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Modernizing Italy's Corporate Governance Institutions: Mission Accomplished?

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Abstract

To come.

(*) University of Bologna, ECGI, and Consob. 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 (and hereinafter) the "Draghi Law". He 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 reform and later amendments to it 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. I wish to thank Enrico Baffi, Marcello Bianchi, Magda Bianco, Matteo Gargantini, Salvatore Providenti, Paolo Santella, Giovanni Siciliano […] for precious comments on earlier drafts, and Rafael La Porta and Andrei Shleifer for giving me 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.

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 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 fostering shareholders 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 we have 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 permitting the allocation of property 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 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 aimed 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.[1]

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, periodic disclosure in listed as well as non-listed companies greatly improved,[2] while a review of ownership disclosure obligations following Directive 88/627/EEC paved the way for a more transparent market for corporate control[3] and rules on securities offerings were refined to implement Directive 89/298/EEC.[4] 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.

In granting the Government legislative authority to implement the ISD,

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[1] See Law 157/1991; Law 1/1991; Law 149/1992.

[2] See Legislative Decree 127/1991. See e.g. Giovanni E. Colombo, *Il Bilancio d'Esercizio*, in Giovanni E. Colombo and Giuseppe B. Portale (eds), *Trattato delle società per azioni*, Vol. 7*, at 47.

[3] See Legislative Decree 90/1992. 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.

[4] See Legislative Decree 85/1992.

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 is 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 were a series of law decrees enacted by the Government between 1991 and 1994.[5]

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 to 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 representation of minority shareholders on privatized companies' boards of directors (one fifth of the seats) and internal auditor boards (one seat) while trying to reduce the cost of voting by mandating mail voting in such companies.[6]

The introduction of *special* corporate governance provisions for privatized companies attracted criticism from reform-minded corporate law

[5] CITES. See especially Law Decree No. 332 of May 31, 1994, converted with amendments into Law No. 474 of July 30, 1994 (hereinafter, Law Decree 332/94).

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

scholars.[7] Intuitively, investor protection needs deserved no differential treatment depending on previous ownership patterns. However, the selective introduction of special protections for minority shareholders in private companies proved to be an ingenious way to experiment in this area without having to win the fierce resistance of incumbent controlling shareholders to any improvement in that direction. 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 also in the UK especially after the Maxwell scandal in 1991.[8] 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 disadvantage:[9] British and North American money managers were understandably suspicious of a corporate governance system that anecdotal as well as empirical evidence showed to allow for dramatic misappropriation of minority shareholders' money.[10]

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[7] See especially G. Minervini, *Contro il Diritto Speciale delle Imprese Pubbliche "Privatizzate"*, in 1994 RIVISTA DELLE SOCIETÀ 740-747.

[8] See e.g. Brian R. Cheffins, *Trends in Corporate Governance: Going from London to Milan via Toronto*, 1999 DUKE JOURNAL OF COMPARATIVE AND INTERNATIONAL LAW 5, especially at 16.

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

[10] 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)

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 abusively to obtain bribes from corporations. The only protection they can really take advantage from is via disclosure obligations and a securities regulator enforcing them.[11] This was the paradigm that had led, in 1974, to the creation of Consob (the Italian S.E.C.) and that had remained unchallenged for almost twenty years.[12]

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 Preite,[13] to recognize that the granting of governance rights and of shareholder remedies would help developing an otherwise stagnant equity market by reducing the scope for tunneling by insiders so as to attract institutional investors.

B. The Draghi Law. The occasion for action in that direction, after the experiment with privatized companies, came with the measures implementing

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(stating that "[i]n many countries today, the law protects investors better than it does in Russia, Korea, or Italy").

[11] 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.

[12] 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.

[13] See Preite, *supra* note 9, *passim*. 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).

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."[14]

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) were granted governance rights and remedies previously either unavailable[15] or subject to higher ownership thresholds.[16] Disclosure on ownership structure was extended by requiring full disclosure of all shareholder agreements, a technique often used in Italian companies to deviate

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

[15] 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 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).

[16] 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.

from one-share-one-vote, by cementing cross-shareholdings relationships.[17] A "mini-breakthrough" rule was also introduced, declaring shareholder agreements by which parties restrict their own freedom to sell shares ineffective in the face of a takeover bid.[18] 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.[19] 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 were strengthened, and its mission was clarified by requiring it to focus on internal controls.[20] Further, a restyling of the legal regime of audit firms was implemented, by clarifying audit firms' tasks.[21] Finally, Consob's aims 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 and impose *ad hoc* disclosure duties extended to a larger set of subjects (e.g., parties to shareholder agreements, blockholders).[22]

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

First, there was the idea, leading to the general corporate law reform of

[17] Article 122 Legislative Decree 58/1998.
[18] Article 123, Para. 3, Legislative Decree 58/1998.
[19] Articles 127 and 136-144 Legislative Decree 58/1998.
[20] Articles 148, Para. 2, 149 and 150-151 Legislative Decree 58/1998.
[21] Articles 155-165 Legislative Decree 58/1998.
[22] Articles CITE.

2002-2004[23] (known as the Vietti Reform after the name of the Undersecretary of Justice in charge of the process), 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 are publicly held and to make Italian corporate law more competitive after the European Court of Justice rulings paving the way for regulatory competition within the EU. 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.[24]

Second, the plethora of post-Financial Services Action Plan Directives and Directives 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.[25]

Finally, much like the US and in other countries had enacted post-scandal reforms following Enron, WorldCom and similar scandals, the Parmalat and the Banca Popolare di Lodi/Antonveneta scandals prompted the Italian Parliament hastily to revise corporate governance rules. The so-called Law on Savings was the outcome.[26]

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

[23] CITE to three legislative decrees (penale, 5/2003, and "correttivo").

[24] 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).

[25] CITE to Legge comunitaria and to Legislative Decrees.

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 corporate governance reform efforts in Italy, perhaps less for what it did achieve in terms of better investor protection than for the signal it sent to market players about the seriousness of Italian policymakers' intent to improve the corporate governance landscape. 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.[27] 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 disparate 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 are 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.[28] And the takeovers regime was reshaped

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[26] CITE to 262 and "Pinza".

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

[28] See Guido A. Ferrarini, *Corporate Governance Changes in the 20th Century: A View from Italy*, in CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES, AND MARKETS IN EUROPE, JAPAN, AND THE US 31, 47 (Klaus J. Hopt, Eddy Wymeersch, Hideki Kanda & Harald Baum eds. 2005).

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 *partial* bid rule triggered by acquisition of control.[29] 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.[30]

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."[31] Chief among them were rules on shareholder agreements. Traditionally, dominant families and financial institutions have built blocks and cross-holdings in the major 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," that allows parties to shareholder agreements to freely tender their shares in a takeover by declaring ineffective any restriction on share sales in the shareholder agreement.[32] One year later, the hostile takeover of Telecom Italia by Olivetti was tangible proof of an

[29] Articles 104 and 106. CITE to Article 10 L. 149/1992 and to Macchiati-Siciliano.

[30] 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).

[31] Ferrarini, *supra* note 28, at 47.

[32] Melis, Corporate Governance developments. CITE Article 123.

active market for corporate control in Italy.[33]

Fourth, while not directly 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,[34] focused boards' minds on how to adapt to a new environment in which a heavy weight was given to corporate governance issues, 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,[35] 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.[36] 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.

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

	pre-1998	pre-1998 corr.*	1998	1998 corr.*
Proxy by mail allowed	0	0	1	1

[33] See Aganin & Volpin, 357.
[34] CITE.
[35] See Ferrarini, *supra* note 28, at 47 (casting doubt on the significance of the La Porta et al.'s index as a measure of shareholder protection).
[36] See Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, & Robert W. Vishny, *Law and Finance*, 106 J. POL. ECON. 1113 (1998).

Shares not blocked before meeting	0	0	0	0
Cumulative voting or proportional representation	0	1	0**	1
Oppressed minorities mechanism	0	1	1	1
Pre-emptive rights	1	1	1	1
Percentage of share capital to call an extraordinary shareholder meeting	0	0	1	1
Anti-director rights index	1	3	4	5

*See fn 37.
** Variable is "0" because the appointment of minorities representatives *within the internal board of auditors* is not considered.

To be sure, if we recalculate their pre-Draghi score to correct for a couple of disputable (and arguably wrong) coding choices,[37] the effect of the Draghi Law is somewhat less impressive (see columns 3 and 5 in Table 1). Further, if we look at La Porta et al.'s revised Anti-directors Index as crafted ten years later to account for the broad range of criticism their original index raised,[38] the improvement is equally less significant (Table 2).[39] However, if

[37] See Luca Enriques, *Do Corporate Law Judges Matter? Some Evidence from Milan*, 3 EUROPEAN BUSINESS ORGANIZATION LAW REVIEW 765, at 779 n43 (arguing …).

[38] 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).

[39] 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

what counts is the signaling effect of the corporate governance reform effort, then columns 3 and 5 and the rankings in the Revised Index are irrelevant, while Italy's improved performance compared to La Porta et al.'s original rankings is revealing.

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

	pre-1998	pre-1998 corr.*	1998	1998 corr.*
Vote by mail	0	0	0	0
Shares not deposited	0	0	0	0
Cumulative voting	0	0	0**	0**
Oppressed minority	0	1	1	1
Pre-emptive rights	1	1	1	1
Capital to call a meeting	0	0	1	1
Anti-director rights index	1	2	3	3

* See fn 37.
** The appointment of minority shareholders representatives *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

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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

provisions in the Law itself and in Consob Regulation on Issuers enacted pursuant to it[40] did effectively improve minority shareholder protection. At the 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, e.g. with regard to IPOs and material extraordinary transactions, such as mergers, new issues of shares, acquisitions and disposals,[41] that can be (and often are) used to extract private benefits of control.[42]

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

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that the new law would no longer score as high." MILHAUPT & PISTOR, *supra* note 27, at 248.

[40] CITE to Reg. Emittenti.

[41] 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).

[42] For a taxonomy of ways to extract private benefits see Atanasov Black…

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 issues of shares (from 120 words to 400) and mergers (from 116 words to 300) improved. 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 about "morbid … curiosity"),[43] with the enactment of Consob Regulation on Issuers, Italy became the first main continental European country to require full disclosure of individual directors' compensation.[44] 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.[45]

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.

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

[44] See Article ??? and Schedule ???, Consob Regulation on Issuers.

[45] Colombo, Trattato, 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]").

2. Governance rights. One of the key ideas behind the Draghi Law was that the increasing institutionalization of share ownership justified granting minority shareholders increased 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). With institutional shareholders increasingly present in Italian companies' capital 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" institutional shareholders versus potentially "bad" individual shareholders explains the Draghi Law's preference for the recognition of governance rights to qualified minorities instead of to shareholders as such. 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.[46] 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,[47] and made an attempt to make it easier and less costly for shareholders to exercise voting rights.

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

[46] CITES. Bianchi/Enriques 35 for claim that shareholder proposals = calling a meeting.

[47] Article 104, Draghi Law.

threaten to use them, especially individually, and sometimes crafted in such a way as to be ineffective, and therefore useless as negotiation tools.[48] Further, the Draghi Law failed to significantly 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 dominant 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.[49] 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,[50] while in various cases they have at least tried to coordinate to do so.[51] *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) in a way that are widely acceptable to minority shareholders.

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 quite a failure for three reasons: first, also because all companies' statutes required a minimum

[48] Bianchi/Enriques 33-8.

[49] CITE to TUIF and then to CIVIL CODE.

[50] Enriques, *supra* note ???, [Eur. Bus. Org. L. Rev.] at ??? (Montedison/Falck).

[51] See Enriques-Bianchi, *supra* note ???, at ??? (Intek). More recently, see Marigia Mangano, *Ifi-Ifil, i fondi contro la fusione*, in IL SOLE 24 ORE, 19 November 2008, at 42 (IFI/IFIL).

threshold for minority shareholders to nominate candidates to the board,[52] 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).[53] 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."[54] 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, prompting Italian mutual funds who had appointed her to sell Parmalat shares early on).[55] But that of course can only be expected in rather exceptional circumstances. Third, the board of auditors as a whole did not perform particularly well as a champion of investors' interests, as argued in Section 3.4 below.

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 according to whether they helped increase the number of widely held companies, then the data show that they were a failure.

Percentage of widely held companies (according to various definitions) on listed companies

Year	1990	1998	2007
Major shareholding <30%	12,0%	26,9%	28,4%
Major 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%

Note: cooperatives included

[52] Ferrarini/Giudici 187.

[53] CONSOB, RELAZIONE PER L'ANNO 2003 – DISCORSO DEL PRESIDENTE DELLA CONSOB AL MERCATO FINANZIARIO 11 (2004).

[54] Enriques-Bianchi 39.

[55] Ferrarini-Giudici 188.

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 of why public companies are still rare.

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 the cause. So, for instance, in the presence of the mini-breakthrough rule,[56] 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 converted into or structured as holding companies to avoid the rule,[57] so that joint control over companies controlled by such holdings is even more stable 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 might find the legal landscape more

[56] CITE TO 123.3.

[57] 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 n14 (2005).

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 minimal. 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 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 imply a lower number of opportunistic, inefficient changes of control going through, but it may also mean that efficient changes of control became more costly, so that only empirical work could tell us which effect prevailed.

4. Board of auditors. Board of auditors had traditionally proved "[in]efficient in discovering mismanagement and fraud," and "complacent" rather than "investigative" with regard to corporate insiders' behaviour.[58] Their performance as champions of shareholders' interests has been dismal even after the Draghi Law increased their powers, clarified their tasks and duties thus allowing their members to focus their minds, and tightened independence standards.[59] This was mainly because corporate insiders mostly kept picking as board of auditors members people that were only formally independent, having instead long-standing advisory relationships with insiders.[60]

[58] Ferrarini-Giudici 186 & 188.
[59] Id. at 188-9.
[60] Ibid.

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*)[61] is enforcement.[62]

Private enforcement mechanisms have proved highly ineffective, both because the Government was extremely cautious in introducing them (suffice it to mention the 5 percent threshold for shareholders to sue directors derivatively or to request for an inspection)[63] and because the surrounding legal and institutional framework was (and still is) least friendly to plaintiff shareholders.[64] No actual use has ever been made of the shareholder remedies the Draghi Law introduced or made at least in theory easier to exercise.

On the public enforcement side, while the Law strengthened Consob's supervisory powers, fines for violations of securities laws were significantly lowered[65] and even criminal sanctions for market manipulation (securities fraud) and insider trading were set at 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.

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[61] CITES. See also SEBASTIANO VASSALLI, LA CHIMERA, 58-9 (year????).

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

[63] CITES.

[64] Ferrarini-Giudici; see also *infra*, Section 6.

[65] 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 those 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.

4. Keeping up with the Brydes: the Vietti Reform

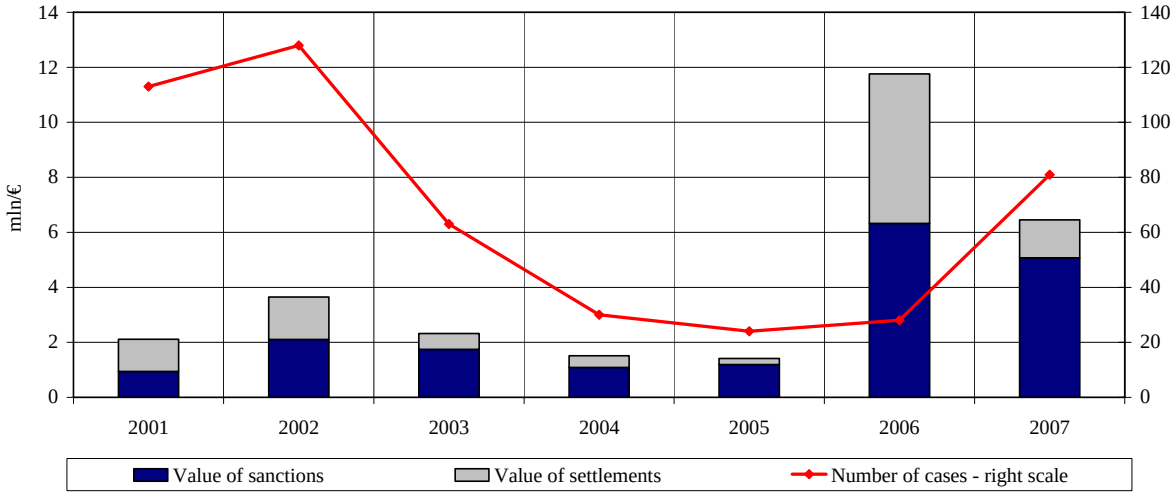
To come.

5. Keeping up with the McCreevies and the Sarbaneses (to say nothing of the Oxleys): The Post-FSAP implementing measures and the Law on Savings

To come.

[…]

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



[…]

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 the highest possible.

Table 3
Antidirectors Rights Index (from pre-Draghi to 2008)

	pre-1998 corr.*	1998 corr.*	2008
Voting by mail	0	1	1
Share deposit	0	0	1
Cumulative voting or proportional representation	1	1	1
Oppressed minorities mechanism	1	1	1
Pre-emptive rights waivable by shareh. vote	1	1	1
Share capital required to call EGM < = 10%	0	1	1
INDEX	3	5	6

* See note 37.

Unfortunately, Italian corporate governance reforms' performance is not as impressive if we use the revised anti-director index that La Porta (Djankov) et al. recently devised to overcome criticism of their original

index:[66] instead of reaching the top, Italy has moved from to 2 to 4 (out of a maximum score of 6).

[66] See Djankov et al. *supra* note ???, at ???.

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

	pre-1998 corr.*	1998 corr.*	2008
Voting by mail	0	0	0
Share deposit	0	0	0**
Cumulative voting or proportional representation	0	0	1
Oppressed minorities mechanism	1	1	1
Pre-emptive rights waivable by shareh. Vote	1	1	1
Share capital required to call EGM < = 10%	0	1	1
INDEX	2	3	4

* See note 37.

** 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 La Porta et al. (*The Law and Economics of Self-dealing*, *supra* note ???, at 454), costs on shareholders stem from company laws that require, or even permit companies to require, that shareholders deposit their 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.[67] Table 5 shows Italy's detailed scores across time.

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). 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 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,[68] the provision was predominantly held not to require detailed disclosure of individual self-dealing transactions,[69] and such has been companies' consistent accounting practice even after implementation of IFRS.[70] Column 6 shows the modest improvements in the score following the

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

[68] Article 2428, Civil Code.

[69] See LUCA ENRIQUES, IL CONFLITTO D'INTERESSI DEGLI AMMINISTRATORI DI SOCIETÀ PER AZIONI 122 n143 (2000).

[70] 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). The Italian standard setter has confirmed the provision (OIC, GUIDA OPERATIVA SULLA INFORMATIVA DI BILANCIO PREVISTA PER I SOGGETTI CHE

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 with no relevant changes from the draft regulation issued for consultation in April 2008. Because respondents to the consultation made no serious criticism to provisions requiring immediate and periodic detailed disclosure of material related party transactions,[71] 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.

ADOTTANO I PRINCIPI CONTABILI INTERNAZIONALI – GUIDA 2??? 140 (2007). Companies do aggregate related party transactions in their annual reports (see Consob, *supra* note ???, at 38).

[71] 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 5). Neither of such solutions has ever been close to be adopted.

Table 5
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 69.
** 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 of course be skeptical about the value of all such indexes, and indeed skepticism about La Porta et al.'s methodology is more widespread today than ten years ago.[72] Further, and more importantly, tables 3, 4, and 5 say 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 ten years, 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,[73] but also in those, like the US and the U.K., we have been trying to catch up with.[74]

Therefore, 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 taken further steps in the direction of better corporate governance should push us in the direction of yet more reform efforts. 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 this direction.

1. Self-enforcement. Despite all the changes and additions in the law on the books, there are still areas to work on to ensure better investor

[72] See e.g. Milhaupt & Pistor, *supra* note ???, at ???. Others????
[73] See Enriques-Volpin.
[74] See John Coates IV, JEP 2007…; Davies, After Enron???. 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

protection by making self-enforcement easier. 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 should be required to appoint an independent proxy agent that shareholders may choose as proxy at the company's expense, provided that they give him 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 hard for shareholders to intervene and to form an informed opinion on how to vote.[75] Finally, a useful and totally drawback-free simplification that would favor international investors' participation to shareholder meetings is the removal of the distinction between first, second, and third calls: once the quorum is the same for all calls, as it is 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, thresholds for minority shareholder governance rights should be significantly lowered by way of default. 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

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governance best practices, but the U.S. and the UK were closer to the core to begin with and moved faster in that direction).

[75] 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

leaving companies free to "opt 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.[76]

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 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 lower. 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.[77] 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,

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end of the fiscal year, so that companies could pick any date between April and June to hold their meeting.

[76] CITE to ESME page 4.

[77] See *supra* section 5.???.

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, but 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.[78] 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 level of 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 awareness that the main challenge for Italy's corporate governance institutions today is much less in designing rules than in ensuring their enforcement.

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.[79]

The problem is that 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 they are improved. At the same time, no serious

[78] See OSOV Study 2007.

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 remain marginal due to their very weakness. To break this vicious circle, 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 enforcement. Effective class action mechanisms are an obvious item on the agenda, but others can be thought of that policymakers haven't played with yet. A simple list is sufficient for present purposes: 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 exceptional circumstances, fee awards for plaintiffs in derivative suits, forms of cooperation between supervisors, such as Consob, and private enforcers (in the form of *amicus curiae* briefs and assistance to courts in the gathering of evidence),[80] all of these measures would encourage shareholders to bring suits in case of corporate insiders' wrongdoing.

Of course, a reform-minded policymaker should start as soon as possible tackling the chronic malaise of 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

[79] See Enriques, Trimestrale.

judges' incentives are more aligned to citizens' interests in a speedier and more accurate justice service.

4. Public enforcement and agencies' governance. Especially after the ABN-AMRO Antonveneta case,[81] 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).[82] 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 similar reforms. Following the current financial crisis, even the US will most likely engage in an overhaul of the architecture of financial market supervision, which itself will increase the pressure on Italian policymakers to do the same. It is therefore ever more likely that such a reform is enacted in Italy in the next future, as the press also reports.[83]

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,[84] 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

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[80] See Enriques, Trimestrale.

[81] See e.g. Carletti et al. ECB WP.

[82] See Enriques, Ruolo delle autorità di vigilanza, available at ssrn.com.

[83] See e.g. Orazio Carabini, *Authority, Riecco il Riordino*, in *Il Sole 24 Ore*, 13 June 2008, at 1.

[84] See e.g. Howell Jackson, A Pragmatic Approach… 28, ssrn.com (describing the carefully crafted, 55-month long transition process that led to the consolidation of supervisory functions into the British Financial Services Authority as a model to establish a US FSA).

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 holding them accountable to their various stakeholders (the general public, politicians, the financial industry, issuers, and investors). While supervisory agencies in Italy have traditionally performed better than average government offices, much can of course be done to attain 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 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.[85] As a matter of fact, if one reads La Porta et al.'s most recent law and finance work,[86] 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 developments 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 civil law's and next wonder whether a reform-minded policymaker can 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.[87] On the legal side, the tradition there is for lawyers and courts to put substance over form

[85] CITES to Coffee, Social Norms, U. Penn.; Licht, Mother of All Path Dependencies.
[86] La Porta et al., JEL.
[87] Shleifer…

and function over doctrine.[88]

A more market-friendly political culture would have a much greater impact on Italian capital markets' competitiveness than any corporate law reform ever could. 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 friendly) bid,[89] 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. 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 functioning of the market for corporate control as a disciplining device, because no outsider (i.e. no foreigner) can ever aspire to play that role effectively.

Finally, legal formalism and doctrinal legal thought are still predominant in law faculties, the legal professions, and the courts. 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,

[88] CITE.

as I have argued elsewhere, tend to be formalistic and deferential to corporate insiders' decisions even when these are tainted by conflicts of interest,[90] 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 thought out to change the broadly prevailing market-hostile political culture, but something can indeed be done to modernize Italian legal culture in the long run. First, public, semi-public (like banking foundations'), and private funds should be channeled to send Italian law graduates in the US or the UK to attend LLM programs,[91] something the Bank of Italy has long and meritoriously been doing with its Menichella scholarships. Second, and much 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 such academics the incentives to make such investment, compensating them for their high opportunity costs.

Given the traditional osmosis between lawyers and politicians, in Italy and elsewhere, such moves could even help changing politicians' culture.

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[89] See Italenergia, Antonveneta, Abertis/Autostrade, Telecom Italia/AT&T-Slim.
[90] See Enriques, EBOR, *supra* note ???, at ???.
[91] Milhaupt-Pistor. Black, Preconditions???.

7. Conclusion

Summary of main points to come.