PRIVATE V. PUBLIC ENFORCEMENT: THE ITALIAN SAI-FONDIARIA CASE

PAOLO GIUDICI

Associate Professor of Business Law, Faculty of Economics and Management, Free University of Bozen, Italy

ECGI Research Member

From a law and economics perspective, where civil remedies are not seen exclusively in terms of corrective justice, liability systems and government regulations have to establish optimal levels of deterrence. Public and private enforcement should cooperate in achieving this goal. With reference to securities law, it is richly debated in the US whether or not American-style private enforcement is too strong. The general view is that US private enforcement is very effective but also inefficient; with reference to the level and the causes of this inefficiency, however, views greatly differ.[1] By contrast, private enforcement of capital market law is generally very low in countries like Italy, where it is both ineffective and inefficient.[2] Italy heavily relies on public enforcement and, in particular, on Consob.

There are at least three strong arguments against a system that relies entirely on the public enforcement of law. First, public watchdogs cannot have access to the widespread information that private parties naturally possess even though they are able to intervene when a company is seeking

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[1] Cf. J. D. Cox, "Private Litigation and the Deterrence of Corporate Misconduct" (1997) 60 Law & Contemp. Prob. p. 1; J. D. Cox, "Making Securities Class Actions Virtuous" (1997) 39 Ariz. L. Rev. p. 497; J. C. Alexander, "Do the Merits Matter? A Study of Settlements in Securities Class Actions" (1991) 43 Stan. L. Rev. p. 1487; J. C. Alexander, "Rethinking Damages in Securities Class Actions" (1996) 48 Stan. L. Rev. p. 1487; J. C. Coffee Jr., "Reforming the Securities Class Action: An Essay On Deterrence and Its Implementation" (2006) 106 Colum. L. Rev. p. 1534.

[2] Cf. R. La Porta, F. Lopez de Silanes, A. Shleifer and R. W. Vishny, "Legal Determinants of External Finance" (1997) 52 J. Fin. p. 1131; A. Shleifer and R. W. Vishny, "A Survey of Corporate Governance" (1997) 52 J. Fin. p. ; R. La Porta, F. Lopez de Silanes, A. Shleifer and R. W. Vishny, "Law and Finance" (1998) 106 J. Pol. Econ. p. 1113; E. L. Glaeser and A. Shleifer, "Legal Origins" (2002) 117 Quart. J. Econ. p. 1193; A. Shleifer and D. Wolfenzon, "Investor Protection and Equity Markets" (2002) 66 J. Fin. Econ. p. ; S. Djankov, R. La Porta, F. Lopez de Silanes and A. Shleifer, "Courts" (2003) 118 Quart. J. Econ. p. 453; R. La Porta, F. Lopez de Silanes and A. Shleifer, "What Works in Securities Laws?" (2006) 61 J. Fin. p. 1

to hide information.[3] Second, they lack adequate financial resources to investigate all potential wrongdoers and to pursue all pending investigations with the same unrestricted vigour.[4] Third, the public agency can face agency costs in the same form of auditors and other gatekeepers, because the public servant could be "amenable to payoffs".[5] Political influence and the incentive to be not too harsh with some wrongdoers in view of potential future employment with them or their advisors in the private sector (the revolving door) are good examples of the nature of these payoffs. Bribery is the extreme form of payoff.[6] Accordingly, in any legal system private parties are usually provided with economic incentives to report wrongdoings, in the form of damages, restitution, bounties or any other form of monetary reward whatsoever.[7] Even though the private incentive to bring suit remains "fundamentally misaligned with the social optimal incentive to do so, and the deviation between them could be in either direction",[8] it is advisable to have a certain level of private

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[3] S. Shavell, *Foundations of Economic Analysis of Law*, (Cambridge, Mass. 2004)., 578-579.

[4] 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 (1983).

[5] With reference to the public prosecutor in antitrust cases, Professor Easterbrook writes: "Unable to 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, at p. 454.

6 E. L. Glaeser, S. Johnson and A. Shleifer, "Coase versus the Coasians" (2001) 116 Quart. J. Econ. p. 853 adopts a different approach and reaches 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 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.

[7] Cfr. R. H. Kraakman, "Corporate Liability Strategies and the Costs of Legal Controls" (1984) 93 Yale L.J. p. 857; R. H. Kraakman, "Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy" (1986) 2 J. Law Econ. & Org. p. 53. 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. Accordingly, in countries like Italy private incentives are always in the form of damages. Usually the right to claim damages is associated to violations of public regulation specifically constructed (in order to grant the action) as instruments to protect private interests also.

[8] Steven Shavell, *supra* note 1, at p. 391.

enforcement pressure. Therefore it comes as no surprise that securities law enforcement is both inefficient and ineffective in Italy.[9] Clearly the problem is that of reaching a good balance between private and public enforcement and creating formal or informal effective mechanisms for coordinating the roles of the two institutional frameworks (litigation and regulation), as is usual in fields where there is a cumulative effect of both.[10]

An effective private enforcement is not only a matter of appropriate substantive and procedure rules, but it is also a matter of interpretation. Rule 10b-5, the US general antifraud provision for the federal securities laws, does not explicitly provide a private cause for damaged investors; it was judicially implied in *Kardon v. National Gypsum*.[11] The rebuttable presumption of reliance based on the Fraud-on-the-Market Theory, which is based on the Efficient Capital Markets Hypothesis and it is now an accepted inference of law (instead of a simple inference of fact), has been judicially implied in *Basic Inc. v. Levinson*[12] and recently reviewed in the famous *Dura* case.[13] Insider trading prohibition was pressed in the courts by the SEC and was progressively reshaped by the US Supreme Court in a famous line of cases which started with *Chiarella*.[14] US private enforcement of securities law is the product of courts' expansive interpretation of the Securities Act of 1933 and the Securities and Exchange Act of 1934.

It is therefore very interesting to analyze how Italian courts deal with hard cases that raise

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[9] G. Ferrarini and P. Giudici, Financial Scandals and the Role of Private Enforcement: The Parmalat Case In J. Armour and J. A. McCahery (eds.), *After Enron*, (2006), pp. 159-213.

[10] K. W. Viscusi (a cura di), *Regulation through Litigation*, (Washington, D.C. 2002)., p. 3. For a recent 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; J. D. Cox and R. S. Thomas, "Public and Private Enforcement of the Securities Laws: Have Things Changed Since Enron?" (2005) 80 Notre Dame L. Rev. p. 893.

[11] 69 F. Supp. 512 (E.D. Pa. 1946).

[12] 485 U.S. 224.

[13] 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. Fox, "After Dura: Causation in Fraud-on-the-Market Actions" (2005) 31 J. Corp. L. p. 829; M. 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.

[14] 445 U.S. 222 (1980).

issues of policy affecting the "public v private enforcement dualism" in securities law. The Sai-Fondiaria litigation is a case in point. At the beginning of 2002 Sai, a large insurance company, was stuck in a situation were it had promised (acting in concert with Mediobanca) to buy a large stake in Fondiaria, another large insurance company, but could not purchase the shares because this would have triggered both mandatory takeover rules (pursuant to Articles 106 and 109 CFSA) and insurance capital adequacy rules. In order to elude both problems, Sai and Mediobanca used five intermediaries (among which JP Morgan and Commerzbank), which bought the stake that Sai should have purchased. The five intermediaries claimed to have acted independently, i.e. not in concert, 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.[15] Following the White Knights' intervention, Consob received many complaints but succinctly 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 Sai's and Fondiaria's shareholders agreed a merger and soon after Sai bought the White Knights' stake in Fondiaria. As a consequence 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 Sai, Fondiaria and Generali. Two days later an inspection was ordered in the offices of Mediobanca, Premafin (Sai's controlling shareholder), Sai, Fondiaria, Generali, Compagnia Fiduciaria Nazionale and Interbanca. The existence of secret, unwritten agreements was confirmed by the inspectors.[16]

At the time the Sai-Fondiaria case looked as a strange tale of public enforcement. Fondiaria's minority shareholders had to rely on complaints lodged to the financial supervisor, who did not take any active role to prevent the infringement of mandatory takeover rules. However, if it had not been for another public agency (the antitrust authority) the elusion would have remained suspected but undisclosed.

The action taken by the antitrust watchdog ignited private actions against the concerting

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[15] Giuseppe Oddo - Riccardo 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).

[16] In a scenario completely re-shaped by the results of the antitrust watchdog analisys, an administrative court declared the Consob's decision to be null and void and ordered Consob to re-evaluate the case. For further details see Consiglio di Stato, 13 May 2003, no. 4142, Giur. It. 2107 (2004), with comment of Eva Desana, *Opa obbligatoria "da concerto occulto": alcune osservazioni a margine della vicenda Sai-Fondiaria*.

parties. A few large Fondiaria blockholders 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, and in the light of enforcement policy issues as well, as Italian mandatory rules do not say anything about the right of minority shareholders to claim damages in case of violation of mandatory takeover rules. Indeed, the substantive applicable rules seem to offer a perfect system of enforcement that does not need any further support by liability rules, as voting rights are suspended, the shares exceeding the legal threshold of 30% of the capital have to be sold within one year (Article 110 TUF) and managers face fines (Article 192). As a matter of fact, however, the mechanism 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 been already merged with Sai.

The Milan Tribunal granted the recovery of damages, through a long and very confused reasoning that takes policy issues in account and explicitly favours private enforcement in case public enforcement fails to prevent infringements of securities laws.[17] The Milan Court of Appeal reversed, following an approach that sacrifices policy issues and seems more grounded in the civil law legal reasoning, but looks unable to capture the problems raised by the modern theory of regulation and deterrence.[18]

In this paper I analyze the legal reasoning followed by the two decisions in this hard case. I would like to highlight how different is the US courts' approach in comparison to the approach of Italian courts, how civil law concepts coupled with its very old-style, formalistic reasoning can produce messy and sometimes even non-sensical legal opinions in fields like securities regulation (antitrust would be another case in point) that are so different from the traditional areas of contract law and tort. I will argue that law and economics, properly understood, provides a manageable consequentialist theory that is not that distant from the many consequentialist views grounded on intuition, ideology, common sense or non-sense that courts and lawyers follow in their every day life and that are well-known weapons of the jurist's rhetoric armoury. Accordingly I will try to show if and how, with the help of law and economics, deterrence arguments can be employed in the

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

[18] Milan Court of Appeal, 15 January 2007.

legal reasoning of civil courts called to decide private law cases concerning securities regulation and affecting the “private v. public enforcement” balance.

References: see footnotes.