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Abstract

Called to vote for a reduction in their dividend privileges, the non-voting shareholders of one of the largest Italian firms appeared to expropriate themselves and favor the voting class of shares. However, what at first seemed to be self-expropriation turned out to be self-interest, as soon as the media coverage, the voting decision, and the dual-class ownership of 36,361 shareholders were investigated. Firstly, our new anecdotal evidence shows that the media can mislead investors and help the approval of harmful proposals when they are not independent of the companies they report on. Secondly, most of institutional investors who cast the "for" vote were in conflict of interest either because of ownership ties with the controlling shareholders or because they held both classes of shares. Finally, we find that both retail and institutional dual-class shareholders are more likely to vote for self-expropriating one class of shares if they benefit from the other class in their portfolios. When conflict of interest in dual-class voting is not regulated, dual-class ownership protects from dual-class wealth transfers but favors the approval of the operations it is meant to hedge from.

Keywords: Shareholders expropriation, Shareholders voting, Dual-class shares, Conflict of interest, Media independence.

JEL Classifications: G32, G34

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1. Introduction

A low cross-border turnout at shareholder meetings together with an increasing portion of shares held by foreign investors have recently pushed the European Union to pass a Directive (Shareholder Rights Directive 2007/36) aimed at strengthening shareholder rights and fostering participation at shareholder meetings by electronic means. The directive sets basic principles with respect to shareholder identification, communication, information, and voting. It also shrinks the procedural costs for cross-border voting (Zetzsche, 2008), but it does not address conflict of interest in shareholder meetings and dual-class voting, though all EU countries are characterized by either multiple-voting shares or non-voting shares.[1]

In this paper we analyze the voting process of an extraordinary resolution taken by Pirelli, one of the world biggest tyre-producers and one of the major Italian listed companies. In November 2007 Pirelli's board of directors proposed to pay back part of the firm's equity by reducing the par value of both classes of shares. Since non-voting shares were granted a minimum dividend payment set as a percentage of the par value, this proposal significantly harmed non-voting shareholders and originated a wealth transfer between the two classes of shares. Since the proposed plan modified the rights of the non-voting shares, it required the approval of both Pirelli's voting and non-voting classes of shares.[2] Obviously, the voting shareholders approved the plan as Pirelli was controlled by a voting pact gathering nine shareholders and 46.22% of voting rights. More surprisingly, the operation was also approved by the non-voting class of shares, which apparently voted against their interests. However, what at first seemed to be "self-expropriation" turned out to be "self-interest" when the voting behavior and the dual-class ownership of 36,361 shareholders

[1] For detailed data, see Institutional Shareholder Services (2007), Proportionality between ownership and control in EU listed companies: External study commissioned by the European Commission, available at http://www.ecgi.org/osov/documents/final_report_en.pdf.

[2] Italian non-voting shareholders are not allowed to vote in the voting shareholder meetings but are entitled by the company's bylaws to some dividend privileges. However, any reduction in their rights must be approved by a non-voting shareholder meeting.

were investigated. Though based on a single case study, the paper provides some new contribution to three different streams of literature: shareholder voting, the corporate governance role of the media and shareholder expropriation.

As far as shareholder voting is concerned, the existing literature has analyzed situations when shareholders vote "sincerely" in their interests, basing their decisions on their own signals (Easterbrook and Fischel, 1983), or "strategically" by also observing the voting behavior of other shareholders (Maug and Rydquist, 2009). Other papers have addressed voting by institutional investors and found that they tend to approve management proposals even when they are detrimental to shareholder value (Brickley et al., 1988) and that the approval rate is higher for institutional investors which have business ties with the related firm (Davis and Kim, 2007). On the other hand, opposition to management proposals is stronger when institutions are more independent (Brickley et al., 1988) and when a negative recommendation has been expressed by the ISS, the leading shareholder-voting advisor (Bethel and Gillan, 2002). In a recent paper by Matvos and Ostrovsky (2008) institutional investors' cross-ownership of both target and acquirer firms is found to favor approvals of value-destroying acquisition at the acquirer's meeting. We report new evidence on institutional investors voting in the presence of two types of conflict of interest not previously considered in the literature: ownership ties with the controlling shareholders and dual-class ownership. In fact, some of the institutional investors who voted for the harmful plan in the non-voting shareholder meeting belonged to the financial institutions participating in Pirelli's voting pact. The second type of conflict of interest arises from dual-class ownership and affects the voting decisions of both institutional investors and retail shareholders. Similarly to what Matvos and Ostrovsky (2008) found for cross-ownership in mergers, we find that dual-class owners are more likely to vote for a proposal that harms one class of shares if they can make up for the losses with the gains from the other class. The rights of an inferior voting class of shares are usually safeguarded by also requiring the approval of the inferior class for any reduction or

change.[3] Our anecdotal evidence shows that the power given to a secondary class of shares to place a veto on proposals aimed at reducing their rights is ineffective in the presence of dual-class ownership and unregulated conflict of interests in dual-class voting. The paper also offers some anecdotal contribution to the literature on the corporate governance role of the media. Independent media have been considered a mechanism of pushing managers towards a more ethical and environmental behavior (Dyck and Zingales, 2002) or of preventing expropriation and enhancing better corporate governance (Dick et al., 2008). Bad media exposure is also found to push boards towards corrective actions and to trigger a different reaction between market participants (Joe et al., 2009). The importance of media coverage in affecting voting decisions is taken into consideration by Brickley et al. (1994). According to their "public information hypothesis", shareholder support for management-sponsored proposals depends on public information about the wealth effects of the proposed action. The present case study shows that an incorrect media-coverage can alter public information, distort the expected wealth effect of a managerial proposal, mislead investors and help its approval by shareholders. While existing literature shows that free media may enhance better corporate governance, we report anecdotal evidence that non-independent media may even worsen it. Since conflict of interest between media and listed companies is not regulated, we bring attention to the fact that financial news can suffer from this potential source of risk.

As far as shareholder expropriation is concerned, scholars showed that the legal system plays a predominant role (La Porta et al., 1998; Doidge et al. 2004), together with the presence of controlling shareholders or business groups (Johnson et al., 2000; Atanasov, 2005). Expropriation can take the form of tunneling (Zingales, 1994; Johnson et al. 2000), can be associated with related party transactions (Cheung et al., 2006), M&A operations (Bae et al., 2002; Bigelli and Mengoli,

[3] Such a requirement is usually regulated by law in civil-law countries and by company bylaws in common-law countries. For example, since 1998 Italian law requires the approval of the non-voting shareholders representing at least 20% of the non-voting equity. In Russia, as from 2002, decisions harmful to Russian non-voting shares must be approved by shareholders representing at least 3/4 of the class equity (Murayev, 2009). In one of the biggest US companies, AIG, the firm's bylaws require that any amendment adverse to its preferred shares should be approved by shareholders representing at least 2/3 of the outstanding preferred capital.

2004, Holmen and Knopf, 2004; Faccio and Stolin, 2006), equity issues (Buysschaert et al., 2004; Baek et al., 2006), and self-dealing (Djankov et al., 2008). In this paper, we document a new form of expropriation, i.e. the reduction of the dividend rights of a second class of shares. Most remarkably, we bring to light "self-expropriation", which is when minority shareholders vote in favor of being expropriated, stressing which conditions may enhance such behavior. The anecdotal evidence of this paper shows that, in the presence of unregulated conflict of interest, dual-class ownership and lack of media criticism, expropriation from one class of shareholders to the benefit of the other class can be approved even by the expropriated class. Though dual-class ownership protects from expropriations that take the form of a dual-class wealth transfer, it ends up favoring the approval of the operations it is meant to hedge from. Such evidence provides one more reason as to why institutional investors should prefer investing in single-class firms (Li et al., 2008).

The remainder of this paper is organized as follows. The next section gives an overview of the institutional setting of Italian non-voting shares. Section 3 describes the timeline of events. Section 4 tries to assess the economic impact of the proposed plan on non-voting shareholders' wealth. Section 5 discusses the media coverage and shows the market reaction to the corporate events. Section 6 analyzes shareholders voting at both the voting and non-voting shareholder meetings, while section 7 reports the major conclusions.

2. Institutional setting of Italian non-voting shares

Italian non-voting shares were introduced by Law 216/1974 and can be issued by listed companies for up to 50% of the equity capital. As a compensation for carrying no voting rights at the voting shareholder meeting, non-voting shares were originally granted the following financial privileges:

- a minimum dividend per share equal at least to 5% of the share's par value;
- an extra-dividend (in excess of the dividend paid to voting shareholders) equal to at

least 2% of the par value;

- in the event that dividends are not paid because of accounting losses, when dividends are paid again, non-voting shareholders have the right to receive up to two past unpaid minimum dividends in addition to the dividend of the current year;
- when accounting losses reduce a company's equity, non-voting equity is reduced only after voting equity is cancelled out;
- in the case of bankruptcy, non-voting shares are senior to voting shares.

In 1998, a new Italian financial code (Law 58/1998) improved minority shareholder rights[4] and brought two major changes to non-voting share regulation: non-voting shareholder rights can be freely set by company bylaws and are no longer subject to the minimum dividend privileges indicated by the original law; proposals deemed harmful to non-voting shareholders must be approved by a special non-voting shareholder meeting with the standard majority quorum and a percentage of favorable votes representing at least 20% of the non-voting equity.[5]

In spite of their higher dividend entitlements, Italian non-voting shares used to be traded at a deep discount with respect to the price of the voting shares. The price difference has often been taken as a proxy of the value of a voting right and averaged as much as 82% of the price of a non-voting share in the late '80s (Zingales, 1994), and it has always been one of the highest at the international level (Nenova, 2003). However, the value of a voting right substantially decreased over time and averaged about 20% of the price of a non-voting share at the end of 2003 (Caprio and Croci, 2008). The reduction continued in the following years down to a 2.91% average level at the end of 2008 (our unreported data). Pirelli non-voting shares followed almost the same trend, as

[4] The Italian investor protection index, as measured by La Porta et al. (1998), went from below to above the continental European average (Enriques, 2002),), while other code's provisions affected the ownership structure of Italian listed firms (Mengoli et al., 2009).
[5] As per article 146, paragraph 1, Law 58/1998.

the price difference between the two classes of shares dropped from 16% in October 2002 to 3.6% at October 2007, the month before the announcement date.

3. Timeline of events

At the end of 2007 the Pirelli group was one of the world's leading tyre manufacturers with significant holdings in other industries like real estate and broadband solutions. Pirelli was controlled by a voting pact owning 46.22% of voting rights (as of November 16th, 2007). The major controlling shareholder was Camfin, a family controlled listed company owning 20.32% of Pirelli's voting rights. Other influential shareholders participating in the shareholders' agreement were: Mediobanca, the most important Italian investment bank (with 4.61% of the votes), Edizione Holding, the Benetton family holding company (4.61%), and some of the major European insurance groups such as Allianz (4.41%), Generali (4.41%), and Fondiaria-Sai (4.42%). Other smaller participants in the pact were Intesa Sanpaolo, the biggest Italian bank (1.62%), Massimo Moratti, a oil refinery businessman (1.19%), and Sinpar Spa (0.63%), the holding company of another Italian industrial family.

After having sold two optical fiber companies to Cisco and Corning, in 2001 Pirelli decided to invest its vast liquidity in the acquisition of a relevant stake of Telecom Italia, the leading Italian telecom company which was privatized in 1997 and had been previously taken over in 1999. The bad timing of the acquisition (before the stock market crash of 2001-2002), together with lower industrial margins due to a more competitive industry, resulted in a progressive relevant loss of Pirelli's initial investment. Moreover, Telecom future investments became incompatible with both the high leverage inherited from the first and second buyout and with the generous payout policy aimed at bringing cash to the upper layers of the long pyramidal group. As a result, in late April 2007 Pirelli decided to sell its investment in Telecom Italia to a group of investors led by Telefonica and received €3.3 billion in cash. The new focused and liquid Pirelli group attracted two

activist funds, Amber Capital and Centaurus, which respectively bought 2.1% and 3.2% of Pirelli's voting shares in August-September 2007. As shown by Klein and Zur (2006), who find that active investors try to force target firms to pay out any excess cash, the two activist funds promptly asked for an extraordinary dividend payment. On November 9th, 2007, Pirelli's board of directors welcomed their requests and proposed to pay an extraordinary dividend through a reduction of the par value of the shares from €0.52 to €0.29. The €0.23 par value reduction was split in two parts: €0.154 was paid out as an "extraordinary dividend" (for a total amount of approximately €827 million), while the remaining €0.076 was set aside to reserves (for a total amount of approximately €408 million). The operation was officially aimed at minimizing taxes on dividends. In fact, being structured as an equity reduction, the extraordinary dividends were tax-exempt to all shareholders.[6] However, it was quite unusual, as extraordinary dividends are usually paid through the distribution of accrued earnings. Besides, the reduction of the par value was significantly greater than the amount paid and it greatly reduced the dividend privileges of the non-voting shares that could have been safeguarded. In fact, Pirelli had both voting and non-voting shares outstanding. The company's charter granted non-voting shares a yearly minimum dividend equal to 7% of par value and an extra-dividend (in excess of that of the voting shares) equal to 2% of par. By reducing the par by €0.23 (from €0.52 to €0.29), the proposed operation was going to appreciably weaken the dividend privileges to non-voting shareholders, therefore reducing the fundamental value of this class of shares.

During the days preceding the required voting and non-voting shareholder approvals, the Italian press positively commented on the plan which was considered advantageous even for non-voting shareholders. The several articles that appeared can be summarized by the one published in the leading financial newspaper, *Il Sole 24 Ore*, which defined the operation as a "Christmas

[6] Dividends are taxed with a 12.5% tax rate, when the percipient is an Italian resident individual, while only 5% of their amount is subject to the corporate tax rate (which was equal to 27.5% in 2008) when the percipient is an Italian corporation.

coupon" for the non-voting shareholders (on December 4th). The proposed plan was first approved by voting shareholders on December 12th. A few days later, on December 14th, the proposal was surprisingly also approved by the non-voting shareholder meeting with a percentage of favorable votes slightly greater than the 20% required equity quorum. Though not mentioned by any press-article commenting on Pirelli's proposal, non-voting shareholders who did not concur with the approval of such an extraordinary operation (either because they did not participate in the meeting or because they abstained or voted against the proposal) were granted the right to withdrawal. The right had to be exercised within fifteen days from the registration date of the non-voting shareholders' resolution by means of sending a registered letter to the company. [7] The exercise price was set equal to €0.8055 and the withdrawal right expired on January 5th.[8] Finally, on March 31st, Pirelli's shares went ex-dividend and their par value was reduced from €0.52 to €0.29. The timeline of all the above events is reported in Table 1.

Insert Table 1 about here

4. Economic assessment of the proposed plan

In this section we estimate the economic impact of the Pirelli board proposal on the value of the non-voting shares. While existing literature is mainly related to the value of the voting premium (Lease et al., 1983; DeAngelo and DeAngelo, 1985; Barclay and Holderness, 1989; Zingales, 1994, 1995; Nenova, 2003; Dick and Zingales, 2004), this case study offers the opportunity to focus on the value of dividend privileges and how it can be affected by shareholder decisions. Dividend

[7] Art. 2437-bis, paragraph 1, of the Italian Civil Code.

[8] The withdrawal price was equal to the arithmetic average of Pirelli non-voting stock prices in the six months preceding the publication date of the notice calling the extraordinary non-voting shareholder meeting, as required by article 2437-*ter*, paragraph 3, of the Italian Civil Code. Since the notice was released on the day after the announcement of the operation, the 6-months period was including the announcement day.

privileges are usually granted to non-voting shares in European Countries and to preferred shares in the US. The right to higher or senior dividends is set either by a specific law or by the firm's bylaws or by the issue prospectus of the class of shares. In Italy some minimum dividend privileges were initially set by law 216/1974 and company bylaws could only improve them. Following the 1998 corporate governance reform, dividend privileges are only regulated by company charters and no longer mandatory. However, almost all company charters maintained the privileges set by the above law or the higher privileges initially set by the company. To the best of our knowledge, no Italian firm has ever cancelled the dividend privileges.

4.1 The dividend patterns of Italian voting and non-voting shares

We now show how the combination of the different dividend privileges set by Law 216/1974 and transposed in dual-class companies' charters (Pirelli included) give rise to specific dividend patterns for voting and non-voting shares. Dividends are decided by the voting shareholder meeting and paid once a year according to the firm's discretionary payout.[9] Non-voting shares are entitled to a minimum dividend equal to a percentage of the shares' par value (set at 5% by the law or at a higher level by the company charter, as in Pirelli). Such dividend has a senior claim, i.e. all minimum dividends to non-voting shares must be paid before voting shares can receive any dividend. In any case, the dividend paid to the non-voting shares must exceed the one paid to the voting shares by an extra-dividend privilege equal to a percentage of the shares' par value (set at 2% by the law or at a higher level by the company charter). This regulation makes dividends per shares of the two classes follow specific patterns which depend on the total amount of dividends under distribution (Figure 1).

[9] As a matter of fact, the payout is subject to one constraint: 5% of earnings must be set aside to legal reserves until they reach 20% of the shareholders' paid-in equity. Since Pirelli's legal reserves were already above such level, this constraint did not apply to Pirelli's payout.

Insert Figure 1 about here

Let *TD* represent the total dividends paid by the firm to all classes of shares and define $PRIV_1$ as the percentage minimum dividend privilege to non-voting shares, $PRIV_2$ as the percentage extra-dividend privilege granted to non-voting shares, *PAR* as the par value of the shares, N_V and N_{NV} as the number of voting and non-voting shares, respectively, and DPS_{NV} and DPS_V as the dividend per share to non-voting and voting shares, respectively. For instance, applied to the Pirelli case, these parameters become $PRIV_1$ = 7.0%, $PRIV_2$ = 2.0%, *PAR* = €0.52, N_V = 5,233,142,003, N_{NV} = 134,764,429 (paragraph 4.2 for details). Depending on the value of *TD*, three different scenarios may occur. In the first scenario, total dividends are so low that only non-voting shares can get paid (thanks to their seniority claim). As *TD* increases, the dividend per share to non-voting shares rises; however, as long as this dividend per share is smaller than the minimum amount guaranteed by the company's charter, i.e. $DPS^*_{NV} = PRIV_1 \cdot PAR$, the dividend to voting shares remains zero. When *TD* is large enough to completely satisfy the minimum dividend guaranteed to non-voting shares by the company's charter, DPS^*_{NV}, voting shares start receiving a dividend. This happens when *TD* reaches the following threshold:

$$TD^* = PRIV_1 \cdot PAR \cdot N_{NV} . \quad (1)$$

At $TD = TD^*$, total dividends can grant exactly the minimum dividend privilege to non-voting shareholders (i.e., $DPS^*_{NV} = TD^* / N_{NV}$), but are insufficient to pay any dividend to voting shares. When $TD > TD^*$ two more situations may occur. In the second scenario, *TD* exceeds TD^* but remains below a threshold, TD^{**}, defined as the level of *TD* prior to which the extra-dividend to non-voting shares relative to voting-shares, i.e. the difference $DPS_{NV} - DPS_V$, is greater than the

minimum amount guaranteed by the company's charter, i.e. $PRIV_2 \cdot PAR$. In this case, non-voting shares keep receiving the minimum dividend, DPS^*_{NV}, and an increasing dividend can be paid also to voting shareholders. As *TD* approaches TD^{**}, the difference between the dividend per share paid to the two classes of shares progressively decreases. When $TD = TD^{**}$ it is no longer possible to increase the dividend paid to voting shares without also raising the dividend paid to non-voting shares, and the difference between DPS_{NV} and DPS_V equals exactly the amount $PRIV_2 \cdot PAR$. This implies that TD^{**} is implicitly defined by the equality:

$$DPS^*_{NV} - DPS_V = PRIV_2 \cdot PAR, \qquad \text{at } TD = TD^{**}, \tag{2}$$

where $DPS_V = (TD - TD^*) / N_V$. Solving equation (2) for *TD* yields:

$$TD^{**} = TD^* + (PRIV_1 - PRIV_2) \cdot PAR \cdot N_V. \tag{3}$$

In other words, since non-voting shares are receiving DPS^*_{NV} and this dividend per share must exceed the dividend to voting shares by an amount equal to at least $PRIV_2 \cdot PAR$, it follows that an increase of €1.0 in *TD* results in the same increase in the total dividend to voting shares until DPS_V equals $(PRIV_1 - PRIV_2) \cdot PAR$. After this point (third scenario), as *TD* exceeds TD^{**}, the difference between DPS_{NV} and DPS_V is exactly equal to the minimum amount guaranteed by the company's charter, i.e. $PRIV_2 \cdot PAR$. Hence, dividends per share to both classes must increase by the same amount, so that:

$$DPS_{NV} = DPS_V + PRIV_2 \cdot PAR. \tag{3}$$

The dividend per share to voting shareholders, DPS_V, can be easily determined by subtracting from *TD* the total extra-dividends granted to non-voting shares ($PRIV_2 \cdot PAR \cdot N_{NV}$) and dividing the remaining amount by the overall number of shares ($N_V + N_{NV}$), that is:

$$DPS_V = \frac{TD - PRIV_2 \cdot PAR \cdot N_{NV}}{N_V + N_{NV}} \tag{4}$$

The resulting dividend patterns (shown in Figure 1) hold for all Italian dual-class firms and for any other international dual-class company who opted for such a combination of dividend privileges.

4.2 The impact of Pirelli's plan approval on non-voting dividends

Non-voting Pirelli shareholders are entitled to a minimum dividend privilege ($PRIV_1$) and to an extra-dividend privilege ($PRIV_2$) respectively equal to 7% and 2% of the par value. Before the proposed operation, the par value (*PAR*) was equal to €0.52 and resulted in a minimum dividend per share of €3.64 cents (= 7% · €0.52) and an extra-dividend of €1.04 cents (= 2% · €0.52). Since the number of voting and non-voting shares amounted to 5,233,142,003 and 134,764,429, the two thresholds for total payable dividends were respectively equal to TD^* = €4.91 million and TD^{**} = €140.97 million. The first indicates that no dividends could be paid to voting shareholders if total dividends were less than TD^* = €4.91 millions. For total dividends between €4.97 and €140.97 million some dividends could also be paid to voting shareholders, with a difference between dividends to non-voting shares and dividends to voting shares ranging from 7% of par value (at $TD = TD^*$) to 2% of par value (at $TD = TD^{**}$). For total dividends greater than TD^{**} = €140.97 million, dividends per share could be set at higher levels as long as the level for non-voting shares did not exceed that of voting shares by 2% of the par value.

After the plan's approval, the percentage privileges ($PRIV_1$ and $PRIV_2$) remained unchanged, but were computed on the lower par value (€0.29 instead of €0.52). It follows that the minimum dividend per share granted to non-voting shareholders dropped from €3.64 cents (= 7% · €0.52) to €2.03 cents (= 7% · €0.29), while the extra-dividend paid to non-voting shareholders dropped from €1.04 cents (= 2% · €0.52) to €0.58 cent (= 2% · €0.29). After the plan was approved, the amount of total dividends that was reserved for non-voting shareholders, TD^*, was reduced to about €2.74 million (from €4.91 million), while the amount of total dividends needed to set only the minimum extra-dividend difference, TD^{**}, almost halved to €78.62 million (from €140.97). From the patterns of overall dividends to non-voting shares before and after the plan's approval (shown in Figure 2), it is clear that the dividend's reduction was relevant, especially for moderate levels of Pirelli's earnings and total dividends.

Insert Figure 2 about here

In fact, the highest overall dividend reduction (€2.17 million) takes place for total dividends ranging between €4.91 million and €78.62 million, when non-voting shares are entitled to an overall amount of minimum dividends equal to €2.74 million, from the previous level of €4.91 million (a per-share reduction of €1.61 cents). At the other extreme, the lowest overall dividend reduction (0.60 million) takes place for total dividends greater than €140.97 million (pre-plan TD^{**}) when only the extra-dividend privilege is affected. In fact, the reduction of the par value only gives rise to a reduction of the extra-dividend privilege equal to €0.46 cent per share which corresponds to almost €0.62 million on all the non-voting class. However, since the reduced cash committed to extra-dividend payments to non-voting shares can be used to increase dividends per share of both classes, the overall dividend reduction to the non-voting class of shares is reduced to about €0.60 million. Since all the cash saved from paying lower dividends to non-voting

shareholders could be used to increase payments to voting shares, the operation gives rise to a wealth transfer between the two share classes, whose relevant harmful effect on non-voting shares is estimated in the Paragraph below.

4.3 An estimate of the plan's impact on the value of non-voting shares

Since the dividend reduction depends on the level of total dividends, the price effect on non-voting shares will be a function of the expected total dividends and of the discount rate. As far as the discount rate is concerned, we adopt the CAPM to determine the non-voting share cost of equity as of the end of October 2007, before the board's announcement date. For the risk-free rate, we take the 10-year Italian Treasury Bond as found in Thompson Financial (4.47%). The beta of Pirelli's non-voting shares is computed using 5-year monthly returns over the Italian market index and equals 0.815. The market risk premium (geometric average) is set at 4.30%, as found by Dimson et al. (2002). The final discount rate equals 7.97% (= 0.0447 + 0.815 · 0.043).

As far as the earnings and dividends estimates are concerned, we consider all the analyst forecasts of Pirelli's earnings as of November 2007 (source: Bloomberg). At that time, seven analysts were following Pirelli's shares and making earnings' forecasts for the following year (2008). Those figures ranged from €107 to €322 million with a mean (median) of €224.7 (€246.9) million.[10] As far as the company's payout is concerned, we asked Pirelli's Investor Relator who indicated a target payout of around 30-40%. We decided to adopt a more conservative 40% payout level to translate average earnings' forecasts into higher levels of total dividends and lower estimates of the wealth transfer from the operation. The resulting expected total dividends average €89.9 million and translate into an amount of dividend reduction from the plan's approval equal to

[10] For the purpose of robustness we cross-checked these data using analyst earnings forecasts from FACTSET and found a more conservative mean (and median) earnings estimate equal to €183 (182) million. Since these figures would have translated into a wider wealth-transfer, we decided to use the more conservative Bloomberg estimates.

€1.887 million for the year after the announcement. However, since we assume a 2% perpetual yearly growth rate for earnings and total dividends, the expected dividend reduction progressively decreases over time and reaches the steady state (the minimum €0.60 million level) after 24 years. The stream of expected dividends without the plan is then compared with the stream after the plan and the present value of the difference is computed. Such economic value is then divided by the market capitalization of the non-voting class of shares at the board's announcement date (€110.37 million) to get the estimated price-effect which equals -14.44%.[11]

5. Media coverage and market reaction

As anticipated above, the operation also needed the approval of the non-voting shareholder meeting and the favorable vote of at least 20% of the non-voting equity. Since shareholders participating in Pirelli's voting pact did not hold non-voting shares,[12] they had to persuade non-voting shareholders to attend the meeting and vote in favor. The company did move in such a direction. In fact, an article published on *Milano Finanza*, the second Italian financial newspaper, reported that Pirelli sent a letter to non-voting shareholders inviting them to participate in the meeting and vote for the operation.[13] The letter (also posted on the company's website) summarized the proposal and indicated a free-toll number to obtain more information, but the right of withdrawal was not mentioned.

The Italian financial press also seemed to help the meeting's attendance and approval. In fact, on December 4th, 2007, *Il Sole 24 Ore* (the most influential Italian newspaper[14]) published an

11 Even using completely different estimates for total dividends, since the overall dividends' cut would vary between -0.60 million and -2.17 million, the price effect would anyway fall in the -6.87%/-24.65% interval.

12 We infer such information from their absence in the list of shareholders represented in the following non-voting shareholders meeting.

13 *Milano Finanza*, November 23rd, 2007, p. 11.

14 *Il Sole 24 Ore* is the largest Italian financial daily with about 90% market share among financial newspapers in 2007, when it went listed on the Milan Stock Exchange. At the end of December 2007, 72.41% of the newspaper was controlled by Confindustria, the association of Italian business firms (Pirelli being one of the most important).

article titled "Christmas coupon to Pirelli's shareholders".[15] The article said that in the case of approval, non-voting shareholders would have made a "big shot" and cashed in a "Christmas gift" as big as at least €0.227 per share. "*Besides the tax-exempt extraordinary dividend payment of €0.154 there was other good news for them. According to Pirelli's computations, the capital reduction should not be harmful to non-voting shareholders. The minimum dividend per share (7% of par) will be computed on the old par value (€0.52) and not on the new par value after the plan's approval. This computation will be made not only on the dividend related to the year 2007 but also on the dividend for the year 2006 (as the company charter grants up to two unpaid past minimum dividends"*).[16] The article then recalled that both voting and non-voting shareholder meetings had to approve the favorable plan and that a 20% equity quorum was needed for the non-voting shares' approval.

In our modest opinion, the article was incorrect, as the payment of the two previous minimum dividends was not a "gift" and both dividends were expected and due according to the company charter. Besides, their amount had to be computed on the old par value which was at the higher pre-plan level of €0.52 in 2006 and 2007.[17] Furthermore, the article could have misled many retail shareholders and made them believe that the minimum dividend would remain unchanged.

Insert Figure 3 about here

The day after, on December 5th, *Il Sole 24 Ore* commented on the rise in Pirelli's non-voting shares, as follows: "*…as anticipated the day before, non-voting shareholders should not be harmed by the equity reduction as the minimum dividend set by the company charter (7% of par value) will*

[15] Il Sole 24 Ore, December 4th, 2007, p. 37.
[16] In fact, Pirelli was not able to pay any dividend to non-voting shares for the 2006 fiscal year, when it reported huge losses due to the devaluation of the Olimpia-Telecom stake.
[17] As far as 2007 is concerned, the par value remained at the previous value for almost the whole year, that is until the registration date of the non-voting shareholder meeting's resolution of the par value reduction (December 21st).

be computed on the old par value (€0.52) and not on the one resulting from the equity reduction operation (€0.29)".[18] Even more clearly than before, the article assured investors that the par reduction would not have affected the minimum dividend granted to non-voting shares, further misleading investors' behaviour.

As far as the market reaction is concerned, the pattern of the beta-adjusted cumulative abnormal returns (CARs) for Pirelli's non-voting shares from the announcement date until after the expiration of the right of withdrawal is shown in Figure 3. The announcement of the operation does not seem to have exercised a significant impact on Pirelli's non-voting shares' stock price. Because of the firm's press release and the fact that all the newspaper articles didn't mention any effect on the dividends, most of the non-voting shareholders were probably not able to infer the expropriation content of the operation when the board announced it. As a matter of fact, the following shareholder meeting could have decided to leave the minimum dividend unchanged notwithstanding the par value reduction. Besides, this scenario was depicted as the most likely by the favourable press articles released in the following days and commented on above. That's why most of non-voting shareholders may have perceived the harmful content of the operation only when its effect on the non-voting dividends became clear, i.e. after the voting and non-voting shareholder meetings. In fact, post-announcement CARs first reached a positive +7.7% peak on December 4th, when the first misleading press article was published and triggered a consequent daily appreciation of about +4.63% with volumes almost ten times the monthly average. Then, around the voting and non-voting shareholder meetings, CARs dropped by almost 4% and kept falling in the following days, when they reached a minimum value equal to -6.4%. At this level, the CARs reduction from the peak reported at the release of the misleading article is equal to about -13.7%. The voting premium[19] follows almost the same behaviour: from the 9.55% level reached

[18] *Il Sole 24 Ore*, December 5th, 2007, p 43.
[19] Computed taking the present value of dividend differences into consideration, as in Chung and Kim (1999).

after the misleading press articles it widens up to 11.91% after the voting shareholders meeting and to 16.09% after the approval by non-voting shareholders, reflecting both the operation's wealth-transfer effect and, maybe, a greater perceived likelihood of future expropriations.

Figure 3 also shows that the stock price of Pirelli non-voting shares remained above the exercise price of the right to withdrawal (€0.8055) until the day after the non-voting shareholder meeting. This could help to explain why only 3.37% of non-voting equity exercised the right. In fact, informed and skilled investors who were aware of the expropriation content of the operation from the announcement day may have preferred to sell their shares at the higher market prices. [20] If we add all the Pirelli non-voting shares traded from the day after the announcement until the day when the price fell below the exercise price, we obtain a cumulative 31.91% non-voting capital that was sold above the withdrawal price either because of the perceived expropriation or for other reasons. Besides, such a right could not be exercised by those non-voting shareholders who voted for the plan, representing 21.63% of non-voting equity. In any case, at least 43.09% of Pirelli non-voting equity (= 100% – 3.37% – 31.91% – 21.63%) did not exercise the right to withdrawal even if they would have been better off. However, this does not necessarily mean that they did not feel themselves expropriated. In fact, they might not have been financially educated enough to understand the expropriation content of the operation (especially in the presence of the positive press articles) or they might have felt expropriated but did not know about the existence of the right to withdrawal. Related to this second conjecture, we must consider that neither the press articles nor the company's letter indicated the right to withdrawal, which had to be exercised during the Christmas holidays.

The major Italian newspaper, *Il Corriere della Sera*, interpreted the drop in Pirelli's stock price after the meeting's approval as a "sensational misunderstanding" in the sense that the

[20] In theory they may have also tried to short-sell the non-voting shares. However, this was unlikely, since short-selling activity is typically limited only to major Italian stocks and Pirelli's non-voting shares had one of the smallest market capitalizations. In any case, we could not control for this possibility as Italian data on short selling are unavailable.

operation was not correctly understood by the market.[21] *Il Corriere della Sera* is part of a listed media company, RCS, which is controlled by a voting shareholder agreement grouping 63.57% of the votes from 15 different shareholders.[22] Looking at their names, we find Pirelli (with a 5.249% of the votes) and five of the nine groups participating in the Pirelli shareholder agreement, i.e. Mediobanca, Fondiaria, Intesa Sanpaolo, Generali, and Sinpar, with respectively 13.699%, 5.257%, 4.927%, 3.713% and 2.038% of voting rights. Social environment and media independence may play a crucial role in condemning shareholders' expropriations and therefore helping to prevent them (Dyck and Zingales, 2002, Holmen and Knopf, 2004). Our case study reports some anecdotal evidence that lack of media independence may actually favour expropriations trying to influence shareholders' behaviour. In the 2008 Global Press Freedom Rankings (made by Freedom House) Italy ranks only 65th after countries such as Mauritius, Ghana and Mali.

6 Shareholders voting

On December 12th, 2007, the Pirelli extraordinary voting shareholder meeting took place. From the minutes of the meeting we were able to gather information on the voting results, names of voters and types of vote. We looked for ownership ties between the five banks or insurance companies participating in the voting pact and the financial institutions which were either voting or non-voting shareholders or both. We classified a financial institution "controlled by the voting pact", "connected to the pact" or "unconnected to the pact" if one or more shareholders participating in the pact directly or indirectly owned more than 50%, less than 50%, or 0% respectively.

As reported in Panel A of Table 2, 227 voting shareholders, representing 59.29% of the voting equity, attended the meeting and cast their votes (directly or by proxies). Only one retail

[21] *Il Corriere della Sera*, December 20th, 2007, p. 45.
[22] As of November 29th, 2006, that is the last update of the voting pact information.

shareholder voted "against" and only 3 shareholders "abstained" (two companies unconnected to the pact and one unconnected financial institution) representing less than 0.01% of the voting shares. All the remaining shareholders, representing 59.29% of the voting capital, voted for the plan's approval. The "for" vote came from 9 shareholders in the voting pact, 10 financial institutions controlled by the pact, 161 apparently unconnected financial institutions, 4 companies controlled by the pact, one unconnected company and 37 retail shareholders (representing 46.22%, 5.70%, 6.35%, 0.01%, 0.97% and 0.03% of the voting equity, respectively).

Insert Table 2 about here

At the following non-voting shareholder meeting, held on December 14th, there were 140 non-voting shareholders representing 22.38% of the non-voting equity, slightly above the minimum 20% quorum required to approve the plan (Panel B, Table 2).[23] From the minutes we realized that some non-voting private shareholders showed their disappointment at the proposed plan. One shareholder stated that the par value reduction would have reduced the minimum dividend and the related yield which was granted on the shares. He also pointed out that in the face of such harm only part of the par value reduction was paid out, the other part being set aside in the firm's reserves. He then said that since the operation was harming non-voting and favouring voting shareholders it should have been accompanied by a proportional increase in the percentage privileges to non-voting shares. He concluded by saying that from a recent article published in *Il Sole 24 Ore* it appeared that payments to non-voting shareholders would have remained unchanged. He then voted against the plan. Another vote against the proposal was announced by another shareholder who said that the proposal was against non-voting shareholders' interests. He questioned why mutual funds and financial institutions were not taking any part in the discussion

[23] In the previous meetings only about 2.08% of the non-voting equity was represented.

and said that they should have explained their "for" vote to their investors. A third shareholder asked how much the non-voting legal representative was paid on a yearly base and how much the non-voting shares expense fund was.[24] He then cast some doubts on the fairness of the legal representative's behaviour since he did not even ask for an opinion on the potential harm from the operation to the class of shareholders he was supposed to represent and economically safeguard. He finally voted against the plan. One final shareholder said that the operation was harming non-voting shares, and he suggested increasing the percentage privilege to compensate for the damage from the par value reduction. In spite of these criticisms, he then "surprisingly" voted for the plan.[25] The plan was finally approved: 121 shareholders, representing 21.63% of the non-voting equity, voted for it, 18 shareholders voted "against" and only one abstained. Since the minimum favourable quorum was 20% of non-voting equity, the plan would have been dumped if only 1.64% of the capital had voted against it or had not participated at the meeting.

As can be seen from Table 2 (Panel B), all 14 financial institutions voted for the plan. Among these institutions, 6 were controlled by participants of the voting pact and 2 connected to the pact, representing 5.72% and 3.78% of the non-voting equity, respectively.[26] Details of the ownership ties relating shareholders participating in Pirelli's voting pact to the six financial institutions holding non-voting equity are shown in more details in Figure 4.

[24] The answers were €8,000 and €40,000 respectively. Italian non-voting shareholders must elect a common representative who is entitled to participate in the voting shareholder meetings and should act in non-voting shareholder interests (article 147, Law 58/1998). The representative's remuneration comes from a fund advanced by the company, which may recover the advance from the profits due to non-voting shareholders in excess of any amount guaranteed (article 146, paragraph 1, Law 58/1998).

[25] However, the final voting decision becomes more rational when we check for dual-class ownership as we find that the shareholders he was representing were holding more voting than non-voting shares (1.18 million versus 1.07 million).

[26] As an exception, we classified CAAM SGR as "controlled" by Intesa Sanpaolo for several reasons. CAAM SGR was a joint venture between Credit Agricole (65%) and Intesa Sanpaolo (35%), However, just some days after the Pirelli non-voting meeting (on December 27th) Intesa Sanpaolo bought the 65% stake from credit Agricole and changed the name into Eurizon Investimenti SGR (thereafter controlled at 100%). In addition, at the end of 2007 Credit Agricole was the third shareholder in Intesa Sanpaolo (with a 5.494% stake compared to the 7.694% stake of the first shareholder) and was participating in Intesa Sanpaolo shareholders' agreement.

Insert Figure 4 about here

The remaining six financial institutions were apparently unconnected to the pact but also approved the management proposal. As argued by Romano (2003), financial institutions may anyway restrain from voting against management proposals because of possible conflicts of interest. Among these, business ties between the firm and the financial group are the most frequent, though probably not so relevant in our case, as dual-class ownership seems to have played a more important role. The favorable votes of all 14 financial institutions cumulated 12.43% of the non-voting equity. The 20% equity quorum was reached thanks also to the favorable votes of 3 apparently unconnected firms (representing 0.73% of the non-voting equity) and of 104 retail shareholders (representing 8.47% of the non-voting equity).

Out of the 121 retail shareholders represented at the meeting only 18 voted against the plan (representing 0.75% of the non-voting equity), while all the others apparently voted against their interests. However, as the operation was carrying out a wealth transfer between the company's two classes of shares, dual-class ownership could have allowed non-voting shareholders to make up the losses on one class with the gains from the other class, and favored a "for" vote in the non-voting shareholders. We therefore look for dual-class ownership at two different dates. For all the 140 non-voting shareholders participating at the meeting we first check their participation and ownership at the preceding voting shareholder meeting. However, since many retail shareholders may have not participated at the voting shareholder meeting, we also check for their voting ownership at the first following dividend date, i.e. when the extraordinary dividend was paid (March 31st, 2008). The second ownership search required much more effort as the list of shareholders kindly provided by the company upon our request was made up of 36,361 shareholders not in alphabetical order and in a paper format. For each case of dual-class ownership

we construct an α-ratio, i.e. the ratio of the percentage of voting shares divided by the percentage of non-voting shares held by the same shareholder. Values of the α-ratio greater than one indicate that the "for" vote to the proposal would have been rational and in the non-voting shareholder's interest, as the gain on the voting shares would have more than offset the losses on the non-voting ones. When shareholders vote against their interests in one class this can therefore be interpreted as a form of "sincere" voting if dual-class ownership makes shareholders better off as a whole.

Table 3 reports the results. Out of 121 non-voting shareholders who approved the plan, 13 were found to also have held voting shares at the preceding voting shareholder meeting and 32 at the following dividend date. Dual-class ownership characterizes 9 institutional investors (out of 14) when we check it at the voting shareholder meeting and one more at the dividend date. At the voting shareholder meeting, five of the six institutions connected with the pact were holding a percentage of voting shares greater than their stakes of non-voting equity (α-ratio greater than 1) and, on average, 3.28 times bigger. The "for" vote cast by these five institutions was therefore "sincere" and rational as they were benefiting at the overall portfolio level. Also, three of the six apparently unconnected institutions held a fraction of the voting shares. For two of them this fraction was greater than the percentage of non-voting shares held and also explains their "for" vote. Data on dual-class ownership by institutional investors almost does not change when it is measured at the following dividend date. Number and values do differ, however, when referred to retail shareholders. In fact, only four retail shareholders participated both at the voting and non-voting shareholder meeting, while 22 non-voting shareholders also owned voting shares at the following dividend date, when all voting shareholders names could be scrutinized. No retail shareholder is found to report an α-ratio greater than one, when we use information available at the voting shareholder meeting, versus nine cases using ownership data at the dividend date.

Insert Table 3 about here

All thirteen non-voting shareholders (institutional or retail) owning both classes of shares (as of the voting shareholder meeting) voted for the proposal at the non-voting meeting while none of the sixteen non-voting shareholders who voted against the plan held voting shares at both measurement dates. Their "against" vote is also classifiable as a "sincere" vote, since they were certainly harmed only in the class of shares held. When we use voting ownership information as from the dividend date, the results do not change: all the 32 shareholders (institutional and retail) with dual-class ownership cast a "for" vote in the non-voting shareholder meeting.

In order to have some robust evidence that dual-class ownership was a significant determinant of the voting decision at the non-voting shareholder meeting, we decide to run some logit models where the probability of voting against the proposal is regressed on some explanatory variables measuring dual-class ownership (results reported in Table 4). Since we exclude the unique "abstain" vote cast at the meeting, a lower likelihood of voting "against" the proposal corresponds to a higher likelihood of a "for" vote.[27] Initially, we also tried to use some indicator variables to identify the type of shareholders. However, since the dummy variable identifying the financial institution either controlled or connected with the pact was perfectly predicting the outcome of not voting against the plan, we had to exclude it from the models. As predictive variables we therefore use both the number of voting shares owned by non-voting shareholders and the α-ratio of the voting stake over the non-voting one owned by non-voting shareholders. These variables are computed both using information available at the preceding voting shareholder meeting (models 1 and 2) and at the following dividend date (models 3 and 4). All four models

[27] In the logit models we set the dependent variable equal to 1 if the vote was against the proposal and zero if the vote was "for". In other words, we estimate the likelihood of voting against the plan, as those observations are far less numerous than the others. In this way, it is guaranteed that the odds ratio lies within the logical bound 0-1 (Gujarati, 2006).

report a robust and (slightly) significant negative relationship between the two measures of dual-class ownership and the probability of voting "against" the proposal. Higher values of dual-class ownership decrease the probability of an "against" vote and increases the probability of a "for" vote. As expected, when an operation originates a wealth transfer between two classes of shares, shareholders of one class are more likely to vote for "self-expropriating" their class of shares when they hold a higher number of shares of the other class or a higher fraction of the other class compared to the expropriated class. We conclude that dual-class ownership may help hedging from wealth transfers between two classes of shares. However, it favors approvals in the expropriated class in the same way cross-ownership of both target and acquirer firms is found to favor approvals of value-destroying acquisition at the acquirer's meeting (Matvos and Ostrovsky, 2008).

Insert Table 4 about here

Though the favorable vote of some retail shareholders can be explained by their dual-class ownership (22 out of 104), all the other shareholders (82 out of 104) seem to have cast a "for" vote against their interests. One possible explanation is that we were not able to find all dual-class ownership situations. In fact, some dual-class shareholders may not have participated at the voting shareholder meeting and may also have sold their voting shares before the dividend date. However, we can propose some other possible reasons. First of all, the misleading media coverage together with a high degree of financial illiteracy may have persuaded some non-voting retail shareholders that the operation was really favoring them. Secondly, a "bird in the hand" (Gordon, 1959) argument may have played a role as they may have approved the plan in order to promptly receive the extraordinary cash payment. Thirdly, they may have preferred the proposed operation to the no pay-out alternative, as non-voting shareholders had no voice in proposing and approving standard extraordinary dividends. Eventually, some behavioral arguments could also justify a reluctance to

vote against the management proposal. As authority can reduce people's attitude to behave ethically (Milgram, 1963, 1974), minority non-voting shareholders might have been affected by an "obey authority" effect. Lakonishok et al. (1992) advocate this claim to explain the scarce influence of institutional investors on board activity, while Morck (2008) adopts the same line of reasoning to explain the ineffectiveness of independent directors to monitor CEOs. Moreover, social influence and conformity is mainly fostered by judgment difficulty (Deutsch and Gerard, 1955) and some shareholders may have conformed their votes with the ones cast by the institutional investors or with what was recommended by the management and the media.

7. Conclusions

In November 2007 Pirelli's board of directors proposed an operation that would have favored voting shareholders and severely harmed non-voting shareholders by reducing their dividend privileges. The transaction also needed the approval of the non-voting shareholder meeting with a percentage of favorable votes equal to at least 20% of the non-voting equity. The plan was surprisingly approved by 21.63% of non-voting equity thanks to the favorable vote of all institutional investors (representing 12.43% of the non-voting equity) and almost all the retail shareholders (8.47%). After a deeper analysis of the media coverage, the institutional investors' ownership ties with the firm's controlling shareholders and the dual-class ownership of both institutional and retail shareholders, what initially looked like "self-expropriation" turned out to be "self-interest". In fact, the media misled investors by reporting that operation was favorable to both classes of shares, and most of the 14 institutional investors which surprisingly voted for the plan either had strong ownership ties with the firm's controlling shareholders or dual-class ownership or both. We further find that when an operation gives rise to a wealth transfer between two classes of shares, dual-class ownership significantly increases the probability that shareholders vote for self-expropriating one class of their shares if they benefit on the other class held. As a conclusion, the

paper shows that the rights of a second class of shares are not efficiently protected by provisions requiring that their amendment should be approved by the same class with a minimum equity quorum. In fact, when conflicts of interests in dual-class voting are not regulated dual-class ownership can make shareholders approve proposals which are detrimental to one class of shares if they gain on the other class held. Future regulation should therefore address conflicts of interests in dual-class voting and media coverage.

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Figure 1

Total dividends and dividends per share payable to non-voting and voting shares

The graph reports the patterns of dividends per share (*Dps*) payable to non-voting shares (D_{nv}) and voting shares (D_v) as a function of the firm's total dividends (*TD*). The pattern assumes that non-voting shares are entitled to two dividend privileges: a senior minimum *Dps* equal to a percentage privilege ($Priv_1$) of the par value of the shares (*Par*) and an extra dividend payment over the *Dps* to voting shares equal to a percentage privilege ($Priv_2$) of par. TD^* indicates the level of total dividends after which a *Dps* can start being paid to voting shareholders. TD^{**} indicates the level of total dividends from which non-voting shares are entitled to the extra dividend privilege.

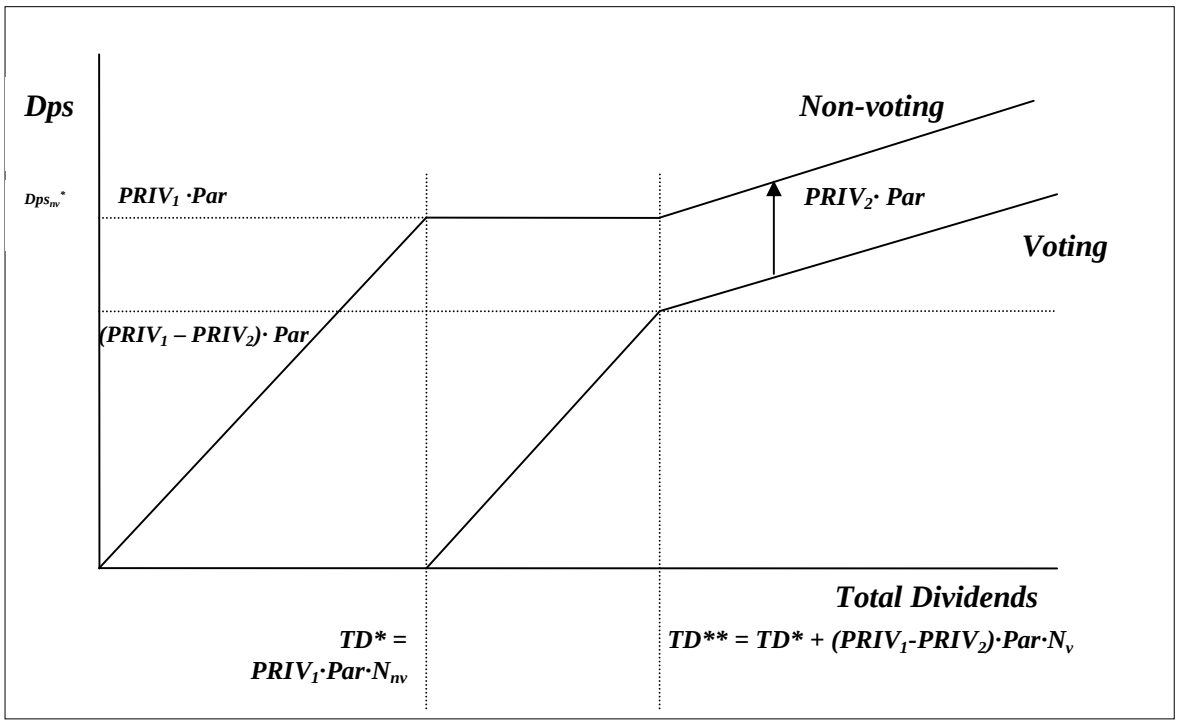

Figure 2

Total dividends payable to Pirelli's non-voting and voting shares

before and after the plan's approval

The first graph shows the yearly total dividends payable to non-voting shares before the plan (dashed line) and after the plan (solid line) as a function of Pirelli's yearly total dividends. The second graph indicates the reduction in total dividends to non-voting shares as a function of Pirelli's yearly total dividends. Pre-plan and post-plan relevant thresholds of firm's yearly total dividends (TD^{*} and TD^{**}) are indicated through the vertical lines. The red vertical line indicates the average analysts' forecast for Pirelli's total dividends, assuming a 40% payout.

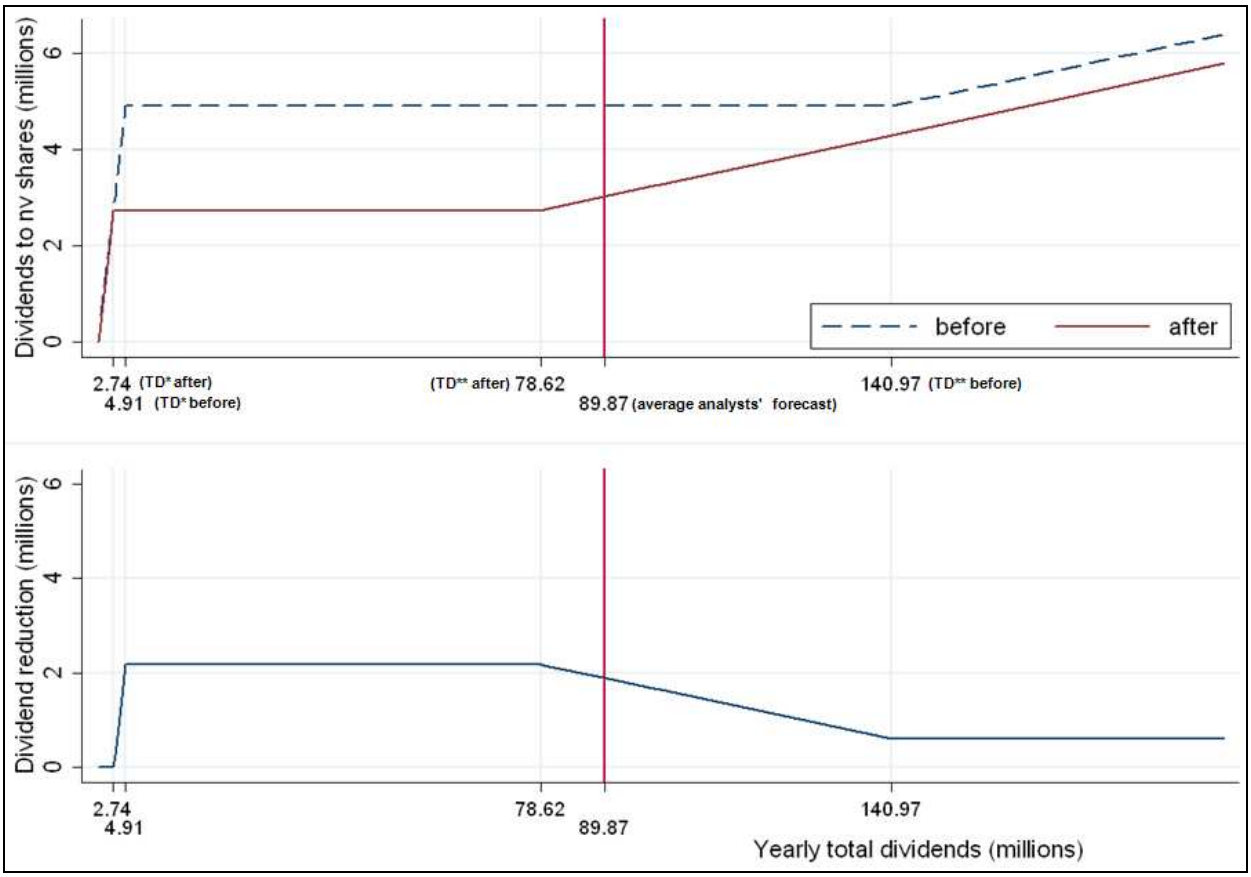

Figure 3

Pirelli's non-voting share stock prices, volumes and CARs around the event dates

This graph shows prices, cumulative abnormal returns (CARs) and volumes of Pirelli's non-voting shares around the relevant event dates: the announcement of the operation, the "Christmas coupon" press article, the voting and non-voting extraordinary shareholder meetings (ESM) and the expiration of the right to withdrawal. Volumes are in thousands of euros.

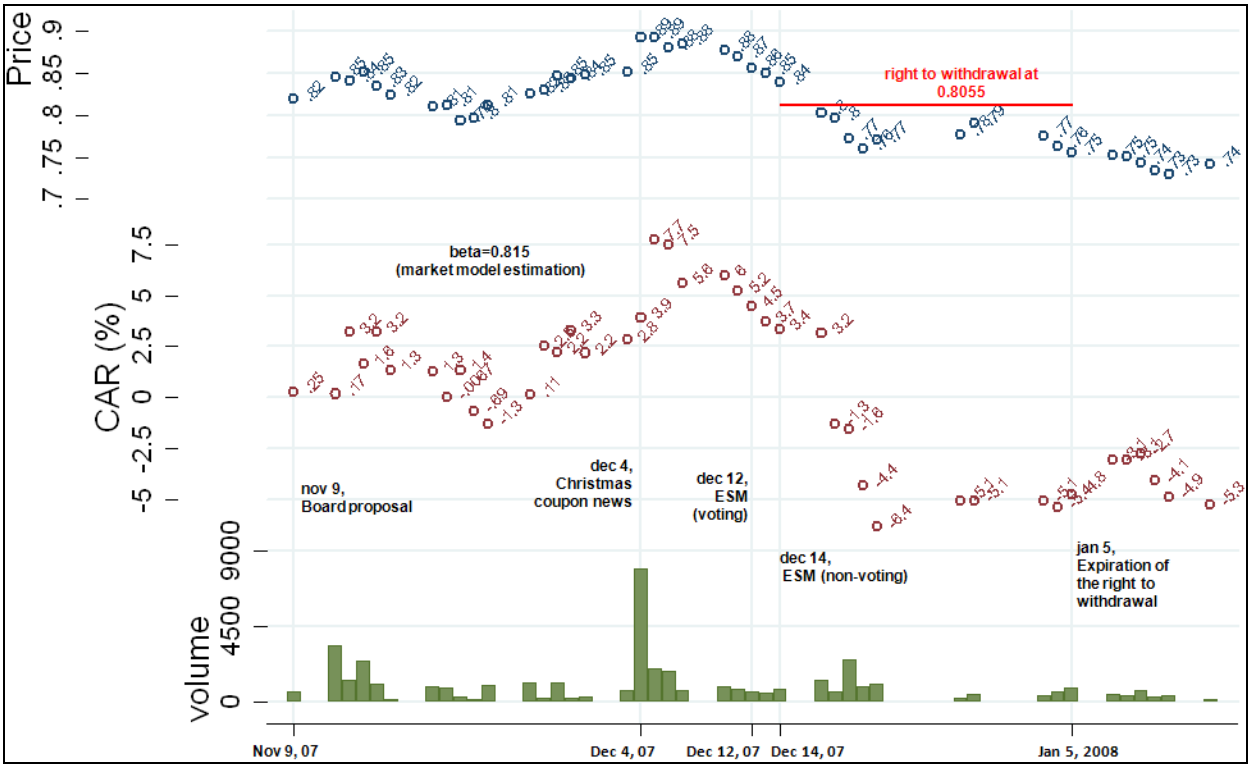

Figure 4

Pirelli's voting pact and their controlled financial institutions owning non-voting shares

This graph reports: the shareholders participating in Pirelli's voting pact and their voting holdings (upper frame); their controlled institutional investors (side ownership links) which appeared to be the major non-voting shareholder voters; the non-voting stakes held by the controlled institutional investors (lower frame). Ownership stakes are in percentages.

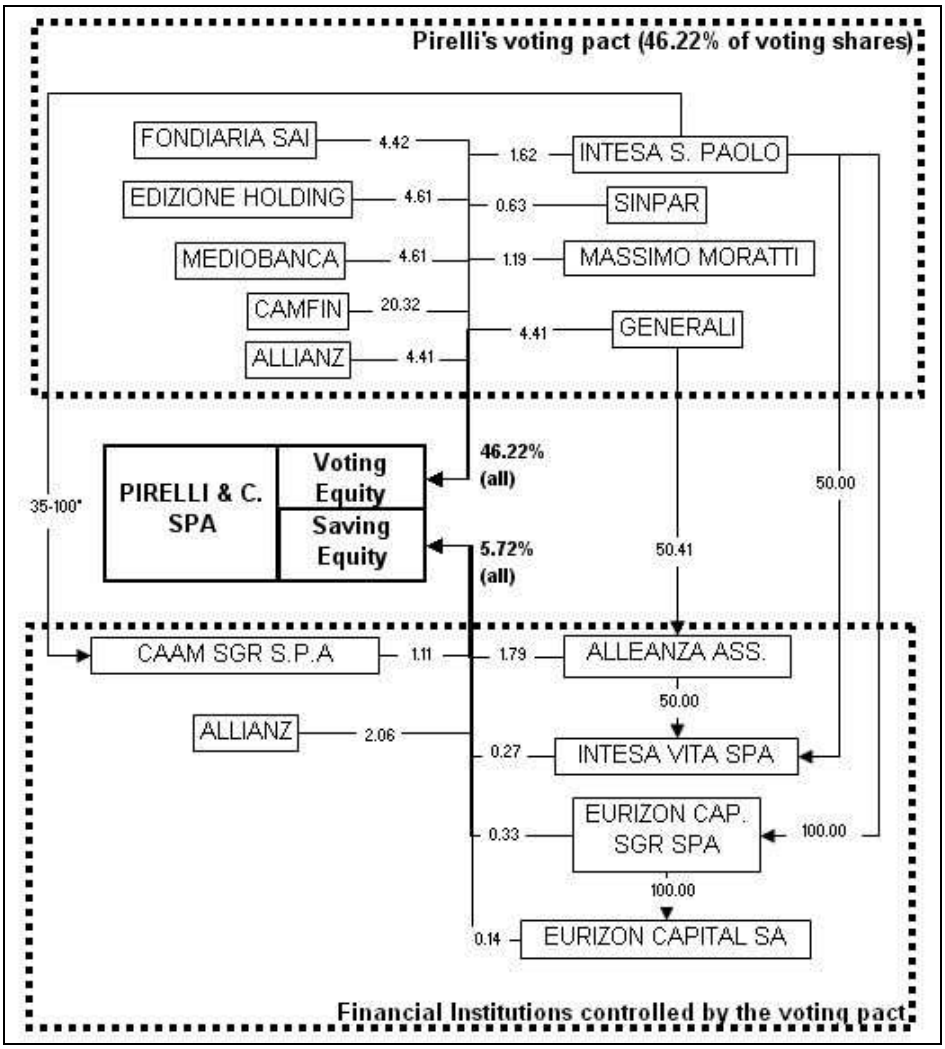

Table 1

Timeline of main events

This table reports the dates of events preceding and following Pirelli's proposal of paying an extraordinary dividend through a reduction in the par value of the shares.

Date	***Event***
Apr-29-07	Pirelli sells its Olimpia-Telecom stake and gets 3.3 billion cash
Aug-23-07	Amber buys 2.1 percent of Pirelli's voting shares
Sept-07-07	Amber asks for extraordinary dividends
Sept-20-07	Centaurus buys 3.2 percent of Pirelli's voting shares
Nov-09-07	Pirelli's board proposes the equity reduction and an extraordinary dividend
Dec-04-07	Operation as a "Christmas coupon" in *Il Sole 24 Ore* financial newspaper
Dec-12-07	Extraordinary voting shareholder meeting approves the plan
Dec-14-07	Extraordinary non-voting shareholder meeting approves the plan
Jan-05-08	Expiration of the right to withdrawal
Mar-31-08	Pirelli's shares go ex-dividend and par value is reduced

Table 2

Voting results at the voting and non-voting shareholder meetings

This table reports the voting results with respect to the management proposal at the extraordinary shareholder meeting of the voting shares (Panel A) and non-voting shares (Panel B). Votes are distinguished for several classes of shareholders: shareholders of the voting pact, financial institutions (controlled, connected or unconnected with the pact), companies controlled and unconnected with the pact, and retail shareholders. For each class of shareholders we report the number of voters, the type of votes and the percentage of the equity class represented.

Panel A: Voting shares extraordinary shareholders meeting

	Number of voters and type of votes casted						Turnout	
	For		Against		Abstain			
Type of voting shareholders	#	%	#	%	#	%	#	%
Shareholders of the voting pact	9	46.22	-	-	-	-	9	46.22
Financial Institutions controlled by the pact	10	5.70	-	-	-	-	10	5.70
Financial Institutions connected with the pact	-	-	-	-	-	-	-	-
Financial Institutions unconnected with the pact	161	6.35	-	-	1	0.00	162	6.35
Companies controlled by the voting pact	4	0.01	-	-	-	-	4	0.01
Companies (unconnected with the pact)	1	0.97	-	-	2	0.00	3	0.97
Retail shareholders	37	0.03	1	0.00	1	0.00	39	0.04
Total	**222**	**59.29**	**1**	**0.00**	**4**	**0.00**	**227**	**59.29**

Panel B: Non-voting shares extraordinary shareholders meeting

	Number of voters and type of votes casted						Turnout	
	For		Against		Abstain			
Type of non-voting shareholders	#	%	#	%	#	%	#	%
Financial Institutions controlled by the pact	6	5.72	-	-	-	-	6	5.72
Financial Institutions connected with the pact	2	3.78	-	-	-	-	2	3.78
Financial Institutions unconnected with the pact	6	2.93	-	-	-	-	6	2.93
Companies (unconnected with the pact)	3	0.73	2	0.00	1	0.00	6	0.73
Retail shareholders	104	8.47	16	0.75	-	-	120	9.21
Total	**121**	**21.63**	**18**	**0.75**	**1**	**0.00**	**140**	**22.38**

Table 3

Dual-class ownership and "FOR" votes at the non-voting shareholders meeting

This table reports the partition of the 121 "For" voters at the non-voting extraordinary shareholder meeting and their voting ownership, as of the preceding voting shareholder meeting (called to approve the plan) or at the following extraordinary dividend date (as of March 31st, 2008). When non-voting shareholders also own voting shares, for each type of shareholder we report the average ratio of their voting stake over the non-voting stake (α-ratio) and the number of cases when such ratio was greater than one (therefore making the wealth-transfer from the operation a positive outcome).

	FOR votes		**Voting ownership as of the voting SM**			**Voting ownership as of the dividend date**		
				α-ratio			α-ratio	
Type of non-voting shareholders	**#**	**%**	**#**	# > 1	Avg	#	# > 1	Avg
Financial Institutions controlled by the pact	6	5.72	6	5	3.28	6	5	3.28
Financial Institutions connected with the pact	2	3.78	0	-	-	1	-	0,00
Financial Institutions unconnected with the pact	6	2.93	3	2	6.48	3	2	6.43
Companies (not controlled or connected)	3	0.73	-	-	-	-	-	-
Retail shareholders	104	8.47	4	-	0.1	22	9	0.44
Total	**121**	**21.63**	**13**	**7**	**0.33**	**32**	**16**	**1.57**

Table 4

Dual-class ownership and probability of voting against the proposal

This table reports Probit estimation (Huber/White covariance noise correction) of the likelihood of voting "against" the plan at the non-voting extraordinary shareholder meeting. Since a dummy variable for financial institutions controlled or connected with the voting pact perfectly predicts the observed outcome, we omit such a variable. As predictive variables we use the number of voting shares owned by non-voting shareholders and the ratio of the voting percentage stake over the non-voting percentage stake owned by non-voting shareholders, when available. Voting ownership variables by non-voting shareholders are computed on information available both at the preceding voting shareholders meeting (models 1 and 2) and at the following dividend date (models 3 and 4). Z-statistics are in brackets. * and *** indicate statistical significance at 10% and 1% levels, respectively.

	Y=1 if Vote is "Against"			
	Voting ownership as of the voting SM		**Voting ownership as of the dividend date**	
	(1)	(2)	(3)	(4)
Constant	-1.84***	-1.82***	-1.77***	-1.83***
	(-7.17)	(-7.12)	(-6.47)	(-7.03)
Ln (1+number of voting shares held)	-0.05*		-0.05*	
	(-1.69)		(-1.86)	
Ln (Alfa ratio)		-2.43*		-2.61*
		(-1.77)		(-1.92)
Number of observations	139	139	139	139
Pseudo R-Square	0.02	0.02	0.02	0.02
Wald χ^2	2.86*	3.12*	3.37*	3.65*

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