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A draft of this paper was presented at the annual conference of the Italian Society of Law and Economics held in Milan on 9-10 November 2007 and at CRELE inaugural conference held in Bolzano-Bozen on 30 November – 1 December 2007. The author is grateful to the conferences' participants for helpful suggestions.

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Abstract

The Sai-Fondiaria case is Italy's most significant action in concert case. In this case public enforcement was unable to prevent the concerting parties from reaching their target. Minority shareholders therefore sued, even though Italian mandatory bid rules (MBRs) do not contain any specific rule concerning minority shareholders' entitlement to damages. At stake is private enforcement of MBRs. Courts and scholars are called to establish whether the law contains an implied right of action in favour of minority shareholders. The problem has also arisen in other European countries, where it is the object of much current debate.

The Milan Tribunal thinks that minority shareholders have a right to damages, whereas the view of the Court of Appeal is diametrically opposed. Needless to say, both positions have considerable support amongst legal writers. Since deterrence arguments are still taboo with regards to private remedies, traditional interpretive canons and concepts are being employed in the debate: on one side to disguise deterrence ideas underpinning the reasoning; on the other, to retort using radical formalism, with its built-in bias against legal change. In this paper I analyze the case, the decisions and the comments. I suggest how deterrence arguments can be appropriately adopted in the reasoning of civil law courts and propose how the case should be decided in favour of minority shareholders, with beneficial effects on private enforcement status. I also analyze the recent amendments to MBRs that implement the Takeover Directive and endanger the future of private enforcement in this area of law.

Keywords: deterrence, private enforcement, public enforcement, mandatory bid rules, takeover regulation, compensation, law & economics, investor protection, securities regulation, directors liability, financial scandals, minority shareholders, Italy, interpretive theories, jurisprudence, legal discourse, litigation, courts, civil damages, contract law, tort law, Sai, Fondiaria, Mediobanca, Consob.

JEL Classifications: G38, K22, K41, K42.

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PRIVATE LAW ENFORCEMENT IN A FORMALIST LEGAL ENVIRONMENT: THE ITALIAN SAI-FONDIARIA CASE

Paolo Giudici[*]

Effective private enforcement is not only a matter of appropriate substantive and procedure rules, it is also a matter of statutory interpretation. Antitrust law and securities law are two cases in point. In the US, antitrust enforcement has always been primarily in the hands of private plaintiffs.[1] In Europe, the discussion about the role of private enforcement has been mainly focused in recent years on competition law, because of the need to enrol private plaintiffs in the fight against cartels.[2]

With reference to securities law, US private enforcement, by far the most intense and hotly debated in the world,[3] is the product of courts' broad interpretation of the Securities and

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[1] "The most distinctive feature of US antitrust enforcement is that it provides actions for treble damages that mean government enforcement is supplemented, and in many areas dominated, by private suits": E. Elhauge – D. Geradin, *Global Competition Law and Economics*, (Oxford/Portland 2007) p. 8.

[2] See generally C.D. Ehlermann – I. Atanasiu (eds.), *European Competition Law Annual 2001: Effective Private Enforcement of EC Antitrust Law*, (Oxford/Portland 2003); J. Basedow, "Who will Protect Competition in Europe? From central enforcement to authority networks and private litigation" (2001) 2 EBOR p. 443; P. Giudici, "Private Antitrust Law Enforcement in Italy" (2004) 1 Comp. L. Rev. p. 61. But see W. Wils, "Should Private Antitrust Enforcement Be Encouraged in Europe" (2003) 26(3) World Comp. p. 473. On 19 December 2005 the Commission published a Green Paper (EC Commission, *Damages actions for breach of the EC antitrust rules*, 2005) and a Commission staff working paper on damages actions for breach of the EC antitrust rules.

[3] See J. C. Coffee, "Law and the Market: The Impact of Enforcement" (2007) Columbia Law and Economics Working Paper No. 304 p. 1; D. C. Langevoort, "On Leaving Corporate Executives Naked, Homeless and Without Wheels: Corporate Fraud, Equitable Remedies, and the Debate Over Entity Versus Individual Liability" (2007) 42 Wake Forest L. Rev. p. 627; R. La Porta, F. Lopez de Silanes and A. Shleifer, "What Works in Securities

Exchange Act of 1934. Rule 10b-5, the US general antifraud provision for the federal securities laws, did not explicitly provide a private cause of action for damaged investors although it was judicially implied in *Kardon v. National Gypsum*.[4] The rebuttable presumption of reliance based on the "Fraud-on-the-Market Theory" (FOTM) and in turn grounded on the "Efficient Capital Markets Hypothesis" (ECMH), which is now an accepted inference of law, has been judicially implied in *Basic Inc. v. Levinson*[5] and recently reviewed in the famous *Dura* case.[6] The much discussed securities class action mechanism is engrained in both these judicial implications. Insider trading prohibition was pressed in the courts by the SEC and was progressively constructed by the US Supreme Court in a famous line of cases which started with *Chiarella*.[7] With regards to the Securities Act of 1933, the severity of its Section 11's liability has been channelled and limited through the judicially implied tracing requirement.[8]

Because of recent corporate scandals, European attention is now turning to securities law as well.[9] Italy is a good example. Spiralling litigation concerning financial intermediaries' rules

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Laws?" (2006) 61 J. Fin. p. 1; J. C. Coffee Jr., "Reforming the Securities Class Action: An Essay On Deterrence and Its Implementation" (2006) 106 Colum. L. Rev. p. 1534.

[4] 69 F. Supp. 512 (E.D. Pa. 1946).

[5] 485 U.S. 224.

[6] Dura Pharms, Inc. v. Broudo, 125 S. Ct. 1627 (2005). See M. B. Fox, "Demystifying Causation in Fraud-on-the-Market Actions" (2005) 60 Bus. Law. p. 507; M.B. Fox, "After Dura: Causation in Fraud-on-the-Market Actions" (2005) 31 J. Corp. L. p. 829; M.B. Fox, "Understanding Dura" (2005) 60 Bus. Law. p. 1547; J. C. Coffee Jr., "Causation By Presumption? Why the Supreme Court Should Reject Phantom Losses and Reverse Broudo" (2005) 60 Bus. Law. p. 533.

[7] 445 U.S. 222 (1980).

[8] H. A. Sale, "Disappearing Without a Trace: Sections 11 and 12(a)(2) of the 1933 Securities Act" (2000) 75 Wash. L. Rev. p. 429.

[9] P. Davies, *Davies Review of Issuer Liability: Final Report*, (2007); P. Davies, *Davies Review of Issuer Liability - Liability for misstatements to the market: A discussion paper by Professor Paul Davies QC*, (2007), both available at www.hm-treasury.gov.uk/independent_reviews/davies_review/davies_review_index.cfm; G. Ferrarini and P. Giudici, Financial Scandals and the Role of Private Enforcement: The Parmalat Case In J. Armour and J. A.

of conduct has probably been the most significant trend in the Italian private law litigation experience of the last decades and has had a strong, salutary impact on the industry.[10] The *Hotel Villaggio Santa Teresa* case, in which the public watchdog (Consob) was held liable for damages suffered by investors because it negligently revised and passed a false prospectus, has shown that Italian courts are prepared to construct and interpret aggressively our general rule on tort (Article 2043 Civil Code – C.c.) when investors' protection is at stake.[11] The *SCI* case, in which banks were accused of insider dealing and had to pay damages in the first Italian private action on the issue, confirmed this approach.[12] However, the most important and most difficult case concerning private enforcement in securities law has been *Sai-Fondiaria*, concerning mandatory bid rules (MBRs). In this case, courts were called to infer a private right to damages from a statutory framework that is silent on the issue and which seems to rely entirely on public authority intervention. Therefore, the Sai-Fondiaria case is a classic "hard case" in which, under thorny problems of statutory interpretation, fundamental policy issues emerge.

The Sai-Fondiaria case concerns the "public v private enforcement" dualism in securities law. In this paper I analyze the legal reasoning followed by Italian courts in this complex case. I will attempt to highlight how civil law concepts coupled with formalistic reasoning can produce messy and even non-sensical legal opinions in fields like securities regulation, which are so different from the traditional areas of contract law and tort. I will argue that law and economics, properly understood, provides a manageable instrumental theory that is not so distant from the

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McCahery (eds.), *After Enron*, (Oxford/Portland 2006) pp. 159-213; C. Amatucci, "L'azione collettiva nei mercati finanziari come strumento di governo societario. (Divagazioni in tema di trasparenza obbligatoria e di effettività dell'art. 2395 c.c.)" (2005) Riv. soc. p. 1336.

[10] There are hundreds of court decisions on the issue. A good starting point is the following website: <www.ilcaso.it >

The Cassation Court has recently decided that the violation of financial intermediaries' rules of conduct gives room to an action in damages and does not make the contract null and void: Cass., Sez. Un., 19 December 2007, no. 26724, not published yet.

[11] Cass., 3 March 2001, no. 3132 (2001) I Foro it. p. 1139.

[12] Milan Tribunal, 14 February 2004 (2004) I Foro it. p. 1581.

many consequentialist views grounded on intuition, ideology, common sense or non-sense that civil courts and lawyers follow in their every day life and that are well-known weapons in the jurist's rhetorical armoury. Accordingly, I will try to show whether and how, with the help of law and economics, deterrence arguments can be employed in the legal reasoning of civil courts called to decide private law cases concerning securities regulation and affecting the "private v. public enforcement" balance.

The paper is organized as follows. Part I briefly describes the case. Part II analyzes the courts' decisions and commentators' views on the problems raised by the case. Part III proposes how the case could be decided in favour of minority shareholders, using some of the conceptual tools offered by economic analysis of law.

I. THE CASE

1. The scenario before the Montedison/SAI deal

Before the turning point dated 1st July 2001 - the day in which the Sai/Fondiaria saga started - Mediobanca was the most significant shareholder in Montedison, with a 14 per cent stake, and its actual controlling party. Mediobanca owned around 31 per cent of Fondiaria Assicurazioni through Montedison and around 13.70 per cent directly.[13] Mediobanca was the main financing party of Premafin, the holding company of the SAI Group, and one of the main financing parties of SAI Assicurazioni.[14] The connections between the Premafin/SAI Group and Mediobanca's management were well known to the financial mass-media and observers alike. A well-known Mediobanca project was the merger between the two insurance companies SAI and Fondiaria, both parties of the shareholder agreements controlling Mediobanca. The latter was also the main shareholder of Generali Assicurazioni.

Fondiaria had since the 4th June 1998 owned more than 2 per cent of Sai. This stake was, as it would be clear after June 2001, a defensive measure relying on the working of the special

[13] On the basis of Consob data the numbers at 31st June 2001 were: Montedison 31.097 per cent; Mediobanca 13.780 per cent.

[14] Autorità garante della concorrenza e del mercato (AGCM), decision no. 11284, 10 October 2002, § 40 et seq.

rule on crossholdings (art. 121-1 Consolidated Financial Service Act, "CFSA"), according to which if a listed company holds 2 per cent or more of another listed company's voting shares (Fondiaria in Sai), the latter may not exercise the voting rights attached to shares in the former exceeding two per cent of the voting shares and must sell such shares within twelve months. SAI's stake in Fondiaria crossed the 2 per cent threshold on 14th March 2001; the exceeding shares had to be sold within one year.

2. *The Montedison-SAI deal*

At the end of June 2001 rumours abounded that Italenergia, a vehicle formed by the Fiat Group and Electricité de France (EDF), was to launch a hostile full takeover bid for Montedison. On Sunday 1st July 2001, Mediobanca-controlled Montedison announced the sale of its Fondiaria shares to SAI. The day after, Italenergia communicated its intention to launch a full bid for Montedison.[15] The Montedison/SAI deal had been structured as follows. Shares representing around 7 per cent of the capital of Fondiaria were immediately transferred to SAI. The transfer of a remaining 22 per cent was conditioned by ISVAP's authorization (ISVAP is the Italian insurance industry regulator) and the absence of any veto by the Italian antitrust authority. Were the transfer to be blocked by one of the two authorities, SAI would be obliged to find another buyer at the same terms and conditions. Since SAI would have individually crossed the 30 per cent threshold, it immediately informed the market that it intended to sell any shares exceeding the limit in order to avoid a mandatory bid for all Fondiaria shares. Nevertheless, since Mediobanca still owned 14 per cent of Fondiaria ordinary shares, SAI's purchase, if secretly concerted with Mediobanca (Montedison's controlling party), would have crossed the 30 per cent threshold, requiring the launch of a mandatory bid under Articles 106 and 109 CFSA. The price of the transaction was very high and seemed to incorporate a control premium.[16]

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[15] It was clear to everyone that Mediobanca had successfully taken a defensive measure in order to protect its grip on Fondiaria. This defensive measure would have not been possible after the launch of the bid, as the management would never have obtained the special authorization by the shareholders' meeting of Montedison (Art. 104 CFSA), since Italenergia had in the meantime disclosed that it already owned 52 per cent of Montedison.

[16] SAI paid Euros 9.5 per share for its stake in Fondiaria. Since the previous market price was around Euros 6 per share, the premium was well above 50 per cent, and SAI was not in a position to exercise its voting rights in Fondiaria, due to Fondiaria's stake in SAI. On 2nd July there were massive sales in SAI's shares and the

On 10th August 2001 Consob issued a press release where it stated that SAI and Mediobanca would be considered concerting parties: the facts surrounding the deal gave rise to supposing the existence of a secret agreement between the two companies. At the end of 2001 the insurance regulator (Isvap) blocked the purchase of the remaining 22 per cent, also in consideration of the impact that a full bid would have had on SAI's accounts.[17] As a consequence, at the beginning of 2002, SAI was stuck in a situation where it had promised (acting in concert with Mediobanca) to buy a large stake in Fondiaria, but could not purchase the shares because of MBRs (pursuant to Articles 106 and 109 CFSA) and insurance capital adequacy rules.

3. *The White Knights*

In order to elude both problems, SAI and Mediobanca used five intermediaries (among which JP Morgan and Commerzbank), which bought both the stake that SAI should have purchased from Montedison and the remaining Fondiaria shares that SAI held. The five intermediaries claimed to have acted independently, notwithstanding the large premium they were paying on the shares. In spite of these declarations, they were immediately and ironically renamed "The White Knights" by the financial press.[18] Following the White Knights' intervention, Consob received many complaints, but dismissed them without any further investigation, asserting that there was no evidence of a running action in concert between SAI (and its five White Knights) and Mediobanca. After this decision, thanks to SAI's improved negotiating position and the appointment of new directors, the management of the two

price dropped, the transaction being considered value destructive from Sai shareholders' perspective. Il Sole 24 Ore, 3 July 2001, p. 29 and Il Sole 24 Ore, 9 July 2001, containing interviews with astonished analysts; Financial Times, 14 August 2001, London Edition, p. 16 (Lex Column), reporting that "the original deal to buy 29 per cent was dreadful – a 56 per cent premium, exhausting SAI's cash resources, for a stake which offered zero synergy opportunities. Having to bid for the rest of the company, at a price of at least Euros 7.66 a share, will be even worse. Even if full control might bring some synergies, the transaction destroys about a third of SAI's value."

[17] Isvap's decision has not been published, as far as I am aware.

[18] G. Oddo - R. Sabbatini, "Fondiaria, Sai trova un tris di acquirenti", Il Sole 24 Ore, 3 February 2002, in an article starting as follows: "Non uno ma ben tre cavalieri bianchi sono giunti in soccorso della Sai" (Not one, but three white knights arrived to help Sai).

companies agreed a merger, which SAI's and Fondiaria's shareholders approved. Fondiaria's new managers sold the 2% defensive stake in SAI, thereby enabling SAI to buy its pawns' stake in Fondiaria. The two companies merged to become Fondiaria-SAI (FonSai). However, the antitrust authority opened a proceeding in order to ascertain whether the concentration would create a dominant position in the insurance market, taking into consideration Mediobanca's influence over FonSai and Generali. Two days later an inspection was ordered of the offices of Mediobanca, Premafin (SAI's controlling shareholder), SAI, Fondiaria, Generali, Compagnia Fiduciaria Nazionale and Interbanca. The existence of secret agreements was confirmed by the inspectors.[19]

In a scenario completely re-shaped by the results of the antitrust agency analysis, an administrative court declared Consob's decision to be null and void and ordered Consob to re-evaluate the case.[20] On the 18th December 2002, Consob issued a new press release, where it stated that, in the light of the evidence obtained by the antitrust authority, there were important elements to hold that the secret agreement pointed out in August 2001 had been still in place and had also involved Premafin. From the new documentation acquired, it could be inferred that the 'White Knights' were SAI's proxies, such that by 18th February 2002 Premafin/SAI and Mediobanca had jointly crossed the 30 per cent threshold, and were from that date jointly obliged to launch a full bid within 30 days. Since they had not complied with their obligation, their voting rights were freezed and the exceeding shares had to be sold within one year as of 18th February 2002. With regards to the shareholders' meetings held on 30th May and 19th September 2002, the results could not be rendered null and void, for Premafin/Sai's votes had not been decisive in reaching the required quorum.

The decision was not clear enough about the voting rights concerning the new FonSai's shares. Therefore Consob stated, in a further press release dated 27th December 2002, that the voting right suspension also affected those shares and that Premafin or Mediobanca (or both) had to sell the exceeding shares in FonSai. On 3rd February 2003, Mediobanca sold the concerting parties' exceeding shares. Nevertheless, because of the method suggested by Consob to re-

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[19] AGCM, decision no. 11284, 10 October 2002, § 40 et seq.

[20] For further details see Consiglio di Stato, 13 May 2003, no. 4142 (2004) Giur. it. p. 2107, with comment of E. Desana, "Opa obbligatoria 'da concerto occulto': alcune osservazioni a margine della vicenda Sai-Fondiaria."

establish the *status quo ante*, Premafin remained in control of FonSai, as planned from the very beginning of this saga.[21] Public enforcement was therefore clearly insufficient, as the two concerting parties achieved what they wanted.

II. THE COURTS' DECISIONS

4. *The claim to damages*

One large Fondiaria blockholder (Promofinan) sued the concerting parties, claiming damages suffered because of the elusion of the mandatory rules. The plaintiffs asked the court to imply the right to damages from general principles of company and tort law, as well as in the light of enforcement policy issues, as Italian mandatory rules do not say anything about the right of minority shareholders to claim damages in case of violation of MBRs. Indeed, the substantive applicable rules apparently offer a perfect system of enforcement that requires no further support by liability rules. If the bid is not made within the 30 days term, all the voting rights are suspended and the shares exceeding the legal threshold of 30% of the capital have to be sold within one year (Article 110 CFSA); moreover, managers face fines (Article 192 CFSA). However, the mechanism only works if the deceptions employed are caught on time. The Sai-Fondiaria case shows an infringement of mandatory rules that was discovered when it was too late to prevent the action, because the target company (Fondiaria) had already merged with Sai.

5. *The First Milan Tribunal's decision*

The First Milan Tribunal granted the recovery of damages.[22] The Tribunal held that mandatory takeover rules are to be considered a mandatory part of the company contract that protects minority shareholder interests and thus investors' reliance on the capital market. The Tribunal acknowledged that by intervening, the watchdog can prevent elusion of takeover bids

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[21] For a criticism of Consob's approach, which contains a mathematical mistake, see C. Mosca, "Acquisti di concerto, partecipazioni incrociate e responsabilità per inadempimento dell'obbligo di opa. (Note a margine del caso Sai-Fondiaria)" (2007) Riv. soc. p. 1290.

[22] Milan Tribunal, 26 May 2005 (2006) II Giur. comm., p. 753, with comments by M. Gatti, "Mancata promozione di opa obbligatoria e risarcimento del danno" (2005) II Giur. comm. p. 774; U. Morello, "Mancata promozione di Opa obbligatoria totalitaria e risarcimento del danno" (2006) 4 Soc. p. 408.

regulation through the freezing of voting rights and compulsory sale of the shares exceeding the threshold. However, it pointed out that when the watchdog does not intervene, minority shareholders are unprotected and civil remedies are necessary (noting by the way that minority shareholders could even sue the watchdog if it fails to protect investors' interests).[23] The Tribunal stressed that the predator has to make a bid and that this is a legal obligation even though minority shareholders cannot enforce a sale. It recognized that minority shareholders have no action to force the predator to buy their shares but pointed out that minority shareholders have a right to damages. Finally, the Tribunal stressed that minority shareholder's claim could also be in tort, as the elusion of mandatory takeover rules represents unjust behaviour worthy of sanction.

The Tribunal condemned the concerting parties to reliance damages represented by the difference between the value of the shares at the time in which the bid should have been made and the price of the mandatory bid. The Tribunal refused to deduct the increase in value that the Fondiaria-Sai shares had recorded in the meantime from this amount. The Tribunal noted that the shares were still in the hands of the plaintiffs and therefore this increase was potential rather than real.

Alas, the first decision on the Sai-Fondiaria case lacks not only clarity but also organization. The Tribunal invokes principles of non discrimination amongst shareholders, contract law, tort law. However, deterrence lurks behind the court's reasoning.

Following this decision, further decisions regarding other minority shareholders' claims were released by the Tribunal.[24]

6. *Scholars' comments*

With few exceptions, commentators criticized the Tribunal's approach. Virtually every

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[23] Cass., cit. n. 11.

[24] Milan Tribunal, 8 May 2006 (2006) Corr. giur. p. 983; Milan Tribunal, 9 October 2006; Milan Tribunal, 2 May 2007 (2007) II Banca borsa, p. 572, commented by E. Desana, "Tribunale versus Corte d'Appello nella vicenda Sai-Fondiaria: due pronunce ambrosiane sulle conseguenza della violazione dell'Opa obbligatoria", p. 593. See *infra*, § 7.

scholar highlighted the unclear distinction between contract and tort law.[25] Many commentators rejected the idea that the protection of shareholders' equality is the cornerstone of mandatory takeover rules.[26] However, the critics went further.

Many commentators noted that if minority shareholders have no right to enforce a sale of shares, they cannot have a right to damages. The argument has been lucidly exposed by Umberto Morello. The duty to make a bid, the argument goes, is an obligation to offer and not an obligation to buy.[27] First, the bidder has to draft an offer document that has to be approved by the supervisory authority;[28] the time allowed for acceptance must be agreed with the stock exchange; the minimum price is established by the law, but the bidder is free to offer a higher price. In short, there is a procedure to be followed, at the end of which the contractual offer is published. If the predator does not start this procedure, the offer never materializes, and there is no way a plaintiff can demand performance of a contract when there is not even a contract offer.[29] Second, the predator must sell the shares if he does not take the procedural steps leading to the publication of the bid. If there were an obligation to buy from minority shareholders, the some person would be obliged to buy and to sell at the same time. The principle of non contradiction would be violated. Since minority shareholders have no right to sell the shares in the absence of a formal offer, they have no right to expectation damages.[30] Professor Morello would allow minority shareholders to claim reliance damages grounded on precontractual

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[25] See A. Gambaro, "Riflessione breve sull'argomentazione giurisprudenziale" (2005) II Giur. comm. p. 769-774.

[26] M. Gatti, op. cit. n. 22, p. 783 et seq.

[27] U. Morello, op. cit. n. 22, p. 408.

[28] In Germany similar opinions are drawn from the fact that the offer document has to be approved by the financial watchdog: see J. Ekkenga and D. Schulz, Comment to § 35 WpÜG, In U. Ehricke, J. Ekkenga and J. Oechsler (eds.), *WpÜG -Kommentar zum Wertpapiererwerbs- und Übernahmegesetz*, (Munich 2003) § 35, 6.

[29] U. Morello, op. cit. n. 22, p. 411.

[30] Francesco Carbonetti, who expresses a similar position, argues that this solution is efficient, as ex post remedies would create excessive litigation and therefore high judicial costs: F. Carbonetti, "Opa obbligatoria e diritti degli azionisti" (2005) Dir. banca merc. fin. p. 634.

liability when there is a reasonable expectation that a takeover bid will be launched; however, this was not the case in the Sai-Fondiaria saga.[31]

Other legal writers have reasoned along different lines. Giuseppe Guizzi argues that mandatory takeover rules aim at protecting minority shareholders against the risk of a share depreciation that might follow the target's take of control by the predator. At the core of mandatory takeover rules there would be informational issues, not control premiums. This writer would accord damages in tort to shareholders who sold during the period in which the bid should have been made, and only if the subsequent share value were to collapse.[32]

Other authors share the view that minority shareholders have no way to coerce a purchase of their shares, but nevertheless think that they can claim expectation damages. Before the decision of the Milan Tribunal this view had been expressed, amongst others, by Luca Enriques.[33]

Just one author, as far as I am aware, joined the debate from a law and economics perspective, discussing the different economic functions of mandatory takeover rules. Matteo Gatti's view is that minority shareholders could be accorded an action in damages if the purpose

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[31] U. Morello, op. cit. n. 22, p. 414-415.

In Germany the main view is that minority shareholders have no right to damages, as § 35, co. 2 WpÜG (the German rule on mandatory bids) is not aimed at protecting private entitlements: cf. see, e.g., P. Pohlmann, "Rechtsschutz der Aktionäre der Zielgesellschaft im Wertpapiererwerbs-und Übernahmeverfahren " (2007) ZGR p. 1, at p. 12; U. Noack, Comment to § 35 WpÜG, In E. Schwark (ed.), *Kapitalmarktrechts-Kommentar*, (Munich 2004) n. 50; but see H. Ihrig, "Rechtsschutz Drittbetroffener im Übernahmeschutz" (2003) 167 ZHR p. 315, at p. 349; C. H. Seibt, "Rechtsschutz im Übernahmerecht" (2003) ZIP p. 1865, at p. 1876. According to the majority of German scholars, an implied right cannot be drawn from § 38 either (see BGH, 18 September 2006, available at www.bundesgerichtshof.de, reporting the different views on the matter).

[32] G. Guizzi, "Notarelle in tema di OPA obbligatoria, violazione dell'obbligo di offerta e interessi protetti" (2005) II Riv. dir. comm. p. 251, at p. 261. See also C. Mosca, op. cit. n. 21, who criticizes the decision on damage issues.

[33] L. Enriques, *Mercato del controllo societario e tutela degli investitori*, (Bologna 2002) pp. 237-238. Cf. also G. Romagnoli, *Diritti dell'investitore e dell'azionista nell'opa obbligatoria*, (Padova 2005) *passim*. After the decision of the Milan Tribunal this line of reasoning has been elaborated in detail by A. Tucci, "Obbligo di offerta e responsabilità civile" (2007) Riv. soc. p. 999.

of MBRs is to protect them from future exploitation by the controlling shareholder. Minority shareholders would have no right to redress if MBRs simply aimed at limiting value-decreasing transfers of control.[34]

7. *Milan Court of Appeal and the second stream of decisions by the Milan Tribunal*

The Milan Court of Appeal substantially rejected the First Milan Tribunal decision, following the view that, in the absence of a duty to purchase, there is not even an obligation to damages. The freeze of voting rights and the duty to sell are the only applicable sanctions in a case like Sai-Fondiaria. Minority shareholders would have a claim to damages if they unsuccessfully relied on the launch of a takeover.[35] The Court of Appeal observed ironically “the strange reference to sanctions adopted by the Tribunal judge with regards to damages in private law.” Deterrence has no place in a legal reasoning concerning civil damages according to the Court of Appeal, whose arguments in places would be appropriate in a philosophical treatise rather than a modern law decision.

In the meantime, the Milan Tribunal was deciding another stream of cases concerning the same issue. This second stream of decisions is much better than the first one. Its organization is clear, as is its language. The Tribunal analyzes the purpose of MBRs and points out that the obligation to bid protects minority shareholders and it is a true obligation. The language of the law uses this technical term, which would be meaningless if this obligation were not mirrored by an entitlement in favour of minority shareholders. Moreover, with reference to actions in concert, the Tribunal points out that the law states that the concerting parties are jointly and severally obliged to launch the bid (Art. 109 CFSA). Joint and several liability is a concept employed by the law when there is a private law obligation. The obligation has a contractual nature, as MBRs are a mandatory part of the company’s governing rules. The Tribunal notes that even though a sale cannot be enforced by minority shareholders, damages can be accorded nevertheless, since there are other cases in the law where the shareholder, though not protected by any *in rem* right,

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[34] M. Gatti, op. cit. n. 22, p. 774.

[35] Milan Court of Appeal, 15 January 2007 (2007) II Banca borsa p. 572.

is protected by liability rules.[36] With reference to damages, the Tribunal improves its analysis concerning the reasons why the post-merger improvement of FonSai share value is not relevant to assess damages. This analysis is grounded on issues of causation. The increase in value that followed the merger is unrelated to the violation that entitles minority shareholders to claim the difference between the mandatory bid price and the share value at the time the bid should have been launched. Accordingly, it cannot be considered in reducing damages.[37]

III. A LAW & ECONOMICS PERSPECTIVE

8. *Method*

Economic analysis of law can be used with two alternative approaches. The first one is to engage in a normative analysis that investigates whether MBRs are welfare-enhancing or not, and thus to evaluate the impact of the courts' decisions on the efficiency of the corporate law system or, more ambitiously, the capital market as a whole. The decision to grant damages would be deemed inefficient if it raises the enforcement level of a welfare-reducing regulation, and vice versa. This approach looks at MBRs and courts' decisions from the external perspective that characterizes economic analysis of law.[38]

The second approach has a milder touch. It adopts the internal view to interpretive problems that is typical of lawyers. It takes the law as a fact, avoiding any entanglement in the discussion concerning MBRs' welfare effects, and investigates how deterrence can be used as an argument in the legal discourse of civil lawyers facing regulatory landscapes that are alien to the

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[36] This passage could be re-phrased, adopting the classic law & economics jargon, by saying that the absence of a property right does not exclude the existence of a liability rule: see the seminal G. Calabresi and A. D. Melamed, "Property Rules, Liability rules, and Inalienability: One View of the Cathedral" (1972) 85 Harv. L. Rev. p. 1089.

Reference in the decision is to Civil code rules that give the shareholder a claim to damages but not a right to make a shareholder meeting decision null and void: see Art. 2377-4, 2378-2 and Art. 2504-*quater*-2 C.c.

[37] For a completely different view see C. Mosca, op. cit. n. 21.

[38] On the distinction between the external and the internal perspective see R. A. Posner, "Legal Scholarship Today" (2002) 115 Harv. L. Rev. p. 1314.

traditional distinction between public and private law. This approach, accordingly, focuses on the discourse of civil lawyers. It offers arguments drawn from economic analysis of law that can help lawyers in reaching reasonable, pragmatic results, acceptable to a Continental tradition that deplores an open use of legal consequentialism or instrumentalism.[39]

In this paper I follow the second approach. There are two reasons to justify this approach. First, a large literature has discussed the impact of MBRs, achieving mixed conclusions.[40] Indeed, there is no clear-cut answer: the problem is probably trans-scientific.[41] Any normative conclusion depends on factors like ownership structure, corporate governance, law enforcement levels, and would lead the discourse astray. The US does not have mandatory takeover rules, whereas Europe has recently embraced mandatory takeover rules through the Thirteenth Directive, notwithstanding the great differences across member states' industries. Time will tell who is right. Second, it is debatable whether or not under-enforcement of a welfare-reducing regulation is always a good thing. Law enforcement is a public good. It could be inefficient not to enforce a welfare-reducing regulation, if under-enforcement signals that the law enforcement system is poor, thereby inducing violations of welfare-enhancing rules as well.[42] Therefore, I will not discuss whether MBRs are efficient or inefficient. I will assume instead that mandatory takeover rules are to be stringently enforced. From this internal viewpoint, I enquire into (i) how arguments based on deterrence can be used when talking about private remedies and (ii) whether or not private remedies are efficient tools in the enforcement of MBRs.

9. *Deterrence*

Tort law concerns interactions between an injurer and a victim or a group of victims. The injurer creates a negative externality and the victims have no way to negotiate a remedy *ex ante*.

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[39] On instrumentalism see A. Vermeule, "Book Review: Instrumentalism" (2007) 120 ibid. p. 2113.

[40] For a recent review M. Burkart and F. Panunzi, "Takeovers" (2006) ECGI Finance Working Paper N°. 118/2006 p. 1.

[41] Following A. Vermeule, "Interpretive Choice" (2000) 75 N.Y.U. L. Rev. p. 74, at p. 100, questions are trans-scientific when they are empirical but also unresolvable at acceptable cost.

[42] I owe this point to Guido Ferrarini.

The law must deal with these cases. The social goal is "the maximization of the utility injurers derive from engaging in their activity less total social costs, that is, less the costs of care and expected accident losses."[43] The social decision concerns the subject who must bear the cost of the accident, and the conditions under which he must do so. From an economic perspective, damages in tort are equivalent to a fine, paid by the tortfeasor to a party that suffered damages.[44] Through the duty to pay damages, a party is compelled to take negative externalities in consideration when deciding whether to start or continue a certain activity. Accordingly, damages compensate and deter at the same time.[45]

Reference to deterrence is less usual in the contractual contexts. From an analytical perspective, the main distinction between contract rules and tort law is grounded on the fact that contract rules are usually default rules that, under certain conditions, parties can opt-out of, whereas "tort law is primarily a set of mandatory rules."[46] In contractual remedies the welfare computation usually concerns two parties and the debate refers to (i) the optimal default remedy in any set of contractual situations (specific performance, expectation damages, reliance damages); (ii) whether to allow parties to opt-out of those default rules (through penalty clauses and the like). Deterrence is typically mentioned when mandatory rules affecting contractual formation or performance are concerned. For instance, it is debated whether penalty clauses overdeter. Assuming that they do so, a mandatory rule limiting the enforceability of penalty clauses is considered to be efficient. Hence, deterrence and mandatory rules are usually twin concepts in the law and economics jargon. Deterrence refers to forced disincentives created by the law.

10. The blurred confines between contract and tort in securities regulation

When contract rules involve a large set of subjects (shareholders, bondholders,

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[43] S. Shavell, *Foundations of Economic Analysis of Law*, (Cambridge, Mass. 2004) p. 193.

[44] G. S. Becker, "Crime and Punishment" (1968) 76 J. Pol. Econ. p. 169.

[45] This point is a common understanding in the law & economics literature on tort: see R. D. Cooter, "Economic Theories of Legal Liability" (1991) 5 J. Econ. Persp. p. 11.

[46] I. Ayres, "Valuing Modern Contract Scholarship" (2003) 112 Yale L.J. p. 881.

consumers, investors), the contract/tort distinction fades away. Collective action problems come to the surface, ex ante regulation through contractual arrangements might become difficult, and therefore regulation can step in and impose non-negotiable rules that replicate the hypothetical bargain that all the parties involved would have struck if they could negotiate. Accordingly, when mandatory rules are applied to contract situations involving a large set of subjects, the contract/tort boundaries blur. Capital market law is a case in point.[47] The auditor/investors relationship is governed either by tort law or contract law.[48] One could look at the contract between the company and the auditor and assert that this contract is aimed at protecting also third-parties such as creditors and investors, and that the law replicates and clarifies the contents of this contract by stating that the auditors' duty is to protect investors. By contrast, one could argue that the audit agreement concerns exclusively the company and the auditor, and therefore that investors are not in privity with the auditor. Accordingly, the rule of law affirming auditors' duties towards investors must be found in tort law rather than in contract. In countries where directors have duties toward creditors similar arguments can be used.[49] Delisting decisions by stock exchanges raise these issues as well, as it is debatable if investor protection is grounded in the listing contract or in the law, and both positions can be argued.[50]

It is therefore clear that the Milan Tribunal's mixed reasoning in its first decision is not unheard of in the capital markets regulatory arena and was excessively derided by Italian legal commentators. It was poorly structured, but it was not without grounds. Mandatory contract rules protecting investors and mandatory regulatory rules protecting investors (through imposed

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[47] See R. A. Prentice, "Contract-Based Defenses in Securities Fraud Litigation: A Behavioral Analysis" (2003) U. Ill. L. Rev. p. 337. Malpractice liability for physicians is another case in point. See J. Arlen, "Private Contractual Alternatives to Malpractice Liability" (2005) p. 1; J. Arlen and B. MacLeod, "Malpractice Liability for Physicians and Managed Care Organizations" (2003) 78 N.Y.U. L. Rev. p. 1929.

[48] Cf. H. B. Schäfer, "Efficient Third Party Liability of Auditors in Tort Law and in Contract Law" (2004) Supr. Ct. Econ. Rev. p. 181.

[49] Italy is a case in point: see article 2394 C.c.

[50] On delisting decisions see S. L. Schwarcz, "Temporal Perspectives: Resolving the Conflict between Current and Future Investors" (2005) 89 Minn. L. Rev. p. 1044, at p. 1060.

gatekeepers or rules of conduct) are quite often very difficult to distinguish. Most important, they are both instruments of regulation and investor protection. Reference to both in the course of a legal reasoning concerning investor protection does not deserve mockery.

11. Deterrence in civil law

The idea that civil remedies (particularly, civil damages) can be viewed as an instrument of deterrence is not welcomed in Italy. Amongst the most preeminent private lawyers, mainly Pietro Trimarchi (curiously, Mediobanca's lawyer in the Sai-Fondiaria litigation) taught and interpreted tort law using a functional approach which adopted a mixed theory of deterrence and compensation.[51] In our tradition, talk about deterrence is quite often confused with talk about punishment. Italy does not know punitive damages and US decisions concerning punitive damages are not enforced in Italy because courts think they are in contrast with the core principles of our private law system.[52] Yet, private sanctions which do not compensate but prevent and deter abound,[53] albeit they are still considered rather diffused exceptions more than another facet of private law. If deterrence is distinguished from punishment, the radicalism that envelops the deterrence/compensation antagonism slightly recedes. Needless to say, the idea that deterrence might be in certain contexts the most important function of an entitlement to damages is far from accepted. The hallmark of tort law in the European tradition is compensation. Basically all general treaties concerning tort law are written from a compensatory perspective and ignore the deterrent potential of damages in tort.[54] However, the idea that damage has two dimensions, with deterrence and compensation being the two sides of the same coin, can be accepted by traditional lawyers if it is clearly stated that deterrence does not mean punishment

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[51] See P. Trimarchi, *Causalità e danno*, (Milano 1967), p. 52 et seq.; P. Trimarchi, Illecito (dir. priv.), *Enc. dir.*, vol. XX, (Milano 1970), p. 90.

[52] Cass., 19 January 2007, no. 1183, (2007) I Foro it. p. 1460.

[53] P. Benazzo, *Le 'pene civili' nel diritto privato d'impresa*, (Milano 2005).

[54] See, e.g., Cass., 19 January 2007, n. 1183; G. Alpa, La responsabilità civile, In G. Alpa (ed.), *Trattato di diritto civile*, vol. IV, (Milano 1999), pp. 760-788

and it is presented as a side-effect of compensation.[55]

When investor protection is at stake, however, the deterrent value of civil remedies cannot be fended off by traditional appeal to the compensatory role of damages in tort. The Italian civil code has a seminal rule that is deterrent more than compensatory. Article 2395 C.c. states that directors are liable towards shareholders and third-parties for damages directly inflicted to them. The damage incurred by shareholders and third-parties must concern their personal wealth. Damages suffered to the share value (or to the value of the credit) in connection with damages inflicted by directors to the company's assets are not recoverable under article 2395, since it is the company (under Articles 2392-2393-2393-bis C.c.) or the creditors in lieu of the company (art. 2394 C.c.) to have a claim to damages in this situation. Therefore, Article 2395 C.c. mainly protects shareholders and third-parties who decided to underwrite or purchase financial instruments issued by the company relying on misstatements provided by the company through its directors.[56]

Art. 2395 C.c. has been routinely examined through the lens of general tort doctrines. Directors' liability has been considered the most significant case of tort liability concerning information to third-parties and from this rule authors and courts have drawn doctrines of liability for pure financial loss.[57] Accordingly, the rule has been considered the normative expression of a general principle of tort liability for misrepresentation, and therefore a rule with compensatory purposes at its heart. It has been rarely analyzed from a functional, company law perspective.

Directors' liability towards investors is more peculiar instead and deserves a better reading. The key feature of company law is, with reference to public companies, "the separation

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[55] An exemplary coverage of this double-dimension is offered by G. T. Schwartz, "Mixed Theories of Tort Law: Affirming Both Deterrence and Corrective Justice" (1997) 75 Tex. L. Rev. p. 1801; in Italy it is offered by P.Trimarchi, *Causalità*, op. cit. n. 51, p. 52 et seq.

[56] G. Ferrarini, *La responsabilità da prospetto. Informazione societaria e tutela degli investitori*, (Milano 1986), p. 147 et seq.

[57] See U. Carnevali, "La responsabilità civile degli amministratori per danno ai risparmiatori" (1988) Contr. impr. p. 83; F. D. Busnelli, "Itinerari europei nella "terra di nessuno tra contratto e fatto illecito": la responsabilità da informazioni inesatte" (1991) Contratto impr. p. 539.

between the firm's bonding assets and the personal assets of the firm's owners and managers".[58] Directors are not liable for the company's liability. Hence art. 2395 C.c. is a remarkable exception to this regime. Directors are liable for untrue information provided to the market even if they intend to favour the company and therefore its current shareholders.[59] There is no other case like this, except (with reference to Italian law) the particular case of directors failing to ascertain the company's cause of dissolution, most notably failing to file a petition in bankruptcy (Article 2485 C.c.).[60] It comes to no surprise, therefore, that Italian legal writers and courts have struggled to understand when and how directors' liability under Art. 2395 C.c. could play a role in a contractual context. The company might decide deliberately not to perform the contract because there might be other and more interesting options available on the market. The contractual party consequently suffers damages. Are they recoverable from the directors under Article 2395 C.c.? A positive answer would dispel one of the core issues of company law, namely protection of directors' personal assets towards a company's creditors, in a case in which the decision not to perform was driven by sound business considerations and enhanced shareholder value and creditors' interest in the company. Directors' liability in a contractual context is a moot point, because the rule was foreseen with investor protection and financial economic loss in mind.

This regime cannot be properly understood in terms of compensation. Directors rarely have assets sufficient to satisfy investors' claims.[61] It is the company that has the assets. Therefore, investors are more interested in attacking the company's assets than those of directors. Indeed, the common view is that Art. 2395 C.c. does not prevent investors from suing

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[58] H. Hansmann and R. H. Kraakman, "The Essential Role of Organizational Law " (2000) 110 Yale L.J. p. 387, p. 393.

[59] See D. C. Langevoort, op. cit. n. 3.

[60] For a European view of the subject-matter see P. O. Mülbert, "A Synthetic View of Different Concepts of Creditor Protection, or: A High-Level Framework for Corporate Creditor Protection" (2006) 7 EBOR p. 357.

[61] D. C. Langevoort, op. cit. n. 3, p. 639, mentioning the widespread "impression that individual liability could never support full (i.e., often multi-billion dollar) compensation for the fraud's victims."

the company, but simply establishes a "dual liability regime",[62] as the doctrine of *respondeat superior* makes the company liable for directors' misrepresentations.[63]

Reinier Kraakman has convincingly analyzed managerial liability issues, pointing out that dual liability has a strong deterrent effect: "Managerial 'bad men' – he writes – will undertake illegal projects only after calculating, however cursorily, the net benefits both for the firm and for themselves. Leaving aside the difficulties of managers' securing personal risk premiums, the break-even point for an illegal activity is established jointly by both the firm's and the manager's expected penalty costs."[64] Dual liability therefore makes it more difficult to carry out cost-benefit analyses of illegal activities, thereby effectively preventing them. Add to this that outside directors, especially independent directors, and statutory auditors as far as Italian law is concerned, can become targets for a gatekeeper liability strategy,[65] as they have access to information and can influence inside managers to forgo offenses, and it is clear that this dual liability regime is addressed at increasing deterrence, whereas it is less interested in granting adequate compensation.[66]

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[62] R. H. Kraakman, "Corporate Liability Strategies and the Costs of Legal Controls" (1984) 93 Yale L.J. p. 857, at p. 858.

[63] With reference to the U.S., see R. A. Prentice, "Conceiving the Inconceivable and Judicially Implementing the Preposterous: The Premature Demise of Respondeat Superior Liability Under Section 10(b)" (1997) 58 Ohio St. L.J. p. 1325.

[64] R. H. Kraakman, op. cit. n. 62, p. 880.

[65] R. H. Kraakman, op. cit. n. 62, p. 888 et seq.

[66] According to Kraakman there are other two reasons why entity liability might fail as a regime of legal control: asset insufficiency and enforcement insufficiency: see R. H. Kraakman, op. cit. n. 62, p. 867-868. As to asset insufficiency, which might be closely associated to compensatory issues, Kraakman suggests that senior managers and directors "are ideal targets for incentives aimed at ultimately prodding the firm to cover its potential liability. Their position normally provides them with information about the need for insurance; their power assures that they can act on their knowledge of risk levels; and their personal assets and risk preferences are likely to encourage them to seek adequate insurance coverage" (p. 871). Thus, personal liability induces directors to protect tort creditors that might be exposed to risk externalization by undercapitalized firms (p. 872 et seq., discussing the pros and cons of shiftable liability as a response to undercapitalization).

Going beyond a superficial analysis, one discovers that directors' liability towards investors is discussed in the Italian legal literature from a deterrence perspective and that the purely compensatory view of tort is confined to general treaties, where there is no direct contact with regulatory matters and the legal discourse can indulge in a conceptualistic, rather than an instrumentalist, form of legal analysis. Our company law legal writers point out that Article 2395 C.c. aims at deterring directors.[67] The same approach is adopted by US federal law, as Section 10b of the Securities Act 1934 is not limited to issuers, but embroils managers too.[68] In the UK, the issue has been recently discussed by the Davies Report from a deterrence perspective.[69] Strategies of managerial liability are always considered strategies of deterrence, not compensatory issues: in large financial markets little credit is given to the idea that single directors can face the whole amount of damages inflicted to investors through the company's misrepresentations and can therefore be the deep-pockets against which investors might be able to channel their claims.[70]

Deterrence appears to be at the heart of Article 2395 C.c., the most important and influential Italian rule of the civil code concerning investor protection and pure financial loss. The Milan Court of Appeal's irony about the role of deterrence in a discourse concerning civil remedies is out of place, at least in securities regulation.

12. Deterrence and the private attorney general

When civil remedies are seen as a component of the deterrence framework built by the law through the interplay of private and public enforcement, new light is shed on the whole landscape. The issue becomes how to develop an effective enforcement system.

A public, monopolistic enforcer enjoys economies of scale and scope, and has full control of sanctions. However, there are at least four strong arguments against a system that relies

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[67] G. Minervini, *Gli amministratori di società per azioni*, (Milano 1956), p. 373-374; A. Borgioli, "La responsabilità per la gestione dei fondi comuni d'investimento mobiliare" (1983) Riv. soc. p. 904, at p. 907.

[68] D. C. Langevoort, op. cit. n. 3.

[69] P. Davies, op. cit. n. 9, p. 41-42.

[70] For a recent discussion of this topic see D.C. Langevoort, op. cit. n. 3.

entirely on the public enforcement of law. First, in the real world public agencies are not always the most efficient enforcers because they cannot have access to the widespread information that private parties naturally possess.[71] The private attorney general of the US experience is a private bounty hunter who can exploit informative advantages to his own benefit. “Qui tam actions” and especially FCA’s actions (actions under the False Claims Act) rely on the informational advantage enjoyed by the private plaintiff.[72]

Second, they lack adequate financial resources to investigate all potential wrongdoers and to pursue all pending investigations with the same unrestricted vigour.[73] The US Supreme Court made this point explicit in *Borak*, when it implied a private right to damages from the antifraud prohibition of the proxy rules.[74] In its reasoning, it stressed the salutary role that the private plaintiff acting as a “private attorney general” has in supporting SEC’s actions in a context of stretched resources, and inferred a tort from the violation of a statute intended for public protection.

Third, the public watchdog can face various agency costs. It can pursue budget maximization objectives instead of public interest.[75] It can play as a political support maximizer.[76] Its employees or its top persons could be “amenable to payoffs”.[77] They could be

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[71] S. Shavell, op. cit. n. 43, p. 578-579.

[72] Cf. P. H. Bucy, "Private Justice" (2002) 76 S. Cal. L. Rev. p. 1; B. Depoorter and J. De Mot, "Whistle Blowing" (2006) 14 S. Ct. Econ. Rev. p. 135; T. Morrison, "Private and Attorneys General and the First Amendment, " (2005) 103 Mich. L. Rev. p. 675.

[73] In favour of private attorneys general it is argued, for instance, that they ensure enforcement as they are “not wholly dependent on the current attitudes of public enforcers”: J. C. Coffee Jr., "Rescuing The Private Attorney General: Why the Model of the Lawyer as Bounty Hunter is not Working" (1983) 42 Md. L. Rev. p. 215, at p. 227.

[74] J.I. Case Co. v. Borak, 377 U.S. 426, 432.

[75] M. A. Cohen and P. H. Rubin, "Private Enforcement of Public Policy" (1985) 3 Yale J. on Reg. p. 167.

[76] S. Peltzman, "Toward A More General Theory of Regulation" (1976) 19 J. L. & Econ. p. 211; G. J. Stigler, "The Theory of Economic Regulation" (1971) 2 Bell J. Econ. Man. p. 3.

[77] With reference to the public prosecutor in antitrust cases, Professor Easterbrook writes: “Unable to

attracted by the "revolving door" between public and private jobs[78] as well as by straightforward political influence. Needless to say, bribery might be the extreme form of payoff.[79]

Fourth, the agency's action could become too predictable. The agency tends to do what it did in the past under similar circumstances and strategically oriented wrongdoers can take this approach into consideration when planning their actions. Needless to say, this approach enhances the incentives to capture the regulator, which decrease if a real danger of private enforcement is foreseen by the regulated industries.

It is for these reasons that private parties are provided with economic incentives to report wrongdoings, in the form of damages, restitution, bounties or any other form of monetary reward whatsoever.[80] Accordingly, even though the private incentive to bring suit remains

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capture the benefits of his work, he would tend to shirk. He might seek to maximize something other than allocative efficiency. He also would be amenable to payoffs, perhaps in the indirect form of future employment (the 'revolving door' between public and private jobs) or support for future political campaign." F. H. Easterbrook, "Detrebling Antitrust Damage" (1985) 28 J.L. & Econ. p. 445.

[78] Doubts concerning the existence of such an "agency problem" affecting regulators have been recently raised by D. C. Langevoort, Structuring Securities Regulation in the European Union: Lessons from the U.S. Experience, in G. Ferrarini and E. Wymeersch (eds.), *Investor Protection in Europe: Corporate Law Making, the MiFID and Beyond*, (New York 2006) pp. 485-505, who argues as follows (p. 493): "Two problems, however, make this problematic. First, the broad consensus among officials needed for significant action makes it hard for one or a handful of officials to push policy in the direction of a particular interest. Second, the dominating strategy for opportunistic officials may be instead to create some new body of regulation that is dense and difficult to interpret or apply, and upon departure claim the rents associated with expert informational advantage."

[79] E. L. Glaeser, S. Johnson and A. Shleifer, "Coase versus the Coasians" (2001) 116 Quart. J. Econ. p. 853, at p. 853 adopt a different approach and reach different conclusions, asserting that regulators are more aggressive enforcers than courts; however, in their analysis the authors "focus on the inquisitorial legal system of civil law countries, where the judge must himself undertake an investigation into the facts of the situation and the law" (at p. 856). Generally speaking, this preliminary assumption is wrong as far as private enforcement is concerned, since also in the so-called "inquisitorial legal systems" facts have to be submitted to the Court by the litigants. Indeed, all the emphasis on the differences existing between adversary and inquisitorial models is, as a well known specialist of the field has written, "meaningless": M. Taruffo, *Sui confini*, (Bologna, 2002) p. 80.

[80] S. Shavell, op. cit. n. 43, p. 578-579. It must be noted that civil law countries such as Italy have never adopted qui tam legislation or citizen-suit provisions, enlisting citizens in law enforcement. On the subject, from a

"fundamentally misaligned with the social optimal incentive to do so, and the deviation between them could be in either direction",[81] a certain level of private enforcement pressure is needed. From this functional perspective, it is clear that the issue is not whether or not private actions should have a role in securities law enforcement; rather, the problem is that of reaching a balance and good interplay between private and public enforcement.[82]

The European competition law experience shows a sector of law in which the public v private enforcement debate is lively and, more important, the idea that private enforcement must support public enforcement has gained momentum even in political circles.[83] Securities law is very similar to antitrust, as it is a form of regulation characterized by intense recourse to public and private remedies, which replicates the original idea of the US 1933 Securities Act to have both public enforcers and private enforcers acting at the same time.

A private remedy can step in when a preventive measure primarily entrusted with the public watchdog fails. Also on this point the Tribunal is correct and the Court of Appeal's rejection is out of place.

13. Is it relevant to establish whether MBRs are distributive or efficiency-driven?

Up to now I have argued that the Tribunal is right on many issues. In its first decision it hovered between contract and tort, but this is normal in these contexts. It explicitly mentioned deterrence, even though referring to punishment more than to ex ante incentives to proper behaviour, and this is not anathema to any regulatory framework, and especially to securities law. Reference to the supplementary role of private enforcement is perfectly consistent in a regulatory setting; every lawyer in the securities arena is used to it.

Before turning to how the court could have dealt with the text of the statute, a last point

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US perspective, see B. Depoorter and J. De Mot, op. cit. n. 72.

[81] S. Shavell, op. cit. n. 43, p. 391.

[82] W. Kip Viscusi, *Regulation through Litigation*, Washington D.C.: Brookings Inst., 2002, p. 3. For an analysis of the interplay and overlap of SEC public enforcement proceedings and private enforcement of securities regulation cf. J. D. Cox and R. S. Thomas, "Sec Enforcement Heuristics: An Empirical Inquiry" (2003) 53 Duke L.J. p. 737.

[83] See n. 2.

has to be covered, concerning MBRs' precise economic role. From a functional perspective, it is clear that one of the key issues of MBRs is the protection of minority shareholders from the extraction of private benefits of control from opportunistic buyers. Scholars debate whether this distributive effect is MBRs' real purpose. Some writers think that distributional arguments are to be considered foreign to MBRs, whose role would be to curb value-decreasing transfers of control. Accordingly, Matteo Gatti pointed out that the answer to the problem raised by the Sai-Fondiaria case lies in the true function of MBRs. If they seek to split the control premium amongst shareholders – the argument goes – thereby protecting minority shareholders, MBRs are distributional in nature and private damages are due. By contrast, if MBRs aim at curbing value-decreasing transfers of control, minority shareholders are not the protected parties and should enjoy no claim to damages.[84]

The distribution v. efficiency dualism replicates the compensation v. deterrence one.[85] The difference between issues of distribution and those of efficiency is not so straightforward.[86] If distributional issues are seen as sanctions, they turn out to be efficiency-oriented ones. If takeover regulation wants to limit value-decreasing transfers of control, private remedies that cause welfare distribution amongst predator and minority shareholders affect the level of deterrence. The distributive effect can therefore be valued as an end in itself or as a means to promote efficiency and therefore social welfare. The point is that you can consider minority shareholders either to be the protected parties (from a distributive perspective) or the best private enforcers (from an efficiency-oriented) - they are indeed both. A court must acknowledge that damages are also sanctions and that they impinge on law effectiveness.[87] If MBRs are to be applied, an appropriate level of enforcement is needed. Minority shareholder rights are enforcers

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[84] M. Gatti, op. cit. n. 22, p. 774.

[85] *Supra* § 11.

[86] L. Kaplow and S. Shavell, *Fairness versus Welfare*, (Cambridge Mass. - London 2002) p. 12: "For instance, corrective justice requires that injurers who act wrongfully be held liable for the harm they cause, but imposing such liability may also deter harm, which would raise individuals' well-being."

[87] This point has also a constitutional relevance, since Article 47 of the Italian Constitution specifically asserts that the Italian Republic protects savings.

whether or not MBRs' intent is to distribute control premiums for equality of concern for shareholders or for reasons of efficiency.

Readers familiar with the debate raised by the *Italian Motor Insurance* cases[88] will recognize in this apparent dualism and its normative implications a well-known pattern. In those series of cases it was discussed whether consumers have a claim to damages against cartel members. Opponents argued that antitrust is not addressed at protecting consumers. Some Italian writers and a decision of the Cassation Court were of the view that antitrust protects competitors, not consumers: a shocking statement for anybody who knows what antitrust is about.[89] Others argued that antitrust aims at improving social welfare and therefore that consumer protection is not its true purpose. However, in a regulatory setting, the problem is sterile as far as enforcement is concerned. Consumers are the only suitable private enforcers of cartel-forbidding rules. Establishing whether their protection is an end in itself or a means to achieve grand welfare improvement is an exciting task, but not a useful one as far as enforcement matters are concerned. Consumers are the protected parties, the perfect enforcers, or both. The final decision of the Cassation Court stated that consumers have a right to damages.[90]

14. How the case should have been decided

The law is mute on whether or not minority shareholders are entitled to damages. However, Italian courts usually considers the violation of a statute intended for public protection as a tort when it causes private damages, at least when the plaintiff is within the boundaries of the protected public. As I have already pointed out, the reference made by the Tribunal to tort law was not incorrect; it was poorly explained. Yet, minority shareholders probably have a contractual claim, not a tort claim, even though as I previously mentioned in this area of law the distinction is blurred. MBRs can be considered mandatory rules inserted by the law in a listed company's articles of associations. The argument the court tried to develop could be simply

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[88] See P. Giudici, op. cit. n. 2.

[89] Cass., 9 December 2002, no. 17475, (2003) I Foro it. p. 1122.

[90] Cass., Sez. un., 2 February 2007, no. 2305, (2007) I Foro It. p. 132; Cass., Sez. Un., 4 February 2005, no. 2207, (2005) I Foro It. p. 1014.

stated. If the violation of a statute intended for public protection is a tort when it causes private damages to a plaintiff who lies within the boundaries of the protected public, *a fortiori* does it confer a private right of action when the plaintiff is part of a contract governed by mandatory terms.

The text of the statute imposes a duty to launch a bid and a duty to sell the exceeding shares if the bid is not made. As noted, this fact has led scholars and the Court of Appeal to endorse a narrow, literal interpretation of the statute: the predator has an obligation to make a bid or, in defect, sell, not an obligation to buy; if there is no obligation to buy, there is no contract and therefore no obligation to pay damages either. This conclusion is puzzling. The first part of the argument is fine: there cannot be any obligation to buy because the predator, after the time period of 30 days, must sell the exceeding shares; an obligation to sell those shares and, at the same time, to buy minority shareholders' ones makes no sense. An equivalent result can be achieved, with a dramatic reduction in transaction costs, by forcing the predator to pay damages measured on the basis of the difference between the compulsory bid price and the share values at the time the bid should have been presented. Thus, the issue turns on whether, in the absence of an obligation to buy, there can be nevertheless an obligation to pay damages. In accordance with standard contractual law the answer is clearly negative: if there is no contract, there can only be precontractual liability, an issue that is not under dispute in the Sai-Fondiaria litigation, in which at stake is the difference between the mandatory bid price and the share value at the time of the missed bid.

However, in securities law we are not in a standard contract law situation; the argument based on textualism can be turned on its head. In no other contractual relationship is the offer subject to such an intense preventive regulation: (a) the offer is mandatory (the predators' directors are punished with fines); (b) the price is given; (c) there must be an offer document; (d) the time allowed for the acceptance of the bid is regulated; (e) the board of the offeree company is required to make public a document setting out its opinion of the bid and the reasons on which that opinion is based; (f) both the regulators and the stock exchange review the offer document.

This is by no means a normal private law environment, but a heavily regulated one, anchored on a mandatory disclosure system. A large literature investigates and debates the reason why this system is in place and whether it is efficient. Again, it might be discussed if this system aims at protecting investors or achieving broader social effects. In both cases, as far as

MBRs are concerned, they unequivocally aim at protecting minority shareholders. It is therefore ironic, to say the least, that because of mandatory disclosure rules that force the predator (through the offer document) and the issuer (through the board's opinion of the bid) to disclose information to the benefit of shareholders,[91] the protected parties should be denied entitlement to damages. The obligation to bid is a put option in favour of the minority shareholder,[92] which is at the core of a special regulation whose purpose is to grant full information and a certain time of reflection for decision. The assertion that "damages cannot be allowed because if you are obliged to bid, there is as yet no contract and so no claim to contractual damages" is remarkably out of context in a regulatory framework of this nature.[93] The obligation is constructed as an obligation to bid because a direct obligation to buy would bypass the process of information creation that is at the core of securities law. Adherence to certain stipulated doctrines of contract law can lead to nonsensical results in securities regulation.[94]

My counterargument, I hope, has more than levelled the playing field. Minority shareholders are the protected parties and the private enforcers. Without a specific remedy, they would remain exposed to predators' attempts to gain control without paying control premiums, whereas with regards to other areas of capital markets regulation, courts have extended the scope of law by asserting the existence of entitlements to damages in tort addressed to protect investors against insider-traders and inadequate preventive protection by public watchdogs.[95]

At this stage, the real question is whether the sanctions explicitly posed by the law are sufficient to protect minority shareholders and deter. A negative answer is too easy in the light of what happened in Fondiaria. Before jumping to the obvious conclusion, it must be considered whether private enforcement of MBRs through action in damages can overdeter. The answer is

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[91] In order to let them weigh up an offer at a minimum price fixed in accord with a formula posed by the law.

[92] M. Gatti, op. cit. n. 22, p. 788.

[93] For similar remarks see M. Gatti, op. cit. n. 22, p. 787-788.

[94] M. B. Fox, "Demystifying Causation in Fraud-on-the-Market Actions" (2005) 60 Bus. Law. p. 507.

[95] See n. 11 and 12.

no. In the absence of claims to damages, investigations concerning alleged actions in concert would cease after the 30 days required for making the bid, because dispersed private shareholders would generally have no interest in pursuing the matter any further, since all they can achieve is the annulment of the shareholder decision taken with the decisive vote of the concerting parties (pursuant to Articles 2377 C.c. and 110 CFSA). Nobody would face private costs of investigation to bring home such a meagre result. Action in concert is secretive by nature and time is needed to disclose it. In the absence of private enforcement, elusion of MBRs would be seriously undeterred.

Private actions have a further advantage. They are informative. Courts' decisions are public, whereas public watchdogs' enforcement actions are not obviously transparent to all.[96] It was impossible to understand, at the time Consob asserted that the action in concert was over, on what evidentiary grounds the public watchdog had decided, and with which intensity it had investigated. Without the minority shareholders' attempt to get damages, Mediobanca's and SAI's action in concert would already be a forgotten story in the murky waters of Italian financial markets.

15. Do the new MBRs rule affect private enforcement?

Italian MBRs have been recently amended to implement Directive 2004/25/EC on takeover bids. There are two salient amendments as far as private enforcement issues are concerned. First, the public watchdog can now order the concerting parties to launch the takeover bid instead of selling their exceeding shares (Art. 110-2 New CFSA). Second, the amount of the fine applicable in case of violation of the obligation to bid is now raised to the price that the predator would have paid if he had launched the mandatory bid.

As to the first rule, the power of the regulator to impose a mandatory bid is one of the arguments that in other European countries are mentioned in order to affirm that minority shareholders have no private right of action.[97] With regards to the second rule, reference to the price that should have been paid could be used to assert that the private sanction has been

[96] F. Tirio, "La Consob e il segreto d'ufficio" (2005) II Banca borsa p. 360.

[97] E. Macchiavello and G. Peruzzo, "Mancato lancio di opa obbligatoria: il puzzle Sai-Fondiaria alla luce di alcune esperienze europee" (2008) Giur. comm., forthcoming.

somehow incorporated by the law in the public one, thereby making clear that private damages have no room in this context. Enforcement would be therefore wholly left in the hands of public agents. A different view could be expressed, stating that reference to the price is a tool to adjust the combined effect of private and public sanctions. When private sanctions (damages) are not effectively enforced, the public authority can increase the amount of the fine, whereas the fine can stay low when the concerting parties are found liable to damages. Yet, the impression is that the new law offers new arguments in favour of public enforcement and against private enforcement. In the light of the Sai-Fondiaria case, this faith in public enforcement appears unjustified.

16. Conclusion

In Continental Europe, the concept of private law enforcement raises suspicion. It evokes deterrence, and talking about private law remedies as deterrent tools is still a taboo in many legal circles. Italy is a case in point. When courts have to face regulatory issues that raise questions concerning private remedies and they feel that those remedies are to be allowed in order to supplement public enforcement, they talk about corrective justice and use concepts drawn from the traditional approach to private law, trying to adapt those concepts to the new regulatory environment. They talk compensation but think deterrence. If they reject any idea of private remedies as deterrent tools, they resort to radical formalism with its built-in bias against legal change.

In this article I have shown how deterrence arguments can be openly employed in the legal reasoning of civil courts called to decide private law cases on securities regulation. A pragmatic interpretive approach of this kind would go someway to revealing the effectiveness of private actions as a support to law enforcement. Unfortunately, the new rules concerning MBRs seem to offer some new arguments in favour of public enforcement and against private enforcement of MBRs. It seems that the poor record of the public watchdog is, in Italy, something deserving awards, not criticism.

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