Form and Function in Doing Business Rankings: is Investor Protection in Italy Still So Bad?

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ABSTRACT: The World Bank’s Doing Business Report (DBR) ranks every year numerous jurisdictions across the globe according to their ability to facilitate business activities. Among the indexes contributing to the definition of the global competitiveness of the legislations, the “Protecting investors index” (PII) measures the protection of minority shareholders in listed companies. In this paper, we analyse the DBR’s assessment of the Italian regulatory framework on investor protection. We find that the PII falls short of properly evaluating the applicable rules. First, it underrates Italy because the DBR evaluation falls short of properly evaluating the role performed by independent directors under Italian rules on related party transactions. In particular, the DBR fails to properly account for independent directors’ power to veto unfair transactions before they are submitted to the board, a safeguard that ensures minority investors’ protection at least as well as mandatory abstention by conflicted directors. Second, past DBR overrated the PII, so that subsequent reforms that substantially improved investor protection have not been grasped by more recent assessments, giving the misleading impression that no relevant changes have occurred. Far from representing one of the multiple coding errors reported in the literature, these flaws aptly show that the DBR methodology, while correctly attempting to preserve consistency in the evaluation of different jurisdictions, adopts an excessively formalistic approach and disregards the function of the rules it scrutinizes. In light of the influence that the DBR exerts on national policymakers, this approach is detrimental because it might induce window-dressing reforms. Moreover, it may rule out experimentation, which is key to ensuring that the applicable rules keep pace with the variety of techniques adopted to expropriate minority shareholders.


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The essay is forthcoming in the Studi in onore di Diego Corapi. The authors were, respectively, a Consob Commissioner and his aide between 2007 and 2012. They also took part to a Bank of Italy seminar in which the issues discussed in this paper were discussed with the DBR team. Although the essay is the result of a joint effort, parts 1, 2, 3, 5, 6, and 7 are to be attributed to Matteo Gargantini.
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1. Introduction

The Doing Business Report (DBR) is an assessment exercise prepared by the World Bank with the aim of comparing the efficiency of nearly 200 jurisdictions. On a yearly basis, the DBR assesses national regulatory frameworks against benchmarks covering various fields of business law; the results of the evaluation are reported in a ranking of all concerned jurisdictions. The DBR exerts significant influence on the assessed nations. If the rankings display unsatisfying results, political pressure in the concerned countries often induces governments and legislators to put the inefficiencies highlighted by the exercise high on the reform agenda.

One of the areas the DBR covers is investor protection: the “Protecting investors index” (PII) aggregates scores calculated for a number of variables, which code the presence (or absence) of rules increasing shareholder protection according to the DBR methodology. More precisely, the PII measures how jurisdictions protect minority shareholders in listed companies in respect of a hypothetical transaction between a listed company and its controlling shareholder.

The DBR methodology on investor protection has triggered a lively academic debate on both theoretical and practical aspects. On the one hand, the adequacy of criteria and even the possibility to measure the efficiency of legislations have been called into question. On the other, coding mistakes have been reported for various jurisdictions. We do not enter here the discussion on the merits of benchmarking economic legislation across jurisdictions belonging to different legal traditions, nor do we scrutinize the appropriateness of the variables the PII relies upon. Rather, our limited purpose is to criticize the DBR assessment of investor protection in Italy as the outcome of exceedingly formalistic evaluations. We also show that previous misunderstandings of the relevant laws led to underestimate more recent progresses of the Italian legislation, so that the historical performances reported in the DBR with a view to showing the historical evolution of the legal framework give the false impression that no advancement was made over the last years.

Although we concentrate on coding mistakes, our analysis has broader implications. Our basic point is that in both the design and the measurement of the

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1 Similar benchmarking exercises are performed in the EU, especially in the field of labour and social law, under the so-called “Open Method of Coordination”: see e.g. REGENT (2003).
variables composing the evaluation grid a functional rather than a formal approach should be adopted. When the relevant legal regime ensures the same result the DBR envisages, although via a different legal device, then the assigned score should reflect the equivalent level of investor protection. This may require greater flexibility already in the definition of variables. Further, we stress that, when assessing the rules applicable to investor protection in any given jurisdiction, attention should be paid to the broader national legal framework. The outcome of effective investor protection may indeed be better ensured by rules that, although not matching the relevant criterion at first sight, bring about different effects if considered as part of a broader legal context rather than in isolation.

After describing the DBR methodology (part 2), the paper summarizes the ongoing academic debate on the positive and negative aspects of the DBR assessments (part 3). The main provisions of the Italian framework on related party transactions (RPTs) are then sketched out (part 4) with a view to demonstrating how the DBR evaluation fails to consider that results equivalent to those provided for by the DBR criteria are ensured via different regulatory tools (part 5). We then analyse more in depth the methodological flaws underlying this miscoding so as to demonstrate how a functional approach would help obtain a more accurate assessment (part 6). The impact of the miscoding are then quantified in order to show how the DBR’s inaccuracies may create perverse incentives by reducing countries’ willingness to enact effective legislation and by inducing window-dressing reforms (part 7). Part 8 concludes.

2. The Doing Business Report and the measurement of investor protection

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2 See ARMOUR et al. (2009a), at 586 and 600 (claiming that variables should be selected according their functional impact on corporate practices and proposing a set of criteria aimed to match functional variables with formal rules). See also SIEMS & DEAKIN (2010), at 124 (comparative law is functionalist, while comparative law and finance typically just verifies if one specific legal rule does or does not exist in different countries); SIEMS (2005), at 531 and 540 (while statistical evaluations typically confine themselves to verifying whether a legal provision exists in a jurisdiction, indices should include measures that contain functional equivalents in order to avoid distorted outcomes).

3 See more generally ARRÜNADA (2009), at 571 (noting that “measuring institutions in countries with different legal traditions requires appreciating that different legal structures suit different contexts”). See also ARMOUR et al. (2009a), at 596 (a particular institution, even if suboptimal in isolation, should be retained when its removal would exert adverse effects on other complementary institutions).
Since 2004, the International Finance Corporation – a member of the World Bank Group – has been assessing the quality of economic legislations across the globe with a view to comparing the relative ease of running a business activity in each jurisdiction. Its results are published on a yearly basis in the Doing Business Report (DBR), which shows how the assessed countries are performing under the common criteria and provides information on their year-to-year performance, so as to highlight improvements in their respective regulatory frameworks.

The DBR results are reported in a single global index (“Ease of doing business”) and in sectorial rankings addressing specific aspects of business activity. Among these partial rankings, the “Protecting investors index” (PII) was first introduced in 2005 in order to assess how effectively minority shareholders’ interests are protected against expropriation via conflict-of-interest transactions. The underlying rationale is that economic development is favoured where property rights (in this case, investors’ entitlements) are clearly defined ex ante and effectively enforced ex post.\(^4\) The assumption is hardly questionable,\(^5\) although causation\(^6\) (and even correlation\(^7\)) between the quality of legislation in force and financial markets development is still an open issue.

In order to assess the protection against directors’ misuse of corporate assets, the PII aggregates data on the relevant legislation according to a standardised set of criteria.\(^8\) Relevant provisions in every jurisdiction are evaluated and scored under three sub-indexes, respectively measuring disclosure


\(^5\) See IEG (2008), at 3 (providing a literature review on the connection between the quality of business regulatory environment and economic development).

\(^6\) COFFEE (2001), at 59-66 (in many instances, stock market developed before legislation aimed at protecting minority shareholders was introduced); CHEFFINS (2010), at 35-40 (UK law traditionally offered scant protection to investors, in spite of financial market development).

\(^7\) ARMOUR et al. (2009), at 364-8 (finding no positive correlation between financial market development and shareholder protection, and supposing that this might be due to incentives to delist in case regulatory burdens become excessive).

\(^8\) Since its first publication in September 2003, the DBR has rested upon methodologies inspired by the well-known scientific studies by Andrei Shleifer and his co-authors. See initially IFC (2003), at vii. For PII see IFC (2004), at 85 (referring to LA PORTA et al. (1998), where a first set of criteria – “anti-director rights index” – was proposed with a view to testing possible correlations between the quality of company and securities law, on the one hand, and ownership concentration in listed companies, on the other hand; id., at 1150)). See subsequently IFC (2009), at 42, where reference is made to DJANKOV et al. (2008) (defining a new and more detailed grid – “self-dealing index”). For further details on similar studies underpinning other indices within the DBR see DAVIS & KRUSE (2007), at 1101. Reliance on academics or outsourcers in the production of indicators is no exception: DAVIS et al. (2012), at 13.
required for RPTs ("Extent of disclosure" index), directors’ liability ("Extent of
director liability" index), and shareholders’ standing to sue ("Ease of shareholder
suit" index). The PII is the average of the three sub-indexes.

Variables register, inter alia, what corporate body is entitled to approve the
transaction, how detailed and extensive is the information available to such a body
before it makes a decision and subsequently provided to the public at large.
Enforcement-related features are also taken into account, such as the possibility
for shareholders representing less than 10% of the outstanding capital to directly
or derivatively suit as well as directors’ liability for damages and the availability
of disgorgement of profits. Access to evidence through discovery is part of the set
of criteria too.

The variables are measured against a hypothetical transaction, identical for
all jurisdictions. The involved company – "Buyer," a manufacturing firm listed on
the most important stock exchange of the concerned country – purchases a truck
fleet from another company ("Seller"). Mr James, holding a 60% stake of the
outstanding capital, is Buyer’s controlling shareholder and a member of the board
of directors. He also owns 90% of Seller. In the transaction, which falls within the
scope of Buyer’s ordinary course of business, the fleet value equals 10% of
Buyer’s assets and its price is set above market value. It is also assumed that all
the “required approvals” for the transaction are obtained and that disclosure is
made, so that no fraud has occurred. In this scenario, Buyer incurs damag
shareholders decide to sue Mr James and those who are involved in the
transaction.

The evaluation team first finds out which rules apply in the various
jurisdictions to such a transaction. Depending on the availability of the legal
devices, scores are assigned so as to reflect the assumption that the higher the
number of regulatory tools for protection against tunneling, the stronger the
protection for investors.

3. The DBR: Impact on national reform agendas and criticisms

In line with the declared purpose of stimulating reforms on the assumption
that an efficient regulatory environment is pivotal in fostering economic growth,
the influence of the DBR on national policy debates is remarkable.9 On the one

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9 IEG (2008) at 44-6 (DBR fosters national debate on legislative reforms, although its role as a
guide for policy priority is weak because it often focuses only on specialized aspects of larger
problems and disregards national contexts). See also INDEPENDENT PANEL (2013), at 19 (many
hand, some countries have passed legal reforms with the explicit purpose of matching the criteria set by the DBR’s evaluation grid. On the other hand, academics and politicians from other jurisdictions have harshly opposed the assessment method and its results, the widespread criticism also testifying to the significance of the DBR.

The reasons for such significance are manifold. For developing countries, lending programs managed by the World Bank may depend on the results of the DBR evaluation, which is regarded as a proxy of the aided country’s willingness to improve its economic performance to the advantage of citizens’ living standards. For developed economies, unsatisfactory rankings exert political pressure on governments, given their “name and shame” effect, which is often magnified by the extensive press coverage on the DBR. Key in this respect is that the DBR, as opposed to other evaluation studies measuring national performances in different sectors, displays the results of benchmarking by ordering all the jurisdictions in rankings, thus creating the perception of a competition among them. Such rankings satisfy the need for easy-to-use information because they exert great symbolic power and, disregarding the technicalities that characterise local legislation, are easy to understand for the public at large.

While DBR’s echo has been significant since its first publication, a number of legal academics have harshly questioned its methodology and results.

institutions refer to the DBR without considering its inherent limitations. See also MICHAELOFS (2009), at 772 (listing the factors making the DBR appealing and assessing DBR’s impact). See e.g. MCLESH & ARIZTI (2006), at 110 (reporting how Jordan, Korea, Mozambique, Nicaragua, Serbia and Montenegro have used the DBR as a reform driver). For France see DU MARAIS (2006).

12 See IEG (2008), at 41 (communication strategy is one of the determinants of DBR’s success but may sometimes mislead users, for example with regard to assertions of causations when only correlation is demonstrated).

13 For e.g. CEPEJ (2012) (on the evaluation of domestic judicial systems).

14 Rankings, as opposed to ratings, may give the impression that no reform is made to the extent that numerous jurisdictions are improving at the same time, and may hide the degree of variation between countries (IRWIN (2013), at 4-5). See also IEG (2008), at xvi (“changes in a country’s ranking depend importantly on where it sits on the distribution; small changes can produce large ranking jumps, and vice versa. These factors contribute to anomalies in rankings”); INDEPENDENT PANEL (2013), at 2 and 20-2 (which, while suggesting maintenance of country rankings, admits that cardinal scores – already provided by the DBR with the “Distance to Frontier” metrics – are more informative; for subsequent developments see infra, text accompanying fn. 18 and 29).

15 SIEMS (2005), at 534 (numerical analysis satisfies the need to reduce complexity in order to increase the practical role of comparative law).

16 See MICHAELOFS (2011), at 31 (reductionist quality of rankings is an advantage for their marketability).

17 The Doing Business indicators are frequently mentioned among the most important indexing exercises; see e.g. DAVIS et al. (2012), at 3.
Criticisms have addressed both the selection of the standards according to which the ease of carrying out an economic activity should be assessed and the process for evaluating actual compliance with those standards. Remarks concerning the selection of standards often address the very possibility of measuring the legislation applicable in different jurisdictions against a single yardstick, thus avowedly18 following a “one-size-fits-all” approach.19 What is best – so the criticism goes – may instead vary from country to country, depending on the legal, political, and social context.20 First, interaction with rules left outside the scope of the assessment may limit, and perhaps even revert, the positive effects of rules that the DBR methodology considers in isolation. Second, good law on the books does not mean good law in action, the latter depending on formal and informal enforcement devices. However, the DBR notoriously disregards enforcement practices.21 Further, in as much as the set of variables may be properly construed, some degree of subjectivity is unavoidable when it comes to weighing each of the criteria and, therefore, in determining the final rankings.22

Doubts are also cast on the ability of one or more specific criteria to properly measure the legal environment where entrepreneurs operate. The World Bank itself has recognised that the policy implication of its evaluation might have been questionable, and has subsequently amended its methodology. This was the case with the original labour law indicator. The index measuring the ease of hiring and firing workers raised widespread concerns, relying as it did on the assumption that less regulation, and therefore fewer burdens on employee dismissal, should be regarded as a proxy for higher efficiency. Critics stressed that deregulation does not necessarily mean better regulation23 and that there is no evidence that light-

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18 IFC (2003), at xxvi; INDEPENDENT PANEL (2013), at 23; but see also, as regards labour law, id., at 3 and 28, highlighting a switch towards a more nuanced approach on the “employing workers” measurement, for which the DBR has recently provided absolute data instead of rankings. Some amendments to the DBR methodology announced in April 2014 will change the approach currently followed for the remaining indexes as well. In particular, the DBR will emphasize variations in the distance between the results achieved by each country, on the one hand, and the performance of the most efficient jurisdiction, on the other hand. This should help point out more clearly improvements that, while changing the distance between competitors, are not sufficient to ensure a better ranking (IFC (2014a), at 1).
19 For a review see PACCES (2011), at 303-7.
21 See IEG (2008), at xv-xvi and xxiv (DB indicators primarily measure laws and regulations as they are written, but the relevance of each indicator depends on actual implementation of the law, which DB does not aim to measure).
22 For a similar consideration with reference to corporate governance indices see BHAGAT et al. (2008), at 1825 (market participants may have divergent preferences when weighting governance features, and some variables may be substitutes for others).
23 Every selection of variables inevitably reflects underlying ideological assumptions on the role of regulation and its effects on society (DAVIS et al. (2012), at 9).
touch labour law improves economic performance or creates more jobs. Such remarks led to an amendment of the methodology for labour law, now included in the new “employing workers” indicator, and to its exclusion from the indexes composing the “Ease of doing business”.

Other criticisms have addressed the “Ease of starting a business” and the PII itself, and have consequently involved the global “Ease of doing business” indicator because this latter inevitably reflects – or even magnifies – improper definitions of sub-indexes. Some scholars have proposed assessment criteria for shareholder protection alternative to the PII in the attempt to have a more accurate grasp of the comparative advantages of different jurisdictions. Further changes in the DBR methodology, announced in April 2014, will tackle some of these critiques with a view to improving the completeness of the exercise and to allowing a more careful consideration of its results, although the evaluation grid will inevitably remain exposed to objections by scholars having different opinions on the relative importance attached of different legal rules.

Irrespective of the theoretical debate, the accuracy of DBR assessments has also been challenged, however. The exercise relies on imaginary transactions – such as the one involving Buyer and Seller, sketched in Part 2 – that are devised to test how the law would operate in their respect. Data on the

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24 See e.g. BERG & CAZES (2008), at 350 and 355-60.
25 See BAKVIS (2009), at 434; IFC (2013a), at 2.
26 See ARRUÑADA (2007) (DBR methodology, which assigns a better score to jurisdictions where procedural requirements such as preregistration and registration are cheaper and less time-consuming, underestimates the costs of reduced legal certainty); for a reply, see DJANKOV (2008). See also ARRUÑADA (2009) for a counter-reply.
27 See INDEPENDENT PANEL (2013), at 4 (noting that there is no strong justification for simple averaging across indicators to produce the Ease of doing business index and suggesting its removal).
28 An alternative shareholder protection index is proposed by LELE & SIEMS (2007). On the same index see also SIEMS & DEAKIN (2010), at 128-35; CENTRE FOR BUSINESS RESEARCH (2009).
29 The PII will be renamed “protecting minority investors” index and will cover an extended set of rules. For instance, attention will be paid to shareholders rights, including pre-emption on newly-issue shares and the presence of a mandatory bid rule, as well as to rules concerning decisions that have to be submitted to the general meeting, such as issuance of new shares. Furthermore, the assessment will address the composition of the board of directors as regards the presence of non-executive or independent members and the separation of the chairperson and the CEO (IFC (2014a), at 3; IFC (2014b).
30 See e.g. DAVIS & KRUSE (2007), at 1104-7, 1111, and 1115 (concluding that shortcomings in the DBR assessments make the report too unsound to be used as the basis for across-the-board legal reforms).
31 This approach has also been criticized by some scholars, in whose opinion the selection of a hypothetical scenario by economists from the US is very likely to reflect the specific characteristics of common law jurisdictions, thus biasing the subsequent comparison with civil law jurisdictions (MICHAELS (2009), at 786). See also SIEMS & DEAKIN (2010), cit., at 125 (as the Law and Finance stream of research is mainly based on US securities law, it can be regarded as a
rules applicable to such hypothetical scenarios are gathered through questionnaires submitted to local experts and subsequently discussed with the World Bank team in charge of the evaluation. That procedure has not always proved reliable. For instance, Italy’s PII score was also affected by mistakes that the DBR itself has later recognized as such.

4. The Italian Framework on related party transactions

The Regulation on Related Party Transactions (hereinafter, “the RPT Regulation” or “the Regulation”) sets out the rules and principles Italian listed companies have to comply with in order to ensure that transactions with related parties are adequately disclosed to the market and fulfil minimum standards of substantial and procedural fairness. The Regulation, approved by Consob – the Italian Securities and Exchange Commission – in 2010 and fully enacted in 2011, contains a set of detailed rules, but it leaves room for some optional choices.

“hidden benchmarking” which measures the vicinity to the US model; INDEPENDENT PANEL (2013), 16 (the selection of the hypothetical scenarios used to test the variables may be prone to home biases). DBR criteria’s appropriateness was however questioned from a US perspective as well (PACCES (2011), at 303).

For a description see IEG (2008), at 13-9; DAVIS & KRUSE (2007), at 1099-100.

Numerous mistakes afflicting the first DBR on France were pointed out in the fracas raised by the French legal and political community (see fn. 11; see also DU MARAIS (2006), at 45 (binary codes do not fit with instances where more than two options are available under national law)) and were therefore fixed in the subsequent editions (KERHUEL & FAUVARQUE-COSSON (2009), at 815-6). Mistakes affecting other countries in the measurement of the “Ease of starting a business” index are reported by ARRUÑADA (2007), at 743-4, and ARRUÑADA (2009), at 559. See also HOYLAND et al. (2012), at 8 (measuring the uncertainty affecting DBR evaluations). Mistakes have similarly been highlighted in LA PORTA et al. (1998) (see supra, fn. 8); see SPAMANN (2010) (finding that data reported for 33 out of the 46 surveyed countries were affected by coding errors, the correction of which falsifies the claim of the original study that common law outperforms civil law in terms of investor protection).

The “Ease of shareholder suits” index includes a variable that measures the level of proof required for civil lawsuits. If this is lower than the burden of proof applicable to criminal cases, then the jurisdiction gets one point. Up to the 2012 Report, the variable scored 0 (see the Country Table for Italy as of 2012). However, the correct indicator should have been 1 because under Italy’s rules criminal liability requires proof of intentionality while civil liability is based on negligence, which is easier to prove. The mistake was fixed as from the 2013 report. As that variation did not reflect any law reform, the 2013 and 2014 Reports properly report no change over time in this respect (see IFC (2014c), at 60). The same holds true for other rankings, which were consequently amended in retrospect (id., at 57). Similar retroactive corrections are not exceptional: see IEG (2008), at 17. See also DU MARAIS (2006), at 40 and 54 (questions on the standard of evidence in the PII are framed according to common law legal tradition and might make little sense for civil law countries, thus leading to coding errors).

See Art. 2 RPT Regulation (Consob Decision No. 17221 of 12 March 2010, as amended; O.J. No. 152 of 2 July 2010). We provide here an overview of the rules applicable to Buyer’s transaction with Mr. James. For a more comprehensive description of the Regulation see BIANCHI et al. (2010), at 10-13; OECD (2012), at 115-6.

See BIANCHI et al. (2010), at 13 (identifying the most relevant optional provisions).
Because the DBR only considers default provisions for its exercise, with few exceptions we limit our description to rules applying to the PII hypothetical transaction by default.

The Regulation prescribes that the board as a whole shall be in charge of deciding whether the RPT is to be entered into, so that no delegation of powers to the executives is allowed in this respect.\(^{37}\) Before such a decision is made, however, a special committee – composed exclusively of unrelated\(^{38}\) independent\(^{39}\) directors – shall evaluate the substantial fairness of the affair as well as the company’s interest in entering into the transaction. The special committee has to be involved in the negotiations and internal decision-making process leading to the RPT approval. Not only is it entitled to receive timely information on the ongoing negotiations, but it may also request clarifications on specific issues and provide comments to the executives throughout the process.\(^{40}\) The committee may also ask for the advice of independent experts of its own choice, the company bearing the related costs.\(^{41}\)

The special committee has a veto power over the transaction, in the form of a binding advice thereon. Alternatively, an express charter provision may opt out of the special committee voting requirement in favour of a double-majority quorum for board approval, so that the transaction may not be entered into unless the majority of the independent board members have approved it.\(^{42}\) The Regulation,\(^{43}\) however, allows companies to overcome the independent directors’ binding negative advice – under the form of either a committee resolution or a double-majority quorum – through an ad hoc authorization by the shareholders’ general meeting.\(^{44}\) When the company opts for this opportunity, the applicable

\(^{37}\) Art. 8(1)(a), RPT Regulation.

\(^{38}\) For the purposes of the Regulation, directors are “unrelated” if they are neither the counterpart of the relevant transaction nor a related party thereof.

\(^{39}\) Directors are deemed independent if they comply with the requirements set by the applicable corporate governance code. If the company does not conform to any code, then some default requirements apply (Art. 3(1)(h), RPT Regulation).

\(^{40}\) Art. 8(1)(b), RPT Regulation. Early involvement of independent directors enhances the quality of their review and improves the general rule requiring disclosure of conflicts of interests to the whole board when the final decision on the transaction is taken (art. 2391 Civil Code). The procedure therefore goes beyond the DBR methodology, where compliance with the general rule suffices to receive the maximum score (2) for the variable “whether disclosure of the conflict of interest by Mr James to the board of directors is required” (one point is given if a general disclosure that a conflict exists is mandated without any further specification, and no point otherwise).

\(^{41}\) Companies may cap the total expenses for opinions concerning transactions of lesser importance.

\(^{42}\) Art. 8(1)(c), RPT Regulation.

\(^{43}\) Art. 8(2), RPT Regulation.

\(^{44}\) In April 2014, the EU Commission adopted a proposal to introduce an EU-wide legislation on related party transactions. According to the proposal, shareholder approval shall be mandated
procedures shall ensure that the proposed transaction can only be entered into if, besides reaching the ordinary quorum, it is approved by a majority of unrelated shareholders (so-called “whitewash” procedure), so that the transaction cannot be entered into if the majority of minority has voted against the transaction.

When it comes to disclosure, specific provisions in the Regulation add on the general rules on ad hoc dissemination of inside information by requiring that information be given, inter alia, on the qualification of the transaction as RPT, on the nature of the relationship with the related party (to be identified), on the amount of the transaction, on the procedure followed for approval, and on dissenting opinions – if any – within the board or the special committee.

Irrespective of the qualification of the RPT as inside information, detailed information must be published within seven days of approval by the competent body of the transaction or, as the case may be, of the contractual proposal. Such information is provided in accordance with a standardised format set by the Regulation that mandates disclosure of the terms of the transaction – including, inter alia, specification of the company’s interest in the operation and description of the criteria adopted to define the consideration paid – and of the conflicting interests, including indirect interests, such as in the case where managers’ compensation is influenced by the performance of the RPT.

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45 Art. 11(3), RPT Regulation. Companies’ code and bylaws are allowed to establish that a minimum threshold, not higher than 10%, must be present at the GM in order to make the whitewash effective.

46 The majority of the minority approval mechanism neutralizes the effects of the provision failing to impose abstention from voting on conflicted shareholders (Art. 2373 Civil Code).

47 According to Art. 114 and 181 of the Consolidated Law on Finance, enacting Art. 6 of directive 2003/6/EC, companies shall immediately disclose inside information concerning transactions that, if made public, would be likely to have a significant effect on the price of their shares. In the DBR’s methodology, no reference is made to how the transaction relates to ad hoc disclosure duties, possibly also because no such duties exist under US law. Any evaluation on whether such a transaction involves price sensitive information will be highly discretioneral, although the size of the consideration paid for the truck fleet is very likely to make dissemination necessary. Because the DBR treats Germany as a jurisdiction imposing immediate, detailed disclosure of Mr. James’s transaction (see IFC (2014d), at 64, where a scoring of 1 is assigned because the applicable rules require disclosure of the transaction, but not of Mr. James’s interest), and such a conclusion can only be based on the ad hoc disclosure duties deriving from EU law (in the absence of specific disclosure duties relating to RPTs under German law), we will similarly assume in the following that Mr. James’s transaction would trigger ad hoc disclosure duties in Italy as well.

48 Art. 6 RPT Regulation; see also Art. 6(7) directive 2003/6/EC.

49 The questionnaire used to gather the relevant data only refers to information disseminated within 72 hours after the transaction is approved (IFC (2013b), at 5).

50 See Art. 5 and Annex 4, RPT Regulation.
Finally, annual and interim reports must provide information on individual major RPTs.51

5. Measuring investor protection in Italy after the Regulation

According to the 2014 DBR, Italy does not reach the highest score in a number of sub-indexes (10 out of 18) within the PII. Furthermore, the DBR does not report, in its section displaying historical performances, any variation in the applicable rules during the last years. Neither approval of the RPT Regulation (in 2010) nor its entry into force (in 2011) are coded as relevant regulatory reforms for investor protection. Most of the scorings assigned adequately reflect Italy’s current and previous legal and regulatory environment, while others do not.

Coding mistakes may affect the assessment of a jurisdiction either because they under- or overestimate the current level of investor protection or because they misrepresent the evolution of the applicable rules, as is the case, for instance, when past overrated scorings hamper the registration of subsequent improvements. The reasons why some of the scores assigned to Italy inaccurately reflect the national legal framework, either for the present or for the past, are manifold. In some cases, the scoring may simply be the result of a basic misunderstanding of the Italian legislation; in others, miscoding may stem from a formalistic interpretation – rather than a functional one – of either the applicable rules or the DB methodology itself. As a result, according to the DBRs, the Italian legal system has made no progress in recent years, and, correspondingly, no noteworthy reform is reported to have been passed in 2010 or enacted in 2011.52 As we show below, these results fail to account for Italy’s improved legal regime following enactment of the RPT Regulation,53 in spite of DBR team’s statement that “a rigorous reform effort will certainly be reflected in the DB indicators,”54 irrespective of whether it is intended to improve on DBR rankings.

We analyse mistakes that affected past assessments, hence providing wrong information on the jurisdiction’s development, in part 7. In this part, we highlight one inaccuracy that miscodes the legislation in force. In particular, the DBR is flawed in that it fails to properly account for the function performed by the review of RPTs by independent directors and the ensuing veto power over unfair deals. We believe that the enhanced role of independent board members

51 Art. 5, RPT Regulation.
52 IFC (2012a), at 61-3. See also Figure 1 below.
53 See OECD (2012), at 117 (“Italy has made considerable progress in recent years to promote and defend shareholder rights and to improve transparency”).
54 IFC (2012b), at 3.
brought substantial change to Italian corporate practices: there is evidence that active shareholders can take advantage of the Regulation to successfully challenge RPTs, showing that the new legal devices aimed to protect minorities are not just cosmetic.

While we acknowledge that one mistake is tolerable in assessing a country’s legal protections for minority shareholders, we focus on it for three main reasons. First, its impact on Italy’s PII ranking is not negligible, as it accounts for 18 positions in the last DBR. Second, it affects one of the core regulatory devices the RPT Regulation relies upon in ensuring that conflicted transactions are entered into at fair conditions; the DBR’s misunderstanding of the Italian jurisdiction is therefore much larger than showed by the skewed ranking. Third, this coding mistake is revealing of the challenges the DBR exercise faces in balancing objectivity, on the one hand, and the need to meaningfully account for peculiar solutions by individual jurisdictions, on the other hand.

Indeed, some of the procedural requirements in the RPT Regulation are admittedly rather unique, so that it may be difficult to precisely fit them within the strictures of the inevitably standardized model legal framework that the DBR exercise is implicitly based on.

That is the case with the special committee’s binding advice on the RPT. The PII variable at stake is the one relating to the corporate body providing legally sufficient approval for the transaction. The evaluation grid assigns a score of zero if the CEO alone can approve the RPT; one point is given if the board of directors or shareholders must vote but Mr James is permitted to vote in his quality of board member or shareholder respectively; a score of two is assigned if the board approval is needed and Mr James is not permitted to vote; finally, a maximum score of three is granted if shareholders must vote on the transaction and Mr James must abstain.

According to the DB team in charge of evaluating Italy, “[RPTs] are pre-approved by the independent directors’ committee and approved by the board of directors. In addition, the new regulation allows the participation of the interested party in the approval process (board of directors). In addition, according to the new regulations, regardless of the committee’s opinion, the board of directors (in which the interested party can vote) has the final say on the transaction. It is important to note that according to the new regulations, the committee of independent directors does not have the power to block or veto related-party

55 See BELCREDI & ENRIQUES (2014), at 27-8 (reporting successful initiatives by Amber Capital LP at companies such as Fondiaria SAI and Parmalat).
56 See Table 6 below.
transactions. Based on the methodology, Italy receives one point under this questions.”

Hence, a score of 1 is assigned to Italy in this regard.

The reported statement is inaccurate in describing the RPT Regulation and shows some misunderstandings on the functioning of its procedural safeguards. As clarified in part 4, the new regulation relies on the review of RPTs by a special committee of independent directors and their veto power thereon as the primary tool for ensuring minority shareholder protection.

More precisely, independent directors are involved in the negotiation and the board of directors approves the RPT subject to a binding favourable advice from a committee of independent directors. In other words, the committee of independent directors does have a veto power on RPTs like Buyer’s.

The requirement for independent committee’s binding opinion neutralizes the disgraceful choice by Italian lawmakers in 2003 not to disqualify interested directors from voting. It does so, because interested directors cannot be pivotal, as they cannot be members of the special committee holding the veto power.

To conclude, under the default regime, a negative advice from the independent directors committee does block the RPT. In such a default situation, therefore, the appropriate score should be 2, instead of 1 (the score assigned to Italy in this regard). As the coding we would deem appropriate at first sight does not correspond to that displayed by the DBR, in the next part we analyse more in depth the reasoning underpinning the DBR judgement and provide a critique thereto.

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58 The committee’s binding advice is the default rule, but a double-majority quorum is required for opting-out companies (see text accompanying fn. 42).
59 Art. 2391, Civil Code (It.). To be sure, if the majority is reached and the interested director’s vote is pivotal, the board resolution (as well as the RPT) is voidable in case it is harmful for the company.
60 Nor can they count for independent directors’ majority purposes in case companies have opted out of the default rule providing for the special committee’s veto power. See supra note 58.
61 To be sure, companies may opt out of the said regime via a charter amendment (to be approved by shareholders holding a two thirds majority of the capital represented at the meeting, according to the general rule: Articles 2368 and 2369 Civil Code), so that the independent committee does not have the final say on the RPT; but, whenever companies opt out this way, the power to approve the RPT is shifted to the general meeting upon the favourable vote of non-interested shareholders. If the optional regime is chosen, therefore, 3 should be the correct score. We leave this hypothesis out of the picture in the following, because the DBR focuses on default rules. If the pending EU Commission’s proposal mandating shareholder approval is eventually to become law (see supra, fn. 44), Italy – as any other EU jurisdiction – will get 3 points for this variable.
6. The DBR evaluation. Methodological issues

The DB team’s explanations\textsuperscript{62} show that the reason why the DBR assigns 1 to Italy in spite of the independent directors’ veto power is twofold:

1. The committee approval is regarded as an obtained “required approval” under the case study assumptions (see part 2). Hence, the independent committee does not have the final say on the RPT because, in case of a positive opinion (which is assumed), the approval is left to the board as a whole.

2. Interested parties may vote when they are called to participate in the final board approval.

Both points are formally correct, but none of them really grasps the regulatory mechanism underlying the Italian rules on RPTs. Suffice it to say that, according to the methodology as applied by the team, no difference would exist between the current Italian regime and one where the RPT is approved by the board with an ordinary voting procedure giving no special role to its independent members. That is misleading because the two mechanisms – ordinary voting procedure and independent committee’s veto – are unlikely to lead to the same outcome. Of course, clear-cut categorizations always bear the risk that regulations like the Italian one – which is admittedly peculiar – do not perfectly match with any of the classifications provided by the methodology. However, approaching law from a functional perspective would seem to be more sensible than engaging in a box-ticking exercise.

As regards the first statement above (the independent committee does not have the final say), what matters from a functional point of view is who bears the final responsibility to screen the RPTs, rather than who has the final say on their positive approval. The two functions are usually commingled because, by casting a single vote, directors may either approve or reject the proposal, and DB’s methodology is consequently based on such a common voting pattern. On the contrary, the procedure set forth by the RPT Regulation somehow splits the two phases so that once a negative vote is expressed by the committee of independent directors, voting by the board is ruled out. In other words, for investor protection purposes, it is indeed relevant whether someone else than Mr James and the board as a whole can say “no” to the transaction. The fact that the whole board (together with Mr James) may still decide whether to approve the transaction and act as a

\textsuperscript{62} DBR TEAM (2011b), at 2.
second, and yet, unlikely and ineffective, screen is irrelevant, because the proposed transaction has already been deemed fair and useful by a subset of independent and disinterested directors alone. Hence, the evaluation grid – or, rather, its application – improperly assume that only mandatory abstention may avoid improper influence by interested parties on the decision to be taken. Hence, the methodology regards any regulatory device deviating from this standard as inadequate, even if it actually delivers results that are (at least) equally effective.\textsuperscript{63}

In Italy, the whole board maintains the power to vote down the RPT, but if and only if the committee of independent directors has given its approval. Since committee approval is a governance device that is specifically intended to ensure independent evaluation of the RPT’s fairness in the light of the company’s interest, regarding it as any other preliminary authorization prevents the assessment exercise from taking into account any regulatory strategy other than full board voting and therefore clearly runs counter to the principle, which is self-evident in comparative law, that the same normative effect can be achieved by different means.\textsuperscript{64} To the extent that independent director approval is required in order for a resolution to pass, one wonders why the fact that the vote is taken before, and separately from, the final approval is regarded by the DBR as lessening investor protection compared to a regime in which the board approves the RPT without the dominant shareholder’s vote. It is true that any classification of legal rules requires a minimum level of formalism, as a purely functionalist interpretation would pave the way to excessive subjectivity in the coding exercise,\textsuperscript{65} but taking positive approval by independent board members for granted, i.e. regarding it as an irrelevant step in the voting process, is no less a subjective and questionable interpretation than considering it the first step of a multi-staged decision.

\textsuperscript{63} Cf. SIEMS (2011), at 120-1 (Djankov et al. methodology assumes that the same type of problem exists in all the jurisdictions considered, while this is far from obvious).

\textsuperscript{64} More broadly, the DBR team’s thinking (as we understand it) is a distortion of the assumption that all required approvals have been obtained (the same assumption is made by DJANKOV et al. (2008), at 432). The assumption enables an unambiguous assessment of criteria such as those included in the director liability index (e.g., whether a shareholder plaintiff is able to hold Mr James liable for the damage the Buyer-Seller transaction causes to the company). The coding of these variables depends in fact on whether the transaction is carried out in breach of the applicable corporate rules, a possibility that the methodology rules out by making the assumption explicit. This being its function, the assumption includes the final approval by the CEO, the board, or shareholders, as the case may be (see DJANKOV et al. (2008), at 433: “Buyers enters into the transaction. All required approvals are obtained and all the required disclosures made”). The same prerequisite does not make much sense if referred to variables dealing with the procedure for approving the RPT, as it includes the variable to be measured (the final decision-making responsibility) in the assumptions.

\textsuperscript{65} See Armour et al. (2009a), at 600-1 (suggesting to enlarge the set of relevant variables in order to reduce the risk that formalism prevails over functionalism).
Moreover, although the special committee vote is the default device according to the RPT Regulation, it may be opted-out in favour of a double-majority quorum for board approval. This is telling in two respects. First, no functional difference exists between a system where the two decisions – one by the plenum and another by the majority of the independents – are merged into one, as is the case in the optional rule, and one in which they are taken in two different moments, as is the case with the default regime. Therefore, because no one would ever regard the double majority requirement as a preliminary authorization to be assumed away, the same should hold true for any functionally equivalent regulatory device.

Second, the reason why requiring abstention by Mr James makes the regulatory environment more effective – and here we come to the fact that interested parties are allowed to vote – is that this may prevent the board from approving the resolution despite the dissenting votes by the majority of disinterested directors. Therefore, although interested directors may vote under the RPT Regulation, the preliminary independent directors’ binding advice (i.e., vote) reaches the same outcome and goes even further. Indeed, even where Mr James is not allowed to vote – and the methodology requires no more than that – he may exert a significant influence over the resolution thanks to his mere presence at the board meeting: the default device adopted by the RPT Regulation avoids this risk because conflicted directors cannot be members of the special committee. If compared with simple abstention by Mr James or other conflicted board members, the Italian procedure for deliberating RPTs ensures a higher level of protection also because, at the special committee stage, it rules out voting by directors that, while disinterested in the specific transaction, are not independent and are therefore less likely to disregard Mr James’s preferences when casting their vote.

From a methodological standpoint, it is worth noting that disregarding the role of the special committee by assuming it away as any other preliminary authorization, as the evaluation team does, is acceptable only if one adopts an extremely formalistic approach when interpreting the applicable legislation. And even in that perspective, qualifying the committee’s approval as a normal

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66 Note that the the Djankov et al. paper requires, with respect to the general meeting approval, that “the transaction must be approved by disinterested shareholders” (DJANKOV et al. (2008), at 434), not that interested shareholders are not allowed to cast their vote. This formulation of the variable – albeit referred to general meetings – better reflects the function of rules that prevent conflicting interests from determining the outcome of decisional processes. Mandatory abstention is the most straightforward, but not the only rule ensuring such a result.

67 This being the reason why the double-majority voting is conceived of as a second best solution which requires an explicit choice by the company when the internal procedures are drafted.
authorization may be questionable. Apparently, formalism is adopted with a view to ensuring that the evaluation is consistent across different jurisdictions. However, relying on formalism to ensure consistency and objectivity can lead to mistaken conclusions. First, we have shown that formal qualifications – such as classifying independent directors’ vote as a preliminary authorization rather than as part of a multi-staged board decision – are themselves arbitrary: arbitrariness and objectivity are hard to match. Second, by focussing on the qualification of procedural steps rather than on the role they perform, current coding practices risk disregarding essential corporate governance features and misjudging the rules’ effectiveness in terms of investor protection.

On the contrary, our analysis confirms that a functional approach would make the DBR assessment more accurate, on the assumption – which is not debated here – that the trust in benchmarking exercises as an instrument for fostering adequate legal reforms is well-placed. A comparative law study, if properly conducted, would indeed refrain from easily stating that a jurisdiction lacks a specific legal tool just because the formal rule which is sought for cannot be found. Rather, it would strive to look for alternative rules that, although formally different from the yardstick adopted as a basis for comparison, perform the same role. Other legal tools are at least as effective as mandatory abstention from voting in blocking a detrimental RPT, because they operate before the transaction is brought to the plenary session of the board and, at the same time, do

68 The approach followed by the DBR team when evaluating the Italian jurisdiction is not isolated. A similar (and symmetric) example is the maximum score (3; see supra, fn. 61) granted to France as a consequence of the provision (art. L225-40 Code de commerce) that enables shareholders to vote on RPTs authorized by the board of directors (IFC (2014e), at 65). First, the evaluation apparently disregards the fact that shareholder approval is required after the contract is entered into, and therefore does not represent a precondition for the transaction to be passed (see COZIAN et al. (2012), at 352; see also ENRIQUES et al. (2009), at 168). Second, the transaction is valid even in case shareholder approval is refused (OECD, Related Party Transactions, cit., at 64), although the directors who approved it may be liable for damages (Art. L225-41 and L225-42 code de commerce; LE CANNU & DONDERO (2013), at 500).

69 See e.g. ZWEIGERT & KÖTZ (1998), at 32-47.

70 See MICHAELS (2009); MICHAELS (2011) (suggesting stronger integration between comparative economics and comparative law); KERHUEL & FAUVARQUE-COSSON (2009), at 828 (same). See also MÉNARD & DU MARAIS (2008), at 76-7 (DBR neglects basic rules for an effective comparative study).

71 We do not therefore enter the discussion on the nature and the merits of functionalism, a concept whose implications for comparative law are still highly debated (for an overview MICHAELS (2008). Rather, it is the DBR’s approach itself that compares different jurisdictions with the purpose of evaluating their relative efficiency (see id., at 373-6); a proper application of the functional method, as opposed to formalism, would be more consistent with the DBR’s assumptions.

72 REITZ (1998), at 621 (on comparative law methodology).

73 REITZ (1998), at 623 (each jurisdiction may conform in different ways to the ideal legal tool adopted as a term of comparison).
not depend on (non-conflicted but) non-independent members’ vote. Since these other tools may perform better than conflicted members’ abstention with no additional costs, the evaluation should reflect this state of facts. According to Konrad Zweigert and Hein Kötz,

“[t]he question to which any comparative study is devoted must be posed in purely functional terms; the problem must be stated without any reference to the concepts of one’s own legal system. Thus instead of asking, ‘What formal requirements are there for sales contracts in foreign law?’ it is better to ask, ‘How does foreign law protect parties from surprise, or from being held to an agreement not seriously intended?’”

Comparative legal studies therefore necessarily entail some degree of generalisation, as the search for rules performing equivalent functions requires that formal definitions are abandoned in favour of broader categories capable of including different rules achieving the same normative result. By inspecting which formalities are required to approve the conflicted transaction, the DBR methodology assumes that board approval without Mr James’s vote is the second most effective governance device (after minority shareholder approval) in ensuring fairness. However, it falls short of asking the correct question: “does the relevant jurisdiction protect external investors by shielding the approval of the transaction from Mr James’s conflicted interest, i.e. by ensuring that the transaction is not passed if disinterested board members do not agree?” This question emphasize the result of the legal tool (sterilization of Mr James’s interests in board decision), rather than the formal features thereof (Mr James’s abstention, double majority, preliminary vote by disinterested members, or other devices).

7. The impact of miscoding

It is mainly in the dynamic evolution of applicable legislation that one can see how indicators deploy their influence on national policies. The DBR provides a diachronic perspective on legal reforms because year-on-year changes highlight whether a country is committed to improve its regulatory environment. Flat performances or lost ground in the rankings may indicate that policymakers are not paying attention to areas of law that are key to boosting economic

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74 ZWEIGERT & KÖTZ (1998), at 34.
75 REITZ (1998), at 625 (“comparative analysis […] forces the comparatist to articulate broader categories to accommodate terms that are […] functional equivalents”).
76 DAVIS et al. (2012), at 11 (on indicators as “technologies” of governance).
77 Historical data are also useful to test the relative attractiveness of a country over time, thus removing the influence of transient conditions on rankings (see ARMOUR et al. (2009b), at 350-3).
growth.78 The DBR’s focus on trends in regulatory reforms therefore provides interested stakeholders with valuable information, as it allows comparisons (not only among different countries, but also) among different evolutionary stages within the same jurisdiction.

In this respect, assigning an erroneously high score to a country in a certain year may paradoxically entail an underestimation of subsequent reforms, thus conveying the wrong idea that there has been no evolution in a jurisdiction even in circumstances where substantial improvements have been achieved. Once more, Italy provides some good examples, because two variables within the PII were wrongly coded prior to the RPT Regulation’s enactment.

The first miscoding was about whether self-dealing transactions such as the one hypothesized in the DBR had to be disclosed in the annual accounts: the DBRs preceding 2012 assigned a 2 score (that is: “disclosure on both the terms and Mr James’s conflict of interest is required”). This means that respondents to the questionnaire had stated that the transaction should indeed have been disclosed in detail in annual accounts.80 However, while before the RPT Regulation 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, the provision was predominantly held not to require detailed disclosure of individual self-dealing transactions,81 and such has been companies’ consistent accounting practice even after implementation of IFRS.82 It is only with the RPT regulation that a specific requirement has been introduced that the annual (as well as the half-yearly) financial reports point out and describe each individual related party transaction falling above the materiality threshold.84 Before the regulation was enacted, 0 would have been appropriate.

78 Of course, this would just be a rebuttable presumption, so to speak, because a country may be even more committed to reforms than others higher in DBR rankings, and just choose to do it “its own way.”

79 Within this variable, a score of 1 is assigned if disclosure on the terms of the transaction is mandated, but not on Mr James’s conflict of interests; 0 is assigned otherwise.

80 A similar mistake affects the Djankov et al. paper’s coding: see ENRIQUES (2009), at 503-4.


82 See IAS 24, § 18 (allowing the aggregation of related party transactions provided that a distinction among categories of transactions is given). See also OIC (2007), at 140. Companies used to aggregate related party transactions in their annual reports before the RPT Regulation entered into force (see CONSOB (2008), at 38).

83 For interim financial reports, Art. 4 directive 2007/14/EC, implementing Art. 5(4) directive 2004/109/EC (transparency directive), requires information on individual transactions that have taken place in the first six months of the financial year to the extent that they have materially affected the financial position or the performance of the enterprise during that period, as well as major developments thereof.

84 See Art. 5(8) RPT Regulation (listed companies shall provide information, in the interim and annual reports, on each material transaction entered into during the reporting period).
In the same vein, before 2012 DBRs assigned a score of 2 for the variable “Whether immediate disclosure of the transaction to the public and/or shareholders is required?” \(^{85}\). Before the RPT Regulation entered into force, a mandate for immediate disclosure of RPTs would either derive from the general rule requiring ongoing disclosure of price sensitive information \(^{86}\) or from a Consob rule requiring ad hoc disclosure for certain RPT (Art. 71-II Issuer Regulation, in place between 2001 and 2010). A transaction like Buyer’s would be very likely to fall within the scope of the ongoing disclosure obligations, \(^{87}\) so that the proper rating would have been 1 (as no disclosure of Mr James’s conflict of interest was explicitly mandated). As for Art. 71-II of Consob Issuer Regulation, the conditions to be met for an obligation to disclose to arise were so hazy that very few transactions had been made public under the rule. More specifically, only transactions jeopardizing an issuer’s financial stability or financial account’s reliability – according to issuers’ own judgment – had to be disclosed. Because no such assumption is made in the case study, one cannot assume that Mr James’s transaction had to be disclosed pursuant to Art. 71-II. By contrast, under the RPT Regulation in force since 2011, \(^{88}\) companies are required to specify, in the releases they publish when disseminating price sensitive information, that a conflict of interest exists as a consequence of the relationship with the other party of the transaction. \(^{89}\)

Once the coding corrections suggested above are considered, the misleading impression that nothing relevant has been done in recent years fades away. Table 1 and Figure 1 below display the DBR coding with the adjustments we deem appropriate. \(^{90}\)

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\(^{85}\) Within this variable, a score of 1 is assigned if disclosure on the terms of the transaction is mandated, but not on Mr James’s conflict of interests; 0 is assigned otherwise.

\(^{86}\) See supra fn. 47.

\(^{87}\) See supra fn. 47.

\(^{88}\) See Art. 6(1)(a).

\(^{89}\) Furthermore, listed companies shall issue, within seven days of the approval, an information document whose contents are set by the Regulation itself and encompass all the features of the transaction as well as a detailed disclosure of James’s interests (text accompanying fn. 49; see Art. 5(1) and (3); see also Annex 4 to the Regulation). Although such information is more detailed than that provided for under Art. 6(1)(a) (see text accompanying fn. 88), it goes far beyond what is necessary to reach a score of 2 for the variable “Whether immediate disclosure of the transaction to the public and/or shareholders is required?”. We therefore leave it aside because the questionnaire sent to local experts – although the methodology is silent on the point – focuses only on disclosure to be performed within 72 hours after the transaction is approved (see supra fn. 49).

\(^{90}\) In order to account for the overall impact of miscoding by the DBR, Table 1 and Figure 1 report all mistakes we identified, whether attributable to basic misunderstandings of the applicable rules (as explained in part 7) or to an unduly formalistic interpretation of the regulatory framework (as explained in part 6).
Table 1

<table>
<thead>
<tr>
<th>Extent of Disclosure Index (Sub-Variables)</th>
<th>2011 Adj.</th>
<th>2012 on Adj.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 What corporate body provides legally sufficient approval for the transaction?</td>
<td>1</td>
<td>2*</td>
</tr>
<tr>
<td>2 Whether disclosure of the conflict of interest by Mr James to the board of directors is required?</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>3 Whether immediate disclosure of the transaction to the public and/or shareholders is required?</td>
<td>1**</td>
<td>2</td>
</tr>
<tr>
<td>4 Whether disclosure of the transaction in published periodic filings (annual reports) is required?</td>
<td>0**</td>
<td>2</td>
</tr>
<tr>
<td>5 Whether an external body must review the terms of the transaction before it takes place?</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

** Extent of Disclosure Index

* The variable is adjusted to reflect the role of the binding opinion by the independent directors’ committee (see parts 5 and 6).

** The variables are adjusted to reflect the situation prior to the full RPT Regulation’s entry into force (January 2011), where no explicit duty to immediately disclose Mr James’s conflict of interest was provided for and no ad hoc disclosure was mandated in the annual accounts.

Figure 1

![Graphic: adjusted rankings for Italy (Extent of Disclosure Index)](image)

Graphic: adjusted rankings for Italy (Extent of Disclosure Index)
By the same token, Tables 2 to 5 and Figure 2 show that Italy would have ranked much worse in 2011 (93rd instead of 59th), and would have held a much better position in the first year in which the Regulation was to be considered (2012) (29th instead of 65th), as well as in the last available survey at the time we are writing (2014: 32nd instead of 49th).

**Table 2**

<table>
<thead>
<tr>
<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>59th</td>
<td>44th</td>
<td>93rd</td>
</tr>
<tr>
<td>Extent of disclosure index</td>
<td>7</td>
<td>7</td>
<td>4</td>
</tr>
<tr>
<td>Extent of director liability index</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Ease of shareholder suits index</td>
<td>6</td>
<td>7*</td>
<td>7</td>
</tr>
<tr>
<td>Strength of investor protection index</td>
<td>5.7</td>
<td>6</td>
<td>5</td>
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</table>

**Table 3**

<table>
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<tbody>
<tr>
<td></td>
<td>65th</td>
<td>46th</td>
<td>29th</td>
</tr>
<tr>
<td>Extent of disclosure index</td>
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<td>7</td>
<td>8</td>
</tr>
<tr>
<td>Extent of director liability index</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Ease of shareholder suits index</td>
<td>6</td>
<td>7*</td>
<td>7</td>
</tr>
<tr>
<td>Strength of investor protection index</td>
<td>5.7</td>
<td>6</td>
<td>6.3</td>
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**Table 4**

<table>
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<th>Protecting Investors (rank)</th>
<th>2013</th>
<th>2013 Adj.**</th>
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<tr>
<td></td>
<td>49th</td>
<td>32nd</td>
</tr>
<tr>
<td>Extent of disclosure index</td>
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<tr>
<td>Extent of director liability index</td>
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<td>Ease of shareholder suits index</td>
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<td>7</td>
</tr>
<tr>
<td>Strength of investor protection index</td>
<td>6</td>
<td>6.3</td>
</tr>
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</table>
Table 5

<table>
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<tr>
<th>Protecting Investors (rank)</th>
<th>2014</th>
<th>2014 Adj.**</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extent of disclosure index</td>
<td>52nd</td>
<td>34th</td>
</tr>
<tr>
<td>Extent of director liability index</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>Ease of shareholder suits index</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Strength of investor protection index</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td>6</td>
<td>6.3</td>
</tr>
</tbody>
</table>

* In Tables 2 and 3, in the “[year] Corr.” column, the variable “Ease of shareholder suits index” is 7 – instead of 6 – so as to reflect the appropriate coding of the variable “Whether the level of proof required for civil suits is lower than that of criminal cases?” as subsequently rectified by the DB team (see text accompanying fn. 34).

** In Tables 2-5, the “[year] Adj.” column displays the appropriate coding in light of our analysis.

Figure 2

Graphic: adjusted rankings for Italy (Protecting Investors Index)

Therefore, while no improvement and a relative loss in competitiveness emerge if one compares years up to 2011, on the one hand, and years since 2012, on the other, the adjusted variables highlight that Italy has actually gained 59 positions as of 2014 in comparison with 2011. Inaccuracies of the DBR are
summarised in Table 6, which measures their impact on the ranking of Italy in 2011 and 2014.

Table 6

<table>
<thead>
<tr>
<th>Investor protection Index</th>
<th>Original Ranking (1)</th>
<th>DBR Corr. Ranking (2)</th>
<th>Adj. Ranking (3)</th>
<th>Δ (3) – (1)</th>
<th>Δ (3) – (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>59 (5.7)</td>
<td>44 (6)</td>
<td>93 (5)</td>
<td>- 34</td>
<td>- 49</td>
</tr>
<tr>
<td>2014</td>
<td>n.a.</td>
<td>52 (6)</td>
<td>34 (6.3)</td>
<td>n.a.</td>
<td>+ 18</td>
</tr>
<tr>
<td>Variation (positions)</td>
<td>n.a.</td>
<td>- 8</td>
<td>+ 59</td>
<td>n.a.</td>
<td>+ 67</td>
</tr>
</tbody>
</table>

8. Conclusions: Functional approach and transparent assessment

The DBR has provided developing and developed countries with incentives to adopt more effective economic regulation, persuading policymakers that sound rules may enhance competitiveness and that cutting back on regulatory costs and redtape are ingredients for growth.\(^{91}\) Accuracy in the preparation of rankings is however essential to avoid that inadequate assessments convey distorted incentives to local reformers. Our analysis reports some coding errors that affect or have affected DBR’s assessment of Italy’s investor protection regime. Some mistakes are simply the result of erroneous readings of the applicable rules, as is the case for the scoring on the mandatory individual RPTs disclosure in the annual accounts (part 7). Others, such as the one still affecting the identification of the body providing legally sufficient approval for the transaction, are instead methodological, as they underestimate the fact that the procedural guarantees set forth by Consob RPT Regulation are, as a matter of fact, more effective than it would be by simply sticking to the relevant DBR variables on board approval (part 6).

No ranking system can be perfect, as any measurement of law is prone to simplifications that are needed to perform quantitative evaluations.\(^{92}\) However, some strategies may be adopted with a view to ameliorating the accuracy of the

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\(^{91}\) See e.g. MÉNARD & DU MARAIS (2008), at 67 (notwithstanding their imperfection, DBRs have the merit of having put high on the agenda the analysis of institutions as a key factor for understanding development and growth); IEG (2008), at 44 (same).

\(^{92}\) See SIEMS (2005), at 529.
DBR assessment, and the magnitude of the shortcomings affecting the evaluation of the Italian legal framework for RPTs transactions confirms that there is room for improving the coding process leading to the formulation of indicators. Although the DBR assessment is already aligned with some best practices for scoring exercises (e.g., publication is made of the identity of the experts providing the first set of information concerning the relevant national provisions\textsuperscript{93}), its transparency is still incomplete when it comes to justifying coding decisions that are not entirely straightforward.\textsuperscript{94}

Furthermore, an external review of the decisions made by the DBR team might enhance the reliability of the rankings, as this would reduce the risk that institutional inertia and confirmation biases affect the accuracy of the final indicators even in cases where the outcome of the process is prone to clerical, rather than methodological, errors.\textsuperscript{95}

Besides making the coding process subject to review and explaining borderline cases in the national reports, the methodology should always follow a more functional approach. Focusing on the results brought about by the rule under scrutiny, rather than on its formal features, could in fact substantially reduce the drawbacks we highlight. In particular, such an approach would bring at least two improvements. First, it would ensure that a more accurate knowledge of the societal context of different countries is obtained before rankings are attributed.\textsuperscript{96} The combination of the rules under scrutiny with other legal and economic features of the concerned jurisdictions may deliver results that the current methodology does not catch, as it relies on the analysis of a stylised set of rules and is therefore prone to simplifications needed to perform statistical analysis.\textsuperscript{97}

Second, any set of regulatory standards will unlikely include all the rules a jurisdiction can resort to with a view to protecting investors, as a complete list of such legal tools would be difficult to collect and, in any case, to handle. In this scenario, functionalism can improve the quality of the assessment by avoiding the risk of circularity to which formalism is prone, as this latter relies on the assumption that only a specific set of legal devices can provide effective investor

\textsuperscript{93} Other organizations providing indicators are not equally transparent: for a sample review see DUTTA (2012), at 449-50.
\textsuperscript{94} See also Independent Panel Review, cit., at 5 (suggesting publication of contributors’ submissions so as to allow external users to gauge the level of uncertainty associated to each index).
\textsuperscript{95} See DUTTA (2012), at 440. According to INDEPENDENT PANEL (2013), at 5 and 29-30, miscoding might be more easily avoided if risk-mitigation devices, such as external reviews, were included in the assessment process.
\textsuperscript{96} On the epistemic role of a functional approach see MICHAELS (2011), at 3-4.
\textsuperscript{97} On statistical reductionism see id., at 12.
protection, and therefore disregards possible alternatives not included in the grid.\textsuperscript{98}

As a consequence of the DBR methodology, countries wishing to reform their regulation on investor protection may be incentivised to adopt a box-ticking approach and hence to pass legislations which mirror the DBR evaluation grid even when this brings no relevant benefit to investors. For instance, Italy would gain a number of positions in the PII ranking by amending a small number of legal provisions in ways that would not substantially add to the current level of minority protection. First, Mr James’s abstention might be mandated, with very little improvement, if any, from the point of view of his ability to influence the company’s decision, as we have shown. Second, as long as the DBR focuses on default rules,\textsuperscript{99} Italy’s performance would further improve if the law provided for shareholder approval of the transaction, while granting companies the possibility to opt-out and to grant independent directors a veto power, as is the case today.\textsuperscript{100}

Once more, it is far from certain that this would strengthen investor protection, as controlling shareholders could easily pass the charter amendments that may be required to deviate from the default rule. Third, as Consob RPT Regulation allows independent directors to appoint an external adviser of their choice but does not mandate it,\textsuperscript{101} imposing fairness opinions would boost Italy’s performance.\textsuperscript{102} However, the reliability of outside experts appointed by the board is often questioned by legal and economics literature,\textsuperscript{103} which has therefore advised against mandating their appointment.\textsuperscript{104}

\textsuperscript{98} An underlying home bias may explain the selection bias, as a consequence of the natural tendency for those involved in the preparation of the assessment grid to prioritise legal solutions in place in the jurisdictions of origin (see references at fn. 31).
\textsuperscript{99} See supra, fn. 61 and accompanying text.
\textsuperscript{100} A similar solution would be ruled out, though, if the EU Commission’s proposal on the approval by general meeting of significant related party transactions were adopted (see supra, fn. 44). In the proposal, shareholder vote is mandated with no possibility of opt-out.
\textsuperscript{101} See text accompanying fn. 41.
\textsuperscript{102} See Table 1, line 5.
\textsuperscript{103} See e.g. MACEY (2013), at 621 (fairness opinions are aimed at providing protection against litigation risk rather than conveying useful information to directors and investors; external experts have an incentive to deliver opinions aligned with the results preferred by the company’s board); KISGEN et al. (2009) (fining evidence that fairness opinions in M&A transactions provide little value to shareholders of target firms, while results are mixed for acquiring firms’ shareholders); CLEVELAND (2006) (reputational concerns provide weak constraints on investment bankers having an incentive to align their opinion with their clients’ whishes).
\textsuperscript{104} MACEY (2013), at 622-3 (absent Delaware courts’ de facto mandate for fairness opinions, these would perform their function better); WALTON (2012), at 276-7 and 295 (when second opinions are deemed useful to convey relevant information to the market, companies are likely to spontaneously resort to them. When this is not the case because the external experts are prone to conflicts of interests, mandating a fairness opinion will unduly certify the transaction to the detriment of investors).
If the measures we hypothesize above were passed, Italy’s Extent of Disclosure Index could reach 10. The PII would subsequently jump to 7, and, ceteris paribus, Italy would rank 16th in the DBR for investor protection. As shown, this may come with no corresponding substantial improvement in terms of investor protection.

The current methodology therefore incentivises convergence to a single set of legal devices and inevitably rules out idiosyncrasies or, at least, makes them harder to evaluate, thus discouraging the quest for new legal devices capable of ensuring the same level of investor protection at lower costs. In other words, homologation trumps experimentation. By contrast, a functional evaluation would increase flexibility and allow for trial and error, which is pivotal in the field of investor protection because tunneling may be carried out through different techniques over time, also depending on the relevant legal framework. Just like in a cops and robbers game, that requires a wide array of new legal strategies to be tested.

105 A mandatory fairness opinion would add one point on the score of 7 currently assigned for the extent of disclosure index. Mandatory Mr James’s abstention would add another point, while shareholder involvement – a measure alternative to Mr James’s abstention – would add two points.

106 PII is in fact the average of the Extent of Disclosure Index (which would increase to 10), the Extent of director liability index and the Ease of shareholder suit index (which would respectively remain 4 and 7).

107 RIBSTEIN & KOBAYASHI (1996), at 140-1 (uniform laws determine a lower degree of experimentation).


109 ATANASOV et al. (2011) (analysing different tunneling techniques and anti-tunneling strategies, and claiming that there is no broad consensus on which rules are better suited to protect investors).
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