARIA E REVISIONE CONTABILE) 18-24 (1998).

[47] For a taxonomy of ways to extract private benefits see Vladimir A. Atanasov, Bernard S. Black & Conrad S. Ciccotello, *Unbundling and Measuring Tunneling*, Working Paper (2007), *at* http://ssrn.com/abstract=1030529.

issues of shares (from 120 words to 400) and mergers (from 116 words to 300) became more extensive. A similar count for IPO prospectuses is also telling: the pre-Draghi Law schedule had roughly 4,400 words, while the 1998 one had 9,961.

Overcoming strong opposition from issuers as well as prominent legal scholars (one of them talked at that time of "morbid … curiosity"),[48] with the enactment of Consob Regulation on Issuers, Italy became the first main continental European country to require full disclosure of individual directors' compensation.[49] Until then, following European Directives, only the aggregate directors' compensation had to be disclosed, the commonly held view being that, as a distinguished corporate law scholar put it, disclosure of individual directors' compensation would qualify rather as gossip than information.[50]

One last innovation in the Draghi Law is worth mentioning with regard to disclosure: Article 114, para. 2, clarified for the first time that on-going disclosure requirements apply regardless of the organizational structure of a given issuer, be it a single entity or a company controlling other companies. Issuers have in fact to instruct controlled companies to provide all information that needs to be disclosed. Before then, it was argued that directors of companies controlled by a listed company had a confidentiality duty preventing them from disclosing information to the parent, no matter how material for investors.

2. Governance rights. One of the key ideas behind the Draghi Law

[48] See Natalino Irti, *Diritti degli Azionisti e Compensi degli Amministratori*, CORRIERE DELLA SERA, July 2, 1998, at 17.

[49] See Article 78 and Schedule 3C, Consob Regulation on Issuers.

[50] See Colombo, *Il bilancio d'esercizio*, *supra* note 4, at 150 ("ad evitare che l'informazione scada in pettegolezzo, è previsto che l'ammontare [dei compensi] sia indicato 'cumulativamente' … e non con riguardo ai singoli [amministratori]").

was that the increasing institutionalization of share ownership justified granting minority shareholders more voice in governance matters. As previously hinted, the traditional view was that the typical minority shareholder, an individual, would never exercise a governance right other than abusively to extract bribes from the company or its majority shareholders (e.g. by asking repeated and disturbing questions at the meeting).[51] With institutional shareholders increasingly holding shares in Italian companies throughout the 1980s and 1990s, good candidates to act as shareholder champions with a low risk of abusive behavior had come to the foreground. The dichotomy between potentially "good" active institutional shareholders versus potentially (and historically indeed) "bad" active individual shareholders explains the Draghi Law's preference for the recognition of governance rights to qualified minorities rather than to individual shareholders. So, for instance, only shareholders representing at least 5 percent of the shares might bring derivative suits and only shareholders representing at least 10 percent of the shares might make shareholder proposals or call a shareholder meeting.[52] The Draghi Law also aimed to revive the shareholder meeting. To do so, it extended shareholders' decision rights, e.g. to cover defensive tactics during a takeover,[53] and made an attempt to make it easier and less costly for shareholders to exercise voting rights.[54]

Almost ten years ago, Marcello Bianchi and I assessed whether such governance rights would have an impact on institutional investors' activism by

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[51] Aurelio Candian, *Delle Assemblee delle Società per Azioni Ovverossia del Dermofilo Penetrante*, 1961 TEMI 163.

[52] Articles 125 and 129 Legislative Decree 58/1998. See Marcello Bianchi & Luca Enriques, *Corporate Governance in Italy After the 1998 Reform: What Role for Institutional investors?*, 2 CORP. OWNERSHIP & CONTROL 11, 27 (2005) for the claim that shareholder proposals are treated like the calling of a meeting under Draghi Law rules.

[53] Article 104, Draghi Law.

effectively strengthening their bargaining position vis-à-vis corporate insiders. Back then, we noticed that the thresholds required to exercise governance rights were in many instances too high to let institutional investors credibly threaten to use them, especially individually, and sometimes crafted in such a way as to be ineffective, and therefore useless as negotiation tools.[55] Further, the Draghi Law failed to lower the cost of voting: the mandatory deposit of shares five days prior to the meeting was left in place, while too little was done to make voting mechanics cheaper for shareholders (mail voting was merely allowed as opposed to mandated; an implicit ban on confidential voting stayed).

However, one new governance provision in the Draghi Law is to single out as an effective tool to protect minority shareholders: the rule that requires a majority of two thirds of the capital represented at the meeting to pass special resolutions, including all charter amendments, new issues of shares, mergers, and so on.[56] There has been at least one instance in which minority shareholders have successfully used the veto power stemming from such provision to block harmful transactions,[57] while in various cases they have at least tried to coordinate to do so.[58] *Ex ante*, of course, such a rule prompts corporate insiders to craft proposals for special meeting resolutions (or at least contentious ones in larger companies) so that they are widely acceptable to (active) minority shareholders.

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[54] Article 127 (allowing vote by mail) and 136-144 (regulating proxy voting) Legislative Decree 58/1998.

[55] Bianchi & Enriques, *supra* note 52, at 26-9.

[56] See Article 126 Legislative Decree 58/1998, now embodied into Articles 2368-9 Civil Code.

[57] Enriques, *supra* note 42, at 782 (for a brief description of the Montedison/Falck case).

[58] See Enriques-Bianchi, *supra* note 52, at 26 n.87 (for a brief description of the Riva Finanziaria/Intek case). More recently, see Marigia Mangano, *Ifi-Ifil, i fondi contro la fusione*, IL SOLE 24 ORE, November 19, 2008, at 42 (IFI/IFIL).

Finally, a potentially meaningful innovation was the idea of reserving one seat in the board of auditors to minority shareholders' nominees. While institutional investors did appoint their representatives in the board of auditors in some of the largest companies, this piece of reform was less effective than expected for at least two reasons: first, also because all companies' statutes required a minimum threshold for minority shareholders' right to nominate candidates to the board,[59] such representatives were only present in a minority of the listed companies (one out of four in 2003, the figure being three out of five for the larger companies).[60] Second, individual board of auditors members "have no autonomous powers of reaction in the event of abuses and irregularities: they may only report their findings to the board of auditors, which will decide what to do about them."[61] Of course, they can always resign or make themselves unavailable for re-election (as apparently was the case with Parmalat's minority-appointed auditor in 2002, which prompted Italian mutual funds who had appointed her to sell Parmalat shares early on).[62] But that of course can only be expected to happen in rather exceptional circumstances.

3. Takeover rules. In order to evaluate Draghi Law's provisions on takeovers, one has first to clarify what it means for such rules to have had a positive impact on Italian companies' corporate governance. If we are to judge

[59] See Guido Ferrarini & Paolo Giudici, *Financial Scandals and the Role of Private Enforcement: The Parmalat Case*, *in* AFTER ENRON: IMPROVING CORPORATE LAW AND MODERNISING SECURITIES REGULATION IN EUROPE AND THE US 187 (John Armour & Joseph A. McCahery eds., 2006)..

[60] CONSOB, RELAZIONE PER L'ANNO 2003 – DISCORSO DEL PRESIDENTE DELLA CONSOB AL MERCATO FINANZIARIO 11 (2004). Massimo Belcredi reports that, as of June 2005, 17 out of the 40 largest companies had minority-elected board of auditors members, but only 9 of them had one nominated by institutional investors. Massimo Belcredi, *Amministratori Indipendenti, Amministratori di Minoranza, e Dintorni*, 2005 RIVISTA DELLE SOCIETÀ 853, 867-8.

[61] Bianchi & Enriques, *supra* note 52, at 29.

[62] Ferrarini & Giudici, *supra* note 59, at 188.

according to whether they helped increase the number of widely held companies (which was one of its goals[63]), then the data show that they were a failure (see Table 3).

Table 3 – *Percentage of widely held companies (according to various definitions) on listed companies*

Year	1990	1998	2007
Largest shareholding <30%	12,0%	26,9%	28,4%
Largest shareholding <25%	10,3%	22,7%	21,8%
Floating securities >70%	0,9%	9,7%	7,4%
of which cooperatives	0,0%	4,6%	2,3%

Consob data as of 31 December 2007.

Of course, other, more relevant factors might better explain why ownership has remained concentrated in the last ten years. Intuitively, the persistently high value of private benefits of control is a much more relevant explanation for why public companies are still rare than takeover rules can be.

The main point here is that attempts to attain widely held ownership of listed companies via “structural” rules, i.e. rules that restrict private parties’ freedom to design ownership structures as they wish, are doomed to be ineffective, because concentrated ownership structures are the symptom of a disease (high private benefits of control) rather than its cause. So, for instance, in the presence of the mini-breakthrough rule,[64] not only didn’t anyone ever try to make a hostile bid for a company jointly controlled by a coalition cemented by a shareholder agreement, but many shareholder agreements were

[63] See Mario Draghi, *Commento* sub *art. 107*, *in* COMMENTARIO AL TESTO UNICO DELLE DISPOSIZIONI IN MATERIA DI INTERMEDIAZIONE FINANZIARIA 988, 994-5 (Guido Alpa & Francesco Capriglione eds., 1998).

[64] See *supra* note 21 and accompanying text.

converted into or structured as holding companies to avoid the rule,[65] so that joint control over companies controlled by such holdings is even more stable now than in the presence of a hypothetically unregulated shareholder agreement.

Leaving aside ownership structures and diffusion of ownership, can we say that the Draghi Law provisions on takeovers have made the market for corporate control more efficient than before? A lawyer is of course in a bad position to answer this question. What a lawyer can do, however, is to compare the new regime with the previous one.

First of all, the mere fact that, as previously hinted, the new regime is less arcane and idiosyncratic than before is a plus, because potential foreign bidders or acquirers of control blocks and their advisers might find the legal landscape more familiar and therfore attractive.

Second, the Draghi Law switched from an Easterbrook and Fischel-style prohibition on defensive tactics to the City Code rule requiring shareholder meeting approval of defensive tactics (with the favourable vote of shareholders representing at least 30 percent of the share capital), but the practical effect of such rule change on the factual availability for targets of defensive tactics was low, given the broad powers shareholder meetings of Italian companies have always had.

Finally, the rules on mandatory bids were streamlined, abandoning the previous "partial" mandatory bid rule in favour of the internationally better known mandatory bid rule (though with a "discount" on the highest price paid in the previous twelve months, which had to be averaged with the average

[65] At the end of 2004 16 were the listed companies controlled by holding companies the shareholders of which were parties to a shareholder agreement, such control structure being used to avoid the mini-breakthrough rule. See CONSOB, RELAZIONE PER L'ANNO 2004 – DISCORSO DEL PRESIDENTE DELLA CONSOB AL MERCATO FINANZIARIO 25 n.14 (2005), *available at* http://www.consob.it.

market price in the same period), and making it harder (albeit far from impossible) to evade the requirement, e.g. by codifying action in concert for the first time. That should have implied a lower number of opportunistic, inefficient changes of control going through, but it might also mean that efficient changes of control have became more costly, so that only empirical work could tell us which effect prevailed.

4. Board of auditors. According to Guido Ferrarini and Paolo Giudici, board of auditors had traditionally proved "[in]efficient in discovering mismanagement and fraud," and "complacent" rather than "investigative" with regard to corporate insiders' behaviour;[66] their performance as champions of shareholders' interests has been dismal even after the Draghi Law tightened independence standards for the board's members, increased their powers, and clarified their tasks and duties.[67] This was mainly because corporate insiders mostly kept picking as board of auditors members people that were only formally independent, the latter having instead long-standing advisory relationships with the former.[68] In fact, independence standards for members of the board of auditors are still quite lenient[69] if compared with those required on a comply or explain basis by the Italian Corporate Governance Code, let alone with Codes and Listing Rules in other jurisdictions.[70]

The negative assessment of board of auditors, which is based on anecdotal evidence, probably reflects the idiosyncratic nature of such

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[66] See Ferrarini & Giudici *supra* note 59, at 186, 188.

[67] *Id.*, at 188-9.

[68] *Ibid.*

[69] See Legislative Decree 58/1998, Article 148(3) (mainly focusing on (i) family ties with the directors of either the company or its controlling or affiliate entities as well as on (ii) current employment, professional and economic relationship with either the directors or the group companies). See also Corporate Governance Committee, CORPORATE GOVERNANCE CODE, March 2006, at 3.C.1 (providing a long list of independence criteria encompassing previous employment, economic and professional relationship, the length of the tenure and cross-directorship) and 10.C.2 (extending independence criteria to statutory auditors).

governance mechanism, unknown to other countries except for Japan. Arguably, audit committees in other jurisdictions appear to have been no better than board of auditors at preventing financial frauds. Nevertheless, anecdotal evidence again suggests that in Italian companies, which now also marshal audit committees to monitor management, such committees are generally more active in defending shareholder interests than boards of auditors, which tend to have a more legalistic view of their role and responsibilities.[71]

5. Enforcement. The dark or, more appropriately, the weak side of the 1998 reform, incidentally reflecting a millennial tradition so well-depicted also in Italian literature classics (from "*le leggi son, ma chi pon mano ad esse?*" in Dante's *Commedia* to Manzoni's *grida* in the *Promessi Sposi*)[72] is enforcement.[73]

Private enforcement mechanisms have proved highly ineffective, both because the Government was extremely cautious in introducing them (suffice

[70] *Id.*, at 186.

[71] See Andrea Melis, *On the Role of the Board of Statutory Auditors in Italian Listed Companies*, 12 CORP. GOVERNANCE 74, 81 (2004).

[72] DANTE ALIGHIERI, LA DIVINA COMMEDIA, Purgatory XVI, line 97; ALESSANDRO MANZONI, I PROMESSI SPOSI, Ch. 1. See also SEBASTIANO VASSALLI, LA CHIMERA, 58-9 (1990). To be sure, formal enforcement of corporate governance laws is a rarity in many jurisdictions. See e.g. Utpal Bhattacharya & Hazem Daouk, *The world price of insider trading*, 57 J. FIN. 75, 77 (2002) (at the end of 1998, insider trading laws existed in 87 countries, but enforcement, as evidenced by at least one prosecution, had taken place in only 38 of them). One should also mention that private enforcement is almost non-existent for listed companies in the UK as well (see John Armour, Bernard Black, Brian Cheffins & Richard Nolan, *Private Enforcement of Corporate Law: An Empirical Comparison of the UK and US*, Working Paper (2009), *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105355). However, in the UK control over listed companies is in the hands of institutional investors, which use governance rights (or in other words, ex ante informal enforcement) to protect against managerial misbehaviour. See John Armour, *Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment*, Working Paper 36-45 (2008), *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1133542.

[73] Ferrarini, *supra* note 33, at 48, similarly criticizes the Draghi reform from this point of view.

it to mention the 5 percent threshold for shareholders to sue directors derivatively or to request for an inspection)[74] and because the surrounding legal and institutional framework was (and still is) least friendly to plaintiff shareholders.[75] No actual use has ever been made of the shareholder remedies the Draghi Law introduced or made at least in theory easier to exercise.[76]

On the public enforcement side, while the Law strengthened Consob's supervisory powers, fines for violations of securities laws were significantly lowered[77] and even criminal sanctions for market manipulation (securities fraud) and insider trading were set at such a level that, because of the interplay between statute of limitations rules and the pathological length of criminal trials, most prosecutions would end up with an acquittal, discouraging public prosecutors from starting one in the first place.

4. Keeping up with the Brydes: the Vietti Reform

As hinted before, Italy revised its general corporate law in 2001-2005 also to react to the competitive threat stemming from the *Centros* line of cases.[78] Overall, the new legal framework for corporations appeared to be more open to contractual freedom than the previous one, although the overall

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[74] See Legislative Decree 58/1998, Article 129 (derivative suit). The threshold was later lowered to 2.5%: see Article 2393-II Civil Code. See also Legislative Decree 58/1998, Article 128(2) (request for inspection), now embodied into Article 2409 Civil Code.

[75] See Ferrarini & Giudici *supra* note 59, at 202. See also *infra*, Section 6.

[76] See Paolo Giudici, *Representative Litigation in Italian Capital Markets: Italian Derivative Suits and (if ever) Securities Class Actions*, 6 EUR. COMP. & FIN. L. REV. (forthcoming 2009).

[77] This is a little known result of the Draghi Law. The act granting the Government the authority to issue a consolidated law also allowed it to "coordinate" criminal and administrative sanctions for violations of securities laws with the sanctions already in place for violations of banking laws (Article 21, Para. 3, Law 52/1996), which were much more lenient. The Government made use of such authority.

[78] See *supra* note 26.

mandatory structure of Italian corporate law was confirmed.[79] From the perspective of listed companies' corporate governance at least two positive features of the new regime deserve mentioning.

First of all, the reformed regime has repealed the provisions requiring the mandatory deposit of shares for five days before shareholder meetings. Deposit of shares has been replaced by a (usually electronic) communication, which corporate charters may require to be sent at most two days in advance of the meeting. Moreover, the communication does not entail share blocking unless – according to the prevailing interpretation – the charter expressly forbids trading after the communication is sent: rather, if shares are sold, voting rights are reduced accordingly.[80] That removes (or lowers in the case of companies requiring an anticipated communication) a significant hurdle to institutional investors' participation to shareholder meetings.

Second, the new law has made the board of internal auditors the default regime for Italian companies. Companies may now opt into either of two alternative corporate governance regimes: a one-tier board comprising an audit committee composed of independent directors (with independence requirements equivalent to those for board of auditor members) and a (broadly

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[79] See Enriques, *supra* note 27, at 172-3, for a critique of the Vietti Reform from this point of view.

[80] Article 2370 Civil Code (for public companies, share deposit cannot be imposed for longer than two days in advance of the meeting and, whenever shares are in electronic form, as is always the case with listed companies. the deposit is replaced by a communication form the intermediary which holds the relevant account); see Carmine Di Noia, Matteo Gargantini & Salvatore Lo Giudice, *General Meeting-Related Processes in Italy: The Role of Listed Companies, Intermediaries and Central Securities Depositories in Light of Recent EU Developments*, 1 J. SEC. OPERATIONS & CUSTODY 195, 202-3 (2008). Currently, one-sixth of companies out of a sample of 283 impose that shares are blocked since the electronic communication is sent and until the meeting is concluded, while two-thirds require that the communication is sent in advance of the meeting but do not impose share blocking; the remaining companies (one-sixth) simply require a communication before the meeting is opened (source: author's elaboration on companies' charters and notices convening annual meetings).

speaking German-style) two-tier board structure (with no employee representation). A few listed companies have indeed chosen one of the two alternative structures.[81] Most companies have thus kept the traditional board structure, also due to the many unclear and complex features in the law devising the alternative ones.[82]

Another area in which the reform has introduced greater flexibility is new issues of shares: Italian law had been stricter than the Second Directive in requiring companies to grant shareholders pre-emption rights in the event of new issues of shares. With the reform, a further case in which companies may issue new shares on a non-pre-emption right basis has been introduced (new shares representing no more than 10 percent of capital issued at "market value")[83] and exclusion of pre-emption rights can also be delegated to the board of directors, provided that the shareholder meeting defines the relevant criteria.[84] It is of course important for companies to have flexibility when they need to recapitalize. However, pre-emption rights are also an effective strategy to protect minority shareholders against recapitalizations at discounted prices in favour of dominant shareholders or their allies. In an environment that

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[81] See Assonime, *Analisi dello stato di attuazione del Codice di Autodisciplina delle società quotate (Anno 2008)*, Note e Studi No. 1, 18 nt.17, 25 (2009), *at* http://www.assonime.it/AssonimeWEB/public/initAction.do?evento=getDocumentAttach&idSelectedDocument=210648&idSelectedAttach=210649 (as of December 31, 2008, 7 two-tier and 4 one-tier companies were listed on the Italian Stock Exchange. However, the figure on companies adopting the two-tier model is partial, because not all the companies which had announced or implemented a change in their governance structure published a corporate governance report as of the end of 2008).

[82] See Federico Ghezzi & Corrado Malberti, *The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Law Reform of Corporate Law*, 5 EUR. COMPANY & FIN. L. REV. 1, 7 (2008) (provisions for the alternative board structures affected by ambiguous wording).

[83] Article 2441(4), Civil Code. On the vagueness of the "market value" criterion see Marco Ventoruzzo, *Experiments in Comparative Corporate Law: The Recent Italian Reform and the Dubious Virtues of a Market for Rules in the Absence of Effective Regulatory Competition*, 40 TEXAS INT'L L.J. 113, 127-9 (2004).

[84] Article 2443, Civil Code.

makes it so difficult for shareholders to enforce their rights vis-à-vis dominant shareholders and managers, especially the choice of granting directors some leeway in determining how to raise new funds puts shareholders' interests at risk.[85]

As a matter of fact, even the 2003 reform was a step backward in terms of ensuring effective enforcement of corporate governance laws. First of all, the Government sent markets the wrong message when, just a few months before the enactment of the Sarbanes Oxley Act, it revised white collar crime law in such a way as to make falsity in annual accounts and other periodic disclosure documents practically impossible to punish.[86] Second, the Government made it more difficult for minority shareholders to obtain judicial nullification of unlawful shareholder meeting resolutions, especially by introducing minimum share thresholds to bring suit.[87] Because nullification suits had traditionally been used also to react against self-dealing transactions,[88] that meant further reducing shareholders' ability to enforce their rights and, correspondingly, making it *ex ante* less risky for dominant shareholders to extract private benefits of control via transactions involving shareholder meeting resolutions such as mergers, new issues of shares, and so on.[89]

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[85] See Ventoruzzo, *supra* note 83, at 130-31 (criticizing the increase in the power of the board of directors to issue new shares excluding pre-emption rights).

[86] See e.g. Luigi Foffani & Francesco Vella, *«Nuovo» Falso in Bilancio: un Passo Indietro nel Cammino verso l'Europa*, 4 MERCATO CONCORRENZA REGOLE 125, 129 (2002).

[87] See Article 2377 Civil Code (in listed companies, shares representing 0,1% of outstanding capital are required to file a nullification suit against a shareholder meeting's resolution).

[88] See Pierre-Henry Conac, Luca Enriques & Martin Gelter, *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy*, 2007 EUR. COMPANY & FIN. L. REV. 491, at 513.

[89] Luca Enriques & Andrea Zorzi, *Spunti in Tema di Rimedi Risarcitori Contro l'Invalidità delle Deliberazioni Assembleari*, 104 RIVISTA DI DIRITTO COMMERCIALE 1, 14-21 (2006).

Finally, the corporate law reform introduced a (broadly speaking German-inspired) law on corporate groups, that appears to have made it lawful for a parent company to impose harmful transactions upon the subsidiary, so long as there is a legitimate business purpose and the damage is compensated as a result of the overall business group policy, a standard quite similar to the French criminal case law on *abus de biens sociaux*.[90] Other protections, such as a duty to motivate board resolutions that have been taken under the influence of the parent have not proved particularly effective in terms of minority shareholder protection. Quite surprisingly, lawmakers failed to judge that a similar regime should not be extended to subsidiaries whose shares are listed on a stock exchange, as it is the case with roughly one fifth of Italian listed companies.[91]

5. Keeping up with the McCreevies and the Sarbaneses (to say nothing of the Oxleys): The post-FSAP implementing measures and post-Parmalat reforms

From 2005 to 2008 further important changes have been made to corporate governance laws. On the one hand, the post-FSAP directives and regulations have been implemented; on the other, following the Cirio, Parmalat, and Banca Popolare di Lodi scandals, reforms mainly, but not exclusively, inspired by the Sarbanes-Oxley Act have been introduced.

Three features of measures implementing EC directives and

[90] Pierre-Henry Conac, Luca Enriques & Martin Gelter, *supra* note 88, at 504 & 518.

[91] See Assonime, *supra*, note 81 Table 26 (60 listed companies out of 291 declare to be subject to the direction and coordination ("direzione e coordinamento") of another company according to Article 2497 Civil Code).

regulations are worth mentioning.[92] First, implementation of the Market Abuse Directive provided the occasion to revise sanctions for insider trading and market manipulation (securities fraud), making them much harsher than before, and to increase investigation powers for public prosecutors and Consob in connection with such crimes (which now Consob can autonomously prosecute with a view to impose a pecuniary sanction). Second, EC rules requiring insiders to report their trades were also extended to significant shareholders (controlling shareholders and shareholders holding more than ten percent of the shares), aptly to reflect Italy's ownership and control structures.[93]

It is finally worth mentioning that at first, in 2007, Italy implemented the Takeover Bids Directive in a way that most favored hostile bids, mandating both the board neutrality rule and the break-through rule.[94] One year later, however, following little grounded fears of foreign takeovers of Italy's largest corporations, the (newly elected) Government backtracked on the previous choices and converted both the neutrality and the break-through rules into opt-in rules.[95] The move was criticized from various quarters, much less for its practical implications (in fact, almost no company existed at the time that could really be taken over via a hostile bid, whether due to companies' ownership structure or to the Government's credible threat to frustrate it via regulation or otherwise) than as the (umpteenth) signal of

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[92] No attention is paid here to changes in Italian laws that follow directly from directives and are therefore common to other EU Member States, such as the adoption of International Financial Reporting Standards and the provisions requiring to inform shareholders on a company's corporate governance arrangements.

[93] Article 114(7) Draghi Law.

[94] Legislative Decree No. 229 of November 19, 2007.

[95] Article 15, Law Decree No. 185 of November 29, 2008.

Italy's hostility to a vibrant market for corporate control.[96]

Post-scandals reforms also brought important changes to Italy's corporate governance. Minority shareholders were significantly empowered, first, by granting minority shareholders representing at least 2.5 percent of the shares the power to add items on the agenda, thus lowering the threshold by three quarters, and making the power easier to exercise;[97] second, and more importantly, by granting them the right to appoint at least one director (or supervisory board member in companies with two-tier boards). Early evidence suggests that institutional investors are increasingly using such power.[98]

Scandals finally prompted lawmakers to improve the regulation of self-dealing transactions,[99] a core area that was conspicuously absent from the Draghi Law,[100] and which the 2003 corporate law reform also failed to tackle

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[96] Marco Onado, *Il Protezionismo sull'Opa*, IL SOLE 24 ORE, November 30, 2008, at 1; Alessandro De Nicola, *Il Gioco dell'Opa non Vale per Tutti*, IL SOLE 24 ORE, December 21, 2008, at 10.

[97] Article 126-II, Draghi Law.

[98] Assonime, *supra* note 81, at 43-6 (as of the end of 2008, 38 companies out of 291 had minority board members, a presence that was compulsory only for companies whose directors had been appointed after July 1, 2007. In 40% of the cases for which information was available institutional investors had nominated them).

[99] Formally, the rules on self-dealing described below were part of the general corporate law reform of 2001-2005, but they would have never been enacted had the Cirio and Parmalat scandals not come to light.

[100] The only provision addressing self-dealing transaction then was Article 150. The provision required directors to inform the board of auditors, on a quarterly basis, of both the course of business and every major new development, including conflicted transactions. I cannot resist telling a personal anecdote here. The Draghi Law was first issued as a Draft Law in order to obtain the Parliament's advice on it. The lower House's opinion recommended that the Government revise the regime on directors' conflicts of interests as then to be found in Articles 2391 and 2631 of the Civil Code. At the time, as a Bank of Italy employee, I was part of the team in charge of revising the Draft Law in light of Parliament's opinions, but I was also in my last year as a Doctorate in Business Law candidate. My thesis topic was corporate directors' conflicts of interests. I spoke with my boss at the Bank of Italy about the idea of following the Parliament's recommendation by revising Articles 2391 and 2631 vis-à-vis listed companies. His reaction was stiff: "Sia chiaro: la tua tesi non la scrivi qui," or: "Let me be clear: you won't write your thesis here." I did not bring up the topic again and unfortunately no one else did.

in any meaningful way.[101] Even Consob had failed to introduce an effective disclosure regime on self-dealing transactions back in 2002, because immediate disclosure of individual transactions was only due in case the transaction might have a negative impact on the company's assets or affect the completeness and correctness of information on the issuer,"[102] while periodic disclosure of individual transactions was only due in case of "unusual" transactions.[103] Intuitively, few issuers are so candid to admit that a transaction may negatively affect the company's assets or that it is unusual, if only not to attract regulators' attention, and therefore tend not to provide such information.[104]

At the end of 2004, the Government entrusted Consob with the power to regulate related party transactions. More specifically, it required issuers to adopt internal codes addressing related party transactions. Such codes are to be drafted pursuant to Consob's "general principles." In April 2008, Consob issued a draft regulation for consultation both identifying those general principles and revising disclosure obligations on related party transactions. In short, the draft regulation requires companies to let independent directors play a key role in vetting substantial related party transactions and mandates their disclosure immediately and in periodic financial documents. The final regulation is expected for April 2009.

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[101] Changes were brought to the Civil Code's provision relating to directors' self-dealing, but only on paper (if at all) did they introduce a more stringent regime. Pierre-Henry Conac, Luca Enriques & Martin Gelter, *supra* note 88, at 504. Further, the reform clarified what was previously at least debated, i.e. that controlling shareholders can cast their vote on shareholder meeting resolution in which they have a conflict of interests. Article 2373, Civil Code.

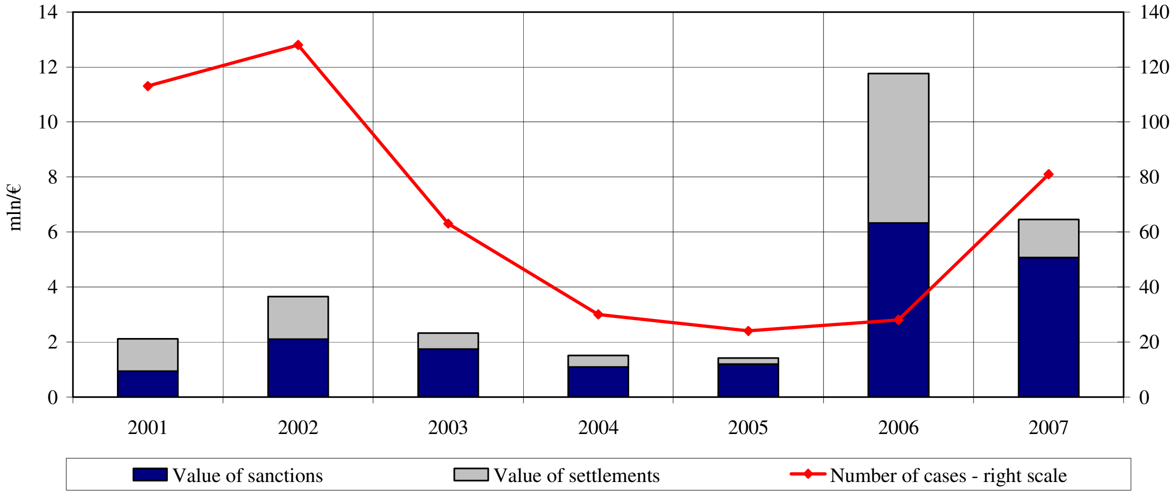
[102] Article 71-II, Consob Regulation on Issuers. The provision is still in force, but will soon be amended to implement Article 2391-II of the Civil Code.

[103] Consob Communication No. 1025564 (6 April 2001).

[104] Companies have seldom disclosed related party transactions pursuant to Article 71-II, Consob Regulation on Issuers (Consob, CONSULTATION DOCUMENT ON THE REGULATION OF RELATED PARTY TRANSACTIONS 64 n51 (2008).

The post-Parmalat reform of 2005 further strengthened public enforcement especially by increasing minimum and maximum fines for securities law violations five-fold. As Figure 1 shows, Consob' enforcement action has indeed intensified following the reform.

Figure 1 – *Sanctions and settlements for breach of rules on disclosure and public offerings (Consob data)*



On the other hand, the post-Parmalat reforms still shied away from paving the way to private enforcement: the only innovation was the reduction from 5 to 2.5 percent of the minimum threshold for derivative suits.

6. Mission Accomplished? An Assessment and a Reform Agenda (for the Next Twenty Years…)

How better are corporate governance institutions ten years after Italian policymakers committed to improve them by enacting the Draghi Law? There is no doubt that the landscape is much friendlier to minority shareholders of listed companies today than ten years ago, as the previous Sections have shown. Although it is of course impossible to measure such improvements, one can go back to La Porta et al.'s indexes to see whether

Italy's updated scores reflect a better corporate governance framework. Starting from the original anti-director index, we can see how Italy's score has steadily gone up, and is now close to the highest possible.

Table 4 – *Antidirectors Rights Index (from pre-Draghi to 2008)*

	pre-1998	1998	2008
Voting by mail	0	1	1
Share deposit	0	0	0*
Cumulative voting or proportional representation	0	0	1
Oppressed minorities mechanism	0	1	1
Pre-emptive rights waivable by shareh. vote	1	1	1
Share capital required to call EGM < = 10%	0	1	1
INDEX	1	4	5

* According to the definition, the variable is 1 if the applicable law "does not allow firms to require that shareholders deposit their shares prior to a general shareholders meeting, thus preventing them from selling those shares for a number of days". The 2003 reform repealed the mandatory deposit but companies can still adopt it on a voluntary basis. The variable is therefore 0.

Unfortunately, Italian corporate governance reforms' performance is slightly less impressive if we use the revised anti-director index that La Porta (Djankov) et al. recently devised to overcome criticism of their original index:[105] Italy has moved from to 1 to 4 (still out of a maximum score of 6).[106]

Table 5 – *Revised Antidirectors Rights Index (from pre-Draghi to 2008)*

	pre-1998	1998	2008
Voting by mail	0	0	0
Share deposit	0	0	0[*]
Cumulative voting or proportional representation	0	0	1
Oppressed minorities mechanism	0	1	1
Pre-emptive rights waivable by shareh. Vote	1	1	1
Share capital required to call EGM < = 10%	0	1	1
INDEX	1	3	4

[*] According to the definition, the variable is 1 "if the law does not require *or* permit companies to require shareholders to deposit with the company or another firm any of their shares prior to a general shareholders meeting" (emphasis added). According to Djankov et al. (*The Law and Economics of Self-dealing*, *supra* note 43, at 454), costs on shareholders stem from company laws that require, or even just permit companies to require, that shareholders deposit their

[105] See Djankov et al. *supra* note 43, at 453.

[106] One is reminded here of Professors Milhaupt and Pistor's story about the "scholar from Beijing who began a presentation about China's new Company Law by highlighting the fact that it scores significantly higher on the investor protection index of La Porta et al. than the law it replaced. But he noted a bit wistfully that the index had been recently updated and that the new law would no longer score as high." MILHAUPT & PISTOR, *supra* note 32, at 248.

shares. The variable is therefore 0 in the Table, because listed companies may impose share-blocking via their statutes (Article 2370 Civil Code).

Finally, we can look at how reform efforts have affected Italy's scores in Djankov et al.'s anti-self-dealing index.[107] Table 6 shows Italy's detailed scores across time.[108]

Column 3 shows the modest impact of the Draghi Law on Italy's score: the score improved very slightly to reflect the introduction of derivatives suits (zero being the number of such suits brought since then, though). Column 4 reports Djankov et al.'s calculation of Italy's variables. The date they considered to assess the sample countries is May 1st 2003, and thus before the Vietti reform came into force. Column 5 corrects for a minor miscoding on access to evidence and for a much more serious miscoding (given the heavy weight the variable is given to build the final index) relating to whether self-dealing transactions such as the one authors devised for their questionnaire had to be disclosed in detail in annual accounts: the Italian law firm responding to the questionnaire stated that the transaction would indeed have to be disclosed in detail in annual accounts. However, while at the time the law generically required companies to provide disclosure on the relations with their controlled, affiliated and controlling entities as well as with other entities under common control,[109] the provision was predominantly held not to require detailed disclosure of individual self-dealing transactions,[110] and such has been companies' consistent accounting practice even after implementation

[107] For the variables description see Djankov et al. *supra* note 43, at 434.

[108] Columns 2, 3, 5, 6, and 7 are the product of my own assessment of Italian law, based on Djankov et al.'s questionnaire.

[109] Article 2428, Civil Code.

[110] See e.g. LUCA ENRIQUES, IL CONFLITTO D'INTERESSI DEGLI AMMINISTRATORI DI SOCIETÀ PER AZIONI 122 n.143 (2000).

of IFRS.[111] Column 6 shows the modest improvements in the score following the Vietti and post-Parmalat reforms, net of implementation of Article 2391-II of the Civil Code by Consob. Finally, the last column shows what Italy's score would be if Consob issued its final rules on related party transactions with no relevant changes from the draft regulation issued for consultation in April 2008. Because respondents to the consultation made no serious criticism to the provisions requiring immediate and periodic detailed disclosure of material related party transactions,[112] it is fair to predict that the Commission will make no relevant changes on that. Therefore, it is also fair to state that Italy's score will greatly improve once the regulation comes into force in 2009.

[111] Commission Regulation (EC) No 1606/2002; Commission Regulation (EC) No 2238/2004 and Legislative Decree 38/2005. See IAS 24, § 18 (disclosure on related party transactions may be rendered on an aggregate basis provided that a distinction among categories of transactions is given). See also OIC, GUIDA 2 – GUIDA OPERATIVA SULLA INFORMATIVA DI BILANCIO PREVISTA PER I SOGGETTI CHE ADOTTANO I PRINCIPI CONTABILI INTERNAZIONALI 140 (2007). Companies do aggregate related party transactions in their annual reports (see Consob, *supra* note 104, at 38).

[112] See http://www.consob.it/main/documenti/Regolamentazione/osservazioni_consultazione/parti_correlate/consultazione_emittenti_20080409_osservazioni.htm. Many Italian respondents as well as international institutional investors and their representing associations criticized Consob's proposal to entrust independent directors with the power to conduct negotiations and decide whether to enter into material self-dealing transactions, the former because their role would erode the whole board's authority to decide on major transactions and/or managerial autonomy, the latter arguing that a better way to ensure procedural fairness would be to let shareholders decide themselves, like under British regulations. Incidentally, to let Italy score even higher on the anti-self-dealing index, Consob's rules could follow institutional investors' advice on shareholders' decision-making and require independent fairness opinions (see rows 2 and 5 in Table 6). Consob has never been close to adopt either of such solutions.

Table 6 – *AntiSelf-dealing Index*

VARIABLE	pre-1998	1998	2003	2003 corr.	2008	2009
Approval by disinterested shareholders	0	0	0	0	0	*0*
Disclosures by Buyer	0	0	0	0	0	**1**
Disclosure by Mr. James	0.5	0.5	0.5	0.5	**1**	1
Independent review	0	0	0	0	0	*0*
Ex ante disclosure	0.17	0.17	0.17	0.17	0.37	0.5
Ex ante private control of self-dealing	0.085	0.085	0.085	0.085	0.185	0.25
Disclosure in periodic filings	0 (*1*)*	0 (*1*)*	*1*	**0**	0 (*1*)*	**1**
Standing to sue	0	**1**	1	1	1	1
Rescission	0	0	0	0	0	0
Ease of holding Mr. James civilly liable	0	0	0	0	0	0
Ease of holding the approving body civilly liable	0.5	0.5	0.5	0.5	0.5	0.5
Access to evidence	0.5	0.5	0.25	**0.5**	0.5	0.5
Ease in proving wrongdoing	0.20	0.40	0.35**	0.40	0.40	0.40
Ex post private control of self-dealing	0.10 (0.6)	0.20 (0.70)	0.675***	0.20	0.20 (0.70)	0.70
INDEX	**0.0925** (0.3425)*	**0.14** (0.3925)*	**0.38********	**0.14**	**0.19** (**0.44**)*	**0.55**

* The figure in parentheses reflects Djankov et al.'s assessment based on the questionnaire response for Italy. See *supra* text preceding note 110.
** The figure for this variable is 0.38 in Djankov et al.'s table, reasonably due to a misprint.
*** Following the misprint highlighted above, Djankov et al.'s score for ex post private control of self-dealing in Italy is 0.69.

**** Following the misprint highlighted above, Djankov et al.'s uncorrected score for Italy is 0.39.

One can reasonably be skeptical about the value of all such indexes, and indeed skepticism about La Porta et al.'s methodology is even more widespread today than ten years ago.[113] Further, and more importantly, tables 3, 4, and 5 tell us nothing about where Italy stands today *compared to other countries*. In fact, virtually all countries around the world have repeatedly intervened to reform their governance institutions in the last two decades, whether to make their capital markets more competitive or to react to major corporate scandals. Such was the case not only in countries with a relatively poor corporate governance record, like Germany or France,[114] but also in those, like the US and the U.K., we have been trying to catch up with.[115]

If policymakers still worry about Italian capital market's competitiveness and still believe that corporate governance institutions can play a role in making a country's capital market more attractive, then the fact that "benchmark" countries have kept moving in the direction of better

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[113] See e.g. MILHAUPT & PISTOR, *supra* note 32, at 20. See also Mark J. Roe, *Legal Origins, Politics, and Modern Stock Markets*, 120 HARV. L. REV. 460, 495 (2006) (labour regulation predicts corporate ownership separation better than legal origin, providing the basis for a political economy explanation for financial market strength); Holger Spamann, *On the Insignificance and/or Endogeneity of La Porta et al.'s 'Antidirector Rights Index' under Consistent Coding*, ECGI Law Working Paper N°. 67 (2006), *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=894301 (if all countries are categorized according to the same La Porta et al.'s criteria in a consistent manner, most of the differences among legal families in the Antidirectors Rights Index are eliminated or reversed).

[114] See Luca Enriques & Paolo Volpin, *Corporate Governance Reform in Continental Europe*, 21 J. ECON. PERSP. 117 (2007).

[115] See e.g. John C. Coates IV, *The Goals and Promise of the Sarbanes–Oxley Act*, 21 J. ECON. PERSP.91 (2007) (US); Paul Davies, *Enron and Conrporate Governance Reform in the UK and the European Community*, in AFTER ENRON, *supra* note 59, at 415 (UK). See also Garen Markarian, Antonio Parbonetti & Gary J. Previts, *The Convergence of Disclosure and Governance Practices in the World's Largest Firms*, 15 CORP. GOVERNANCE 294 (2007) (arguing that all major jurisdictions have converged towards a common core of corporate governance best practices, but the U.S. and the UK were closer to the core to begin with and moved faster in that direction).

corporate governance should push us to take further steps in that direction. In fact, the previous sections have shown that there is still plenty of scope for improvements in Italian corporate governance institutions. In the following, I sketch out a few thoughts on how to keep moving in that direction.

1. Corporate governance and self-enforcement. Despite all the changes and additions in the law on the books, there are still areas to work on to strengthen minority shareholder voice in corporate governance and to improve internal controls.

Starting with voice, first and foremost, measures to lower the cost of voting for shareholders should be introduced. The implementation of the Shareholder Rights Directive can provide the occasion for doing so. Following the example of Germany, issuers could be required to appoint an independent proxy agent that shareholders may choose as their proxy at the company's expense, provided that they give her specific voting instructions. Distance voting should become available as a default. A change in rules on annual meetings could help solve the problem that virtually all annual meetings are concentrated in the last days of April, which means that it is more difficult for shareholders to intervene and especially to form an informed opinion on how to vote.[116] Finally, a useful and totally cost-free simplification that would

[116] In Italy, general meetings held in April account for around 50% of the total number of general meetings held form January to August (the highest concentration in Europe): see GEORGESON, PROXY VOTING SEASON REVIEW 2007 – UK AND EUROPE 28 (2007) *at* http://www.georgesonshareholder.com/emea/research/1)%20Proxy%20Voting%202007%20–%20A%20Pan-European%20Perspective.pdf). Concentration of meetings at the end of April depends on the fact that, on the one hand, the Transparency Directive requires to publish the annual financial report at the latest four months after the end of the fiscal year; on the other hand, the Italian traditional view is that the annual financial report can only be published as such (as opposed to mere draft reports) after approval by the meeting. That view is obviously idiosyncratic and nothing would prevent the law from requiring publication of the report as approved by the board before the end of April. General meetings could thus be held e.g. within six months from the end of the fiscal year, so that companies could pick any date between April and June to hold their meeting.

favor international investors' participation to shareholder meetings is the removal of the distinction between first, second, and third calls:[117] once the quorum is the same for all calls, as it is currently the case for listed companies, it makes no sense to have more than one call, which can only bewilder foreign investors and increase the cost of voting.

Second, default thresholds for minority shareholder governance rights should be significantly lower. In other words, the minimum number of shares required to exercise a given shareholder right should be much lower than currently provided for (and possibly determined with reference to some fixed amount in terms of market value of the shares), while leaving companies free to "opt up" up to the current thresholds via a charter amendment.

Finally, as the European Secutiries Markets Expert Group has recently suggested, rules on shareholder agreements and acting in concert should be modified so as to exclude from disclosure (and mandatory bid) obligations coordination among shareholders to exercise governance rights for activism as opposed to control purposes.[118]

2. More focused (and fewer) rules. A number of Italian corporate law rules address the problems that arise because private benefits of control are so valuable. If one commits to tackle the cause instead of the symptoms, then some of the rules addressing symptoms can be repealed, with an overall reduction of regulatory costs. The main example is rules limiting deviations from one-share-one-vote, such as those capping the number of non-voting and limited voting shares, prohibiting multiple voting shares or even limiting contractual freedom with regard to shareholder agreements. In the presence of

[117] Article 2369 Civil Code.

[118] See ESME, PRELIMINARY VIEWS ON THE DEFINITION OF "ACTING IN CONCERT" BETWEEN THE TRANSPARENCY DIRECTIVE AND THE TAKEOVER BIDS DIRECTIVE 4 (2008) (available at http://ec.europa.eu/internal_market/securities/docs/esme/acting_in_concert_20081117_en.pdf.

high private benefits, rules of this kind only push towards more baroque, opaque, and costly structures, like pyramids and cross-holdings.

If effective rules are in place to curb pecuniary private benefits of control, then the very incentive to deviate from one-share-one-vote will be weaker. Of course, this is a big "if," and it would be naïve to think that Consob rules implementing Article 2391-II alone will do the trick, especially due to their weaknesses from an enforcement perspective.[119] Further, one could object that until we can be confident that corporate governance institutions are in place that curb private benefits, we should not get rid of symptomatic drugs, just like a doctor would never refuse to prescribe them in the absence of an effective cure. The point, however, is that we are already using many symptomatic drugs to cure the symptoms of high private benefits. Despite this, such symptoms are as visible as they could be: few widely held companies exist and deviations from one-share-one-vote are still more common than in most EU countries.[120] Perhaps, then, rules limiting such deviations are just ineffective even as symptomatic drugs.

Quite aside from the example of rules on ownership structures, if policymakers focus on strategies that directly tackle the extraction of pecuniary private benefits, then they might reconsider a number of existing regulations in light of their cost-effectiveness. At a time of forthcoming re-regulation of financial markets, it would be important for policymakers to signal awareness that rules should always pass a cost-benefit test, and that new rules possibly make old ones useless and obsolete. But they should also signal

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[119] See *supra* text accompanying notes 92-97.

[120] See INSTITUTIONAL SHAREHOLDER SERVICES, SHERMAN & STERLING LLP & EUROPEAN CORPORATE GOVERNANCE INSTITUTE (ECGI), REPORT ON THE PROPORTIONALITY PRINCIPLE IN THE EUROPEAN UNION 24, 58-63 (2008), *available at* http://ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf)

awareness that the main challenge for Italy's corporate governance institutions today is much less in designing rules than in ensuring their enforcement. A narrower, more focused set of rules would help enforcers concentrate on enforcing the really relevant, fewer provisions that are left in place.

3. Private enforcement. Private enforcement is a necessary evil for effective corporate governance regimes, unless and until control over listed companies is in the hands of institutional investors (as in the UK). Without private enforcement, self-enforcement (shareholders' voice) is itself emasculated, because there can be no credible commitment to obtain justice via formal enforcement, and even public enforcement is less effective, because of the lower "competitive" pressure on supervisors.[121]

The problem is that Italian private enforcement institutions are currently in such a bad shape that one is reluctant to push for greater access to justice for minority shareholders before those institutions are improved. At the same time, no serious improvement of private enforcement institutions can be expected if rules remain in place that basically discourage plaintiffs from bringing suits or, in other words, if private enforcement institutions are not given a chance to gain experience on the field. To break this deadlock, shareholders' access to justice should be encouraged with the very purpose of making the longer-term reform efforts that are needed to improve private enforcement institutions politically salient.

Repeal of the ban on contingency fees in 2006 was a first, important step in the direction of removing obstacles to shareholder suits, but much more can be done before we come even close to the excesses of US private

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(Italy ranks among the European countries where the percentage of companies featuring at least one control-enhancing mechanism is higher).

[121] See Luca Enriques, *Il ruolo delle Autorità di Vigilanza sui Mercati Mobiliari nelle Controversie Economiche*, 2009 RIVISTA TRIMESTRALE DI DIRITTO E PROCEDURA CIVILE (forthcoming).

enforcement.[122] A simple list is sufficient for present purposes: no thresholds for derivative suits (possibly with an "opt-up" clause allowing to impose threshold lower than the current ones), discovery mechanisms, notice pleading as opposed to fact pleading, a selective American rule preventing judges from burdening losing plaintiff shareholders with defendants' fees and costs other than in case of strike suits, better cooperation mechanisms between supervisors, such as Consob, and private enforcers (in the form of *amicus curiae* briefs and assistance to courts in the gathering of evidence).[123] All of these measures would encourage shareholders to bring suit in case of corporate insiders' wrongdoing while at the same time stopping short of sparking the problems associated with US excesses.

Of course, a reform-minded policymaker should start as soon as possible tackling the chronic malaise of the Italian civil justice system, i.e. the length of trials and the average low level of specialization of its courts, and of course not just to improve listed companies' corporate governance. To do so, reforms should tackle the very governance of civil justice institutions, so that judges' incentives are more aligned to citizens' interests in a speedier and higher-quality justice service.

4. Public enforcement and agencies' governance. Especially after the Banca Popolare di Lodi/ABN-AMRO/Antonveneta case, and following the greater powers entrusted to it by subsequent reforms, Consob's formal and informal enforcement action has become significantly more intense both ex ante and ex post (see Figure 1). This has been the case despite the failure to enact a much-needed reform of supervisory agencies' architecture and governance at a time when all other European supervisory agencies underwent

[122] See e.g. JONATHAN R. MACEY, CORPORATE GOVERNANCE. PROMISES KEPT, PROMISES BROKEN 132-47 (2008).
[123] See Luca Enriques, *supra* note 121.

similar reforms.[124] Following the current financial crisis, even the US will most likely engage in an overhaul of the financial market supervision's architecture, which will also increase the pressure on Italian policymakers to do the same.

While the issue of how supervisory functions are divided among the various authorities is crucial, especially after the crisis, and itself requires a great deal of care in designing both a possibly new architecture and, no less importantly, the transition to it,[125] a topic that deserves at least as much policymakers' attention is the corporate governance of the supervisory agencies resulting from the reform effort. Especially in the prospective post-financial crisis environment of greater regulation and more intense supervision, it is of essence that supervisory agencies are well governed and able to strike the right balance between the benefits and the costs of their actions. It is therefore crucial to design governance mechanisms providing the right incentives for such authorities' agents and capable of holding them accountable to their various stakeholders (the general public, politicians, the financial industry, issuers, and above all investors). While supervisory agencies in Italy have traditionally performed better than average government offices, much can of course be done to ensure even greater consistency between their actions and their objectives.

5. Culture: legal and political. One of the criticisms that La Porta et al.'s work received is that what they identify as the determinant of financial

[124] See Luca Enriques, *A Dieci Anni dal Testo Unico della Finanza: il Ruolo delle Autorità di Vigilanza*, Working Paper (2008), *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1304274, at 4.

[125] See e.g. Howell E. Jackson, *A Pragmatic Approach to the Phased Consolidation of Financial Regulation in the United States*, Working Paper 28 (2008), *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1300431 (describing the carefully crafted, 55-month long transition process which led to the consolidation of supervisory functions into the British Financial Services Authority as a model to establish a US FSA).

market development, i.e. legal families, may in fact be just a proxy for some other, murkier factor that truly is relevant for finance: culture.[126] As a matter of fact, if one reads La Porta et al.'s most recent law and finance work,[127] one gets the impression that at the core of their thesis itself lies the idea that common law countries' *political* and *legal* culture is more favorable to capital markets development than civil law countries'. That may well prove to be the main legacy of La Porta et al.'s "Law and Finance" strand of research.

It is therefore worth asking what features in the common law tradition are more favorable to financial development than those of the civil law tradition and next wonder whether a reform-minded policymaker can fruitfully conceive of transplanting them. In my view, there are two cultural features in common law countries that have a clear connection with financial development, one political and one legal. On the political side, a greater respect for private ownership by politicians historically characterizes common law countries' experience.[128] On the legal side, the tradition there (or at least in the US[129]) is for lawyers and courts to put substance over form and function

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[126] See John C. Coffee Jr., *Do Norms Matter? A Cross-Country Evaluation*, 149 U. PA. L. REV. 2151 (2000) (enforceable legal rights constraining managers and controlling shareholders may account less than legally nonenforceable norms when investors decide to invest in public corporations in common law legal regimes rather than in similar corporations in civil law legal regimes); Amir N. Licht, *The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems*, 26 DEL. J.CORP. L. 147 (2001) (national cultures can be seen as the mother of path dependence dynamics in the sense that they play a role in both the origin and in future development of corporate governance systems).

[127] Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Economic Consequences of Legal Origins*, 46 J. ECON. LITERATURE 285 (2008).

[128] See e.g. Edward L. Glaeser & Andrei Shleifer, *Legal Origins*, 117 Q. J. ECON. 1193 (2002).

[129] See P.S. ATIYAH & R.S. SUMMERS, FORM AND SUBSTANCE IN ANGLO-AMERICAN LAW: A COMPARATIVE STUDY IN LEGAL REASONING, LEGAL THEORY AND LEGAL INSTITUTIONS 408-10 (1987).

over doctrine.[130]

A more market-friendly political culture would have a much greater impact on Italian capital markets' competitiveness than any corporate law reform ever could.[131] In fact, the persistent and bi-partisan meddling of politicians with the allocation of control rights in listed companies and their clear and credible commitment to keep control in Italian hands, should a foreigner launch a hostile (or even a friendly) bid on any large Italian company,[132] intuitively make investment in Italian listed companies less attractive.

From another perspective, the central role politics still has in economic activities, whether via regulation or via informal interference, makes it valuable for listed companies to have dominant shareholders who mediate with politicians in the interest of minority shareholders too. In other words, in such an environment dominant shareholders are the lesser evil: because they can better resist the State's grabbing hand than non-owner managers could, ownership (together with political connections) grants dominant shareholders the social and political legitimacy that is needed to defend the firm. That it is thus impossible to dispense with (politically well-connected) dominant shareholders is also detrimental to the efficient allocation of control and to the

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[130] See e.g. Thorsten Beck & Ross Levine, *Legal Institutions and Financial Development*, *in* HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 251, 257 (Claude Ménard & Mary M. Shirley eds. 2005).

[131] More generally, it is well known that "[g]overnment respect of property rights is the first step toward the development of financial markets." RAGHURAM G. RAJAN & LUIGI ZINGALES, SAVING CAPITALISM FROM THE CAPITALISTS 201 (2003).

[132] See Tony Barber & Martin Arnold, *EDF Plans Expansion as Italy Agrees to Abolish Cap*, FINANCIAL TIMES, May 7, 2005, at 9 (on the EDF/Italenergia-Edison case); Adrian Michaels, *Taking a Toll: How Italy Is Giving the Sale of a Road Operator a Bumpy Ride*, FINANCIAL TIMES, May 11, 2006, at 11 (on the Abertis/Autostrade case); Adrian Michaels and Andrew Parker, *AT&T Quits Telecom Italia Talks*, FINANCIAL TIMES, April 17, 2007, at 13 (on the Telecom Italia/AT&T-Slim case). On the Banca Popolare di Lodi/ABN AMRO/Antonveneta case see *supra* note 30.

functioning of the market for corporate control as a disciplining device, because no outsider (i.e. no foreigner) can aspire to play that role, let alone to play it effectively.

Finally, legal formalism and doctrinal legal thought are still predominant in courts, law faculties, and the legal professions. That negatively affects the quality of corporate governance institutions, because in order for the law to effectively protect equity holders, substance has always to trump form and standards need to be applied creatively (albeit with a market-friendly approach). In fact, dominant shareholders have a number of ways to evade bright line rules or to formally adhere to the letter of the law. If courts, as I have argued elsewhere, tend to be formalistic and deferential to corporate insiders' decisions even when these are tainted by conflicts of interest,[133] then even shareholder plaintiff-friendly procedural rules will prove insufficient to protect minority shareholders.

Similarly, for Consob to effectively perform its investor protection functions, it should be possible for it to go beyond the formalistic interpretation of its own rules. However, such is not a realistic course of action, because formalistic courts review its resolutions.

Is there any chance to move in the direction of a more common law-style, equity-friendlier legal and political culture in Italy? Unfortunately, little if anything can be done to change the broadly prevailing market-hostile political culture, but something can indeed be thought out to modernize Italian legal culture in the long run. First, public, semi-public (like banking foundations'), and private funds could be channeled to send Italian law graduates in the US or the UK to attend LLM programs.[134] Second, and much

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[133] See Enriques, *supra* note 42, at 794-807.

[134] Cf. MILHAUPT & PISTOR, supra *note* 29, at 214. Bernard Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 848 (2001).

more ambitiously, a bottom-up reform of Italian legal education could be given a try. By bottom-up, I mean that a good start would be if groups of academics, however small, and preferably within the same few above-average law faculties, invested in teaching law to students from a functional perspective. Again, private, semi-private and perhaps public funds could be used to give those academics the incentives to invest in such endeavor, compensating them for their high opportunity costs.

Given the traditional osmosis between lawyers and politicians, in Italy and elsewhere, again in the long run such moves might even help changing Italy's political culture.

7. Conclusion

This essay has taken stock of almost twenty years of corporate governance reforms in Italy. It has shown that important steps have been taken to improve investor protection and therefore to make Italy's corporate governance system more attractive to institutional investors.

Yet, both because also other countries have moved in the same direction and because in areas such as private enforcement too little has been done so far, there is still work to do before policymakers can declare "mission accomplished." First, self-enforcement should be encouraged via broadened governance rights, measures reducing the costs of exercising them, and more effective internal control mechanisms. Second, private enforcement is still practically not an option for minority shareholders of Italian companies, while a minimum level of access to justice should be granted to them, if only to make self-enforcement mechanisms more effective. Third, supervisory authorities should be further strengthened by improving their governance. In

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The Bank of Italy has long and meritoriously been encouraging law graduates to study abroad doing all this, one should not forget that new rules have costs as well as benefits, and that older rules that have proved ineffective, such as those trying to mandate contestability of corporate control, should be scrapped. But, even more importantly, for Italy to become attractive as an equity market a change in legal and political culture would do much more than any legislative reform could ever accomplish. The current formalistic and a-functional legal culture, coupled with a political culture that deems it to be perfectly normal for Governments to meddle with corporate control contests and even to vet friendly deals over control, is clearly harmful to the country's competitive position in the international market for equity capital.

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