

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

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ABSTRACT: Every year the World Bank's Doing Business Report (DBR) ranks numerous jurisdictions across the globe according to their ability to facilitate business activities. Among the indexes which contribute to the definition of the global competitiveness of 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 fails to properly evaluate the applicable rules. First, it underrates Italy because the DBR evaluation misinterprets the role performed by independent directors under Italian rules on related party transactions. In particular, the DBR fails to properly account for the powers of independent directors to veto unfair transactions before they are submitted to the board. This measure ensures that minority investors are assured a level of protection which is at least equivalent to the mandatory abstention by conflicting directors. Second, as past DBR overrated the PII subsequent reforms which have substantially improved investor protection have not been accounted for by more recent assessments, which give 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 a key element in ensuring that the applicable rules keep pace with the variety of techniques which are adopted to expropriate minority shareholders.

KEYWORDS: *Doing Business Report; Investor Protection; Related Party Transactions; Law and Finance; Comparative Corporate Governance.*

This paper is due to appear in the Studies in Honour of 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 addressed 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 [hereinafter DBR] is an assessment exercise prepared by the World Bank with the aim of comparing the efficiency of nearly two hundred 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 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” [hereinafter 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 with regard to 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 hand, coding mistakes have been reported for various jurisdictions. We do not enter here the discussion on the merits of benchmarking economic legislation across jurisdictions which belong to different legal traditions,¹ nor we scrutinize the appropriateness of the variables the PII relies upon. Rather we purport 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 have led to underestimate more

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¹ Similar benchmarking exercises are performed in the European Union, especially in the field of labour and social law, under the so-called “Open Method of Coordination”: *see, e.g.*, Sabrina Regent, *The Open Method of Coordination: A New Supranational Form of Governance?*, 9 EUR. L. J. 190 (2003).

recent progresses of the Italian legislation, so that the historical performances reported in the DBR with a view to showing the 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 key argument is that in both the design and the measurement of the variables composing the evaluation grid a functional approach should be preferred over a formalistic analysis.² 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 in the definition of variables. Further, we stress that, when assessing the rules which apply to investor protection in a given jurisdiction, attention should be paid to the broader national legal framework. Effective investor protection may, indeed, be better ensured by rules that, despite not matching the relevant criterion at first sight, could lead to a different assessment if considered as part of a broader legal context rather than in isolation.³

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 [hereinafter RPTs] are then illustrated (part 4). It is then shown how the DBR evaluation fails to consider that this framework ensures results equivalent to those provided for by the DBR criteria by utilising different regulatory tools (part 5). We then analyse more in depth

² See John Armour et al, *How Do Legal Rules Evolve? Evidence from a Cross-Country Comparison of Shareholder, Creditor, and Worker Protection*, 57 AM. J. COMP. L. 586, 600 (2009) (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 Mathias Siems & Simon Deakin, *Comparative Law and Finance: Past, Present and Future Research*, 166 JITE 124 (2010) (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); Mathias Siems, *Numerical Comparative Law: Do We Need Statistical Evidence in Law in Order to Reduce Complexity?*, 13 CARDOZO J. INT'L & COMP. L. 531, 540 (2005) (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 generally Benito Arruñada, *How Doing Business Jeopardises Institutional Reform*, 10 EUR. BUS. ORG. L. REV. 571 (2009) (noting that “measuring institutions in countries with different legal traditions requires appreciating that different legal structures suit different contexts”). See also Armour et al., *supra* note 2, at 596 (a particular institution, even if suboptimal in isolation, should be retained when its removal would exert adverse effects on other complementary institutions).

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 is then quantified in order to show how the DBR's inaccuracies may create perverse incentives by reducing countries' willingness to enact effective legislation whilst inducing window-dressing reforms (part 7). Part 8 concludes.

2. THE DOING BUSINESS REPORT AND THE MEASUREMENT OF INVESTOR PROTECTION

Since 2004, the International Finance Corporation – a member of the World Bank Group – has been assessing the quality of economic legislations across the globe. The study compares the relative ease of running a business activity in each jurisdiction. Its results are published on a yearly basis in the DBR, which shows how assessed countries are performing under the common criteria 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 which address specific aspects of business activities. 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 prospers where property rights (in this case, investors' entitlements) are clearly defined *ex ante* and effectively enforced *ex post*.⁴

⁴ See Claude Ménard & Bertrand Du Marais, *Can We Rank Legal Systems According to Their Economic Efficiency?*, 26 J.L. & POL'Y 61 (2008) (recalling Hernando de Soto's theory on reduction of informality – and consequently of transaction costs – through definition and implementation of property rights). On the theoretical framework underlying the DBR see Beth Ahlering & Simon Deakin, *Labor Regulation, Corporate Governance, and Legal Origin: A Case of Institutional Complementarity?*, 41 LAW & SOC'Y REV. 865, 869–872 (2007); BERTRAND DU MARAIS, DES INDICATEURS POUR MESURER LE DROIT?: LES LIMITES MÉTHODOLOGIQUES DES RAPPORTS DOING BUSINESS 21–23 (Bertrand Du Marais ed., 2006); Alessio M. Paccas, *How does Corporate Law Matter? 'Law and Finance' and Beyond*, in MICHAEL FAURE & SMITS, DOES LAW MATTER? ON LAW AND ECONOMIC GROWTH 297, 299–300 (Michael Faure & Jan Smits eds., 2011).

The assumption is hardly questionable,⁵ although causation⁶ (and even correlation⁷) between the quality of legislation in force and the development of financial markets 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 according to three sub-indexes which respectively measure disclosure required for RPTs ("Extent of disclosure" index), directors' liability ("Extent of director liability" index), as well as the availability of legal remedies to shareholders ("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 body before it decides and subsequently provided to the public at large. Enforcement-related features are also taken into account (e.g. the possibility for shareholders which represent less than 10% of the

⁵ See INDEP. EVALUATION GRP., *An Independent Evaluation Taking the Measure of the World Bank-IFC Doing Business Indicators*, 3 (Oct., 2008).

⁶ John Coffee, *The Rise of Dispersed Ownership: The Role of Law in the Separation of Ownership and Control*, 111 YALE L. J. 1, at 59-66 (2011) (in many instances, stock market developed before legislation aimed at protecting minority shareholders was introduced); BRIAN R. CHEFFINS, *CORPORATE OWNERSHIP AND CONTROL: BRITISH BUSINESS TRANSFORMED* 35-40 (2010) (U.K. law traditionally offered scant protection to investors, in spite of financial market development).

⁷ See also John Armour et al., *Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origin Hypothesis*, 6 J. EMPIRICAL LEGAL STUD. 343 (2009).

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 Int'l Fin. Corp. [IFC], *Doing Business in 2004. Understanding Regulation*, DOINGBUSINESS.ORG, 7 (Sep., 2003), <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB04-FullReport.pdf>. For PII see Int'l Fin. Corp. [IFC], *Doing Business in 2005. Removing obstacles to growth*, DOINGBUSINESS.ORG, 85 (Jan. 1, 2005), <http://www.doingbusiness.org/~media/FPDKM/Doing%20Business/Documents/Annual-Reports/English/DB05-FullReport.pdf>, referring to Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (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 Int'l Fin. Corp. [IFC], *Doing Business 2010. Reforming through difficult times*, DOINGBUSINESS.ORG, 42 (Sep. 9, 2009), <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB10-FullReport.pdf>, where reference is made to Simeon Djankov et al., *The law and economics of self-dealing*, 88 J. FIN. ECON. 430 (2008) (defining a new and more detailed grid – "self-dealing index"). For further details on similar studies underpinning other indices within the DBR see Kevin E. Davis & Michael B. Kruse, *Taking the Measure of Law: The Case of the Doing Business Project*, 32 LAW & SOC. INQUIRY 1101 (2007). Reliance on academics or outsources in the production of indicators is no exception: cf. Kevin E. Davis et al., *Introduction: Global Governance by Indicators in GOVERNANCE BY INDICATORS. GLOBAL POWER THROUGH QUANTIFICATION AND RANKINGS* 3, 13 (Kevin E. Davis et al. eds., 2012).

outstanding capital to directly or derivatively initiate a claim, as well as directors' liability for damages and the availability of disgorgement of profits). Access to evidence through discovery is also a criterion of assessment.

Variables are measured against a hypothetical transaction which is identical for all jurisdictions. The fictional 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 also a member of the board of directors. He also owns the 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 the 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 into a loss and its shareholders decide to sue Mr James, along with those who are involved in the transaction.

The evaluation team first establishes what rules apply to the relevant transaction in the various jurisdictions. Depending on the availability of the legal remedies, scores are then assigned by reflecting the assumption that the higher the number of regulatory tools for protecting against tunneling, the stronger the protection for investors.

3. THE DBR: IMPACT ON NATIONAL REFORM AGENDAS AND CRITICISM

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

⁹ See INDEP. EVALUATION GRP., *supra* note 5, at 44-6 (DBR fosters national debates 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 INDEP. PANEL, *Review of the Doing Business Report*, DBRPANEL.ORG, 19 (Jun. 24, 2013), <http://faculty.washington.edu/hgwo/Doing%20business%20review%20panel%20report%20with%20signatures%20and%20Bibliography.pdf>, many institutions refer to the DBR without considering its inherent limitations. See also Ralf Michaels, *Comparative Law by Numbers? Legal Origins Thesis, Doing Business Reports, and the Silence of Traditional Comparative Law*, 57 AM. J. COMP. L. 772 (2009) (listing the factors making the DBR appealing and assessing DBR’s impact).

On the one hand, some countries have passed legal reforms with the explicit purpose of matching the criteria set by the DBR's evaluation grid.¹⁰ On the other hand, academics and politicians from other jurisdictions have harshly opposed the assessment method and its results. Widespread criticism also testify to the significance of the DBR.¹¹

The reasons for such significance are manifold. For developing countries, the possibility to access the lending programs of 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. Their "name and shame" effect is often amplified by the extensive press coverage on the DBR.¹² The DBR, as opposed to other evaluation studies on national performances,¹³ displays the results of benchmarking by ranking all participating jurisdictions on the basis of their performance. This creates a feeling of competition among jurisdictions.¹⁴ These rankings satisfy the need for easy-to-use information¹⁵ because they exert great symbolic power and, regardless of the technicalities that characterise local legislation, are easy to understand for the public at large.¹⁶

¹⁰ See, e.g., Caralee McLiesh & Pedro Arizti, *The Doing Business Project*, in OECD, *MFDPR PRINCIPLES IN ACTION: SOURCEBOOK ON EMERGING GOOD PRACTICES* 110 (2006) (reporting how Jordan, Korea, Mozambique, Nicaragua, Serbia and Montenegro have used the DBR as a reform driver).

¹¹ For France see DU MARAIS, *supra* note 4.

¹² See INDEP. EVALUATION GRP., *supra* note 5, 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 See, e.g., CEPEJ, *European Judicial Systems. Efficiency and Quality of Justice*, COE.INT (2012), http://www.coe.int/t/dghl/cooperation/cepej/evaluation/2014/Rapport_2014_en.pdf (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 (David Irwin, *Doing Business: Using Ratings to Drive Reform*, 26 J. INT'L. DEV., 658 (2013) (ebook). See also INDEP. EVALUATION GRP., *supra* note 5, 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"); INDEP. PANEL, *supra* note 9, at 2, 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* note 18 and text accompanying note 29).

¹⁵ See Siems, *supra* note 2, at 534 (numerical analysis satisfies the need to reduce complexity in order to increase the practical role of comparative law).

¹⁶ See Ralf Michaels, *The Functionalism of Legal Origins*, in DOES LAW MATTER? ON LAW AND ECONOMIC GROWTH 31 (Michael Faure & Jan Smits eds. 2011) (reductionist quality of rankings is an advantage for their marketability).

While DBR's influence has been significant since its first publication,¹⁷ a number of legal academics have harshly questioned its methodology and results. Criticisms have addressed two key aspects of the evaluation process. The selection of the standards according to which the ease of carrying out an economic activity should be assessed, along with the process for evaluating compliance with those standards have both been contested. 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 Critics argue that the preferable approach varies according to 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 mechanisms. However, the DBR notoriously disregards enforcement practices.²¹

¹⁷ The Doing Business indicators are frequently mentioned among the most important indexing exercises: *see, e.g.*, DAVIS et al., *supra* note 8, at 3.

¹⁸ Int'l Fin. Corp. [IFC], *supra* note 8, at xvi; INDEP. PANEL, *supra* note 9, at 23; *see also* as regards labour law *id.* at 3, 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. *See* Int'l Fin. Corp. [IFC], *Forthcoming changes to the Doing Business report*, DOINGBUSINESS.ORG (Apr. 30, 2014), <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Methodology/Survey-Instruments/DB15/Forthcoming-methodology-changes-to-the-Doing-Business-Report.pdf>.

¹⁹ For a review *see* Paces, *supra* note 4, at 303-307.

²⁰ Davis & Kruse, *supra* note 8, at 1102-1103. Benito Arruñada, *Pitfalls to avoid when measuring institutions: Is Doing Business damaging business?*, 35 J. COMP. ECON. 734 (2007); Ménard & Du Marais, *supra* note 4, at 77-80; INDEP. PANEL, *supra* note 9, at 3.

²¹ *See* INDEP. EVALUATION GRP., *supra* note 5, 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).

Further, regardless of how well the variables have been construed, some degree of subjectivity in weighing the importance of each criterion and, therefore, in determining the final rankings is unavoidable.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 implications of its evaluation might be questionable, and has subsequently amended its methodology. For instance, the original labour law indicator which measures the ease of hiring and firing workers has raised widespread concerns. The indicator rested 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 regulation.²³ They argue that there is no evidence that light-touch labour law improves economic performance or creates more jobs.²⁴ 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”.²⁵

Other criticisms have addressed the “Ease of starting a business”²⁶ and the PII itself. As a consequence, they have called into question the global “Ease of doing business” indicator which inevitably reflects, or even amplifies, improper definitions of sub-indexes.²⁷

²² Cf. For a similar consideration with reference to corporate governance indices see Sanjai Bhagat et al., *The Promise and Peril of Corporate Governance Indices*, 108 COLUM. L. REV. 1825 (2008) (market participants may have divergent preferences when weighting governance features, and some variables may be substitutes for others).

²³ See DAVIS et al., *supra* note 8, at 9 (Every selection of variables inevitably reflects underlying ideological assumptions on the role of regulation and its effects on society).

²⁴ See, e.g., Janine Berg & Sandrine Cazes, *Policymaking Gone Awry: The Labor Market Regulations of the Doing Business Indicators*, 29 COMP. LAB. L. & POL'Y J. 350, 355–360 (2008).

²⁵ See Peter Bakvis, *The World Bank's Doing Business Report: A last fling for the Washington Consensus*, 15 EUR. REV. LAB. RES 434 (2009); Int'l Fin. Corp. [IFC], *Doing Business 2014. Understanding Regulations for Small and Medium-Size Enterprises*, DOINGBUSINESS.ORG, 2 (Jun. 1, 2013), <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB14-Full-Report.pdf>.

²⁶ See Arruñada, *supra* note 20, (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 *contra* Simeon Djankov et al., *The law and economics of self-dealing*, 88 J. FIN. ECON. 430 (2008). See also Arruñada, *supra* note 3, for a counter-reply.

²⁷ See INDEP. PANEL, *supra* note 9, 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).

Some scholars have proposed alternative assessment criteria for shareholder protection in the attempt to have a more accurate understanding of the comparative advantages of different jurisdictions.²⁸ Further changes in the DBR methodology, which have been announced in April 2014, will tackle some of these critiques in an attempt to improve the completeness of the evaluation. This would lead to a more careful consideration of its results.²⁹ The evaluation grid will inevitably remain exposed to critiques. Scholars would still have diverging opinions on the relative importance of the diverging legal rules.

Regardless of the theoretical debate, the accuracy of DBR assessments has also been challenged.³⁰ 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 similar circumstances.³¹ Data on the applicable rules are gathered by submitting questionnaires to local experts. Results are subsequently discussed with the World Bank team in charge of the evaluation.³²

²⁸ For an alternative shareholder protection index cf. Priya P. Lele & Mathias M. Siems, *Shareholder Protection: A Leximetric Approach*, 7 J. CORP. L. STUD. 17 (2007). On the same index see also Siems & Deakin, *supra* note 2, at 128-135. CENTRE FOR BUSINESS RESEARCH, EXTENDED SHAREHOLDER PROTECTION INDEX (www.cbr.cam.ac.uk).

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-issued 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; see Int’l Fin. Corp. [IFC], *supra* note 8, at 3. See also Int’l Fin. Corp. [IFC], *Doing Business 2015. Measuring Business Regulation – Questionnaire*, DOINGBUSINESS.ORG (2015), <http://www.doingbusiness.org>.

³⁰ See, e.g., Davis & Kruse, *supra* note 8, at 1104-1107, 1111-1115 (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 United States is very likely to reflect the specific characteristics of common law jurisdictions, thus biasing the subsequent comparison with civil law jurisdictions (see Michaels, *supra* note 9, at 786). See also Siems & Deakin, *supra* note 2 (as the Law and Finance stream of research is mainly based on U.S. securities law, it can be regarded as a “hidden benchmarking” which measures the vicinity to the U.S. model); INDEP. PANEL, *supra* note 9, at 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 U.S. perspective as well (Pacces, *supra* note 4, at 303).

³² For a description see INDEP. EVALUATION GRP., *supra* note 5, at 13-9; Davis & Kruse, *supra* note 8, at 1095, 1099-1100.

That procedure has not always been reliable.³³ For instance, Italy's PII score has also been affected by mistakes which were later admitted by the DBR itself.³⁴

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 that Italian listed companies have to respect in order to ensure that RPTs are adequately disclosed to the market and fulfil minimum standards of substantial and procedural fairness.³⁵ The Regulation was approved by Consob – the Italian Securities and Exchange Commission – in 2010 and fully enacted one year later. The Regulation contains a set of detailed rules while

³³ Numerous mistakes afflicting the first DBR on France were pointed out in the fracas raised by the French legal and political community (see also DU MARAIS, *supra* note 4, 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 (Anne-Julie Kerhuel & Bénédicte Fauvarque-Cosson, *Is Law an Economic Contest? French Reactions to the Doing Business World Bank Reports and Economic Analysis of the Law*, 57 AM. J. COMP. L. 811, 815–816 (2009). Mistakes affecting other countries in the measurement of the "Ease of starting a business" index are reported by Arruñada, *supra* note 20, at 743–744, and Arruñada, *supra* note 3, at 559. See also Bjørn Høyland et al., *The tyranny of international index rankings*, 97 J. DEV. ECON. 8 (2012) (measuring the uncertainty affecting DBR evaluations). Mistakes have similarly been highlighted in La Porta et al., *supra* note 8, at 1113; see also Holger Spamann, *The "Antidirector Rights Index" revisited*, 23 REV. FIN. STUD. 467 (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).

³⁴ 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 Tbl. 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 Int'l Fin. Corp. [IFC], *Doing Business 2014 – Economy Profile: Italy*, DOINGBUSINESS.ORG, 60(Oct.29,2013), <https://openknowledge.worldbank.org/bitstream/handle/10986/18495/828700ItalyITAoBoxo382099B00PUBLICo.pdf?sequence=1&isAllowed=y>. The same holds true for other rankings, which were consequently amended in retrospect (*id.*, at 57). Similar retroactive corrections are not exceptional: see INDEP. EVALUATION GRP., *supra* note 5, at 17. See also DU MARAIS, *supra* note 4, at 40, 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).

³⁵ See Art. 2 RPT Regulation (Consob Decision No. 17221 of 12 Mar. 2010, as amended; O.J. No. 152 of 2 Jul. 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 Marcello Bianchi et al., *Regulation and self-regulation of related party transactions in Italy*, QUADERNI DI FINANZA CONSOB NO. 75, at 10–13 (2010); Organisation for Economic Co-operation and Development [OECD], *Related Party Transactions and Minority Shareholder Rights*, 115–6, (2012).

leaving room for some optional choices.³⁶ Because the simulation of the DBR only considers default provisions, with few exceptions we limit our description to rules which apply to the PII hypothetical transaction by default.

The Regulation prescribes that the whole board shall be in charge of deciding whether the RPT is to be entered into. Therefore, 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 unrelated³⁸ independent³⁹ directors – shall evaluate the substantial fairness of the affair as well as the company’s interest in the transaction. The special committee has to be involved in the negotiations and internal decision-making process leading to the RPT approval. Not only the special committee is 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 will bear the related costs for the additional expertise.⁴¹

The special committee can veto the transaction by releasing a binding advice. Alternatively, an express charter provision may opt out of the special committee voting requirement in favour of a double-majority quorum in the board of directors. The transaction may not be entered into unless the majority of the independent board members have approved it.⁴² The

³⁶ See, e.g., Bianchi et al., *supra* note 35, at 13 (identifying the most relevant optional provisions).

³⁷ See RPT Regulation, *supra* note 35, art. 8(1)(a).

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 (see RPT Regulation, *supra* note 35, art. 3(1)(h)).

⁴⁰ See RPT Regulation, *supra* note 35, art. 8(1)(b). 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 CODICE CIVILE [CIVIL CODE] [C.C.] art. 2391. 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 See RPT Regulation, *supra* note 35, art. 8(1)(c).

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 procedures shall ensure that the proposed transaction can only be entered into if it reaches the ordinary quorum and is approved by a majority of unrelated shareholders (so-called "whitewash" procedure).⁴⁵ Therefore, the transaction cannot be entered into if the majority of minority shareholders has voted against the transaction.⁴⁶

Disclosure is mandated by specific provisions within the Regulation. These requirements are complementary to the general rules on ad hoc dissemination of internal information.⁴⁷ They require to disclose information in relation to, inter alia, the qualification of the transaction as RPT, the nature of the relationship with the related party (to be identified), the amount of the transaction, the procedure followed for approval, and the dissenting opinions - if any - within the board or the special committee.⁴⁸

⁴³ See RPT Regulation, *supra* note 35, art. 8(2).

⁴⁴ In April 2014, the E.U. Commission adopted a proposal to introduce an European-wide legislation on related party transactions. According to the proposal, shareholder approval shall be mandated before any such transaction is entered into which exceeds 5% of company's assets or which can have a significant impact on profits or turnover: see European Commission, *Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC Art. 9c(2)*, at 9, (2014).

⁴⁵ See RPT Regulation, *supra* note 35, art. 11(3). 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 (C.c. art. 2373).

⁴⁷ According to Art. 114 and 181 of the Consolidated Law on Finance, enacting Commission Directive 2003/6/EC, Art. 6, 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 U.S. law. Any evaluation on whether the DBR model transaction involves price sensitive information will be highly discretionary, 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 Int'l Fin. Corp. [IFC], *Doing Business 2014 - Economy Profile: Germany*, DOINGBUSINESS.ORG, 64 (Oct. 29, 2013), http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/05/01/000260600_20140501155900/Rendered/PDF/828430Germany0DEU0Box0382098B00PUBLIC0.pdf, 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 E.U. 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 See RPT Regulation, *supra* note 35, art. 6; see also Commission directive 2003/6/EC, Art. 6(7).

Regardless of the qualification of the RPT as inside information, detailed information must be published within seven days from the approval by the competent body or, when the circumstances so require, from the contractual proposal.⁴⁹ Such information is provided in accordance with a standardised format set by the Regulation that mandates disclosure of the terms of the transaction. Disclosure must, *inter alia*, specify the company's interest in the operation and describe the criteria adopted to define the consideration paid. Conflicting interests, including indirect interests, are to be divulged (e.g. when the managers' compensation is influenced by the performance of the RPT).⁵⁰

Finally, annual and interim reports must provide information on individual major RPTs.⁵¹

5. MEASURING INVESTOR PROTECTION IN ITALY AFTER THE REGULATION ON RELATED PARTY TRANSACTIONS

According to the 2014 DBR, Italy does not reach the highest score in a number of sub-indexes (ten out of eighteen) within the PII. Furthermore, the DBR does not report, in its section displaying past performances, any variation in the applicable rules during the last years. The approval of the RPT Regulation (in 2010), as well as its entry into force (in 2011) have not been 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 lead to underestimate or overestimate the current level of investor protection in a given jurisdiction. They can also misrepresent the evolution of the applicable rules because inflated past scorings can hamper the registration of subsequent improvements. The reasons why some of the scores assigned to Italy inaccurately reflect the

⁴⁹ The questionnaire used to gather the relevant data only refers to information disseminated within 72 hours after the transaction is approved (Int'l Fin. Corp. [IFC], *Doing Business 2014. Measuring Business Regulation – Questionnaire*, DOINGBUSINESS.ORG, 5 (2014), <http://www.doingbusiness.org>).

⁵⁰ See RPT Regulation, *supra* note 35, art. 5 and Annex 4.

⁵¹ See RPT Regulation, *supra* note 35, art. 5.

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 the applicable rules or of the DB methodology itself. As a result, according to the DBRs, the Italian legal system has made no progress in recent years. According to the evaluation no noteworthy reform has been passed in 2010, or enacted in 2011.⁵² Although the DBR team stated that “a rigorous reform effort will certainly be reflected in the DB indicators,”⁵³ regardless of whether it is intended to improve on DBR rankings we intend to show that the ranking fail to account for Italy’s improved legal regime.⁵⁴

In part 7, we analyse how mistakes in past assessments are responsible for delivering misleading information on the jurisdiction’s legal developments. In this section, we highlight one inaccuracy in the coding of the legislation currently in force. In particular, the DBR 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 introduction of independent board members brought substantial change to Italian corporate practices: there is evidence that active shareholders can take advantage of the Regulation to successfully challenge RPTs.⁵⁵ This shows that the new legal devices which aim at protecting 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 this mistake for three main reasons. First, its impact on Italy’s PII ranking is not

⁵² Int’l Fin. Corp. [IFC], *Doing Business 2012 – Economy Profile: Italy*, DOINGBUSINESS.ORG, 61–63 (Jan. 1, 2012), http://www.wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2012/02/23/000333038_2012022323235145/Rendered/PDF/653230Italy0Do0Box0365711B00PUBLIC0.pdf. See *infra* Fig. 1.

⁵³ Int’l Fin. Corp. [IFC], *Doing Business in Italy – Reform opportunities*, DOINGBUSINESS.ORG, 3 (2012), <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Subnational-Reports/DB13-Italy.pdf>.

⁵⁴ See Organisation for Economic Co-operation and Development, *supra* note 35, at 117 (“Italy has made considerable progress in recent years to promote and defend shareholder rights and to improve transparency”).

⁵⁵ See BELCREDI & ENRIQUES (2014), at 27–8 (reporting successful initiatives by Amber Capital LP at companies such as Fondiaria SAI and Parmalat).

negligible. Indeed, it accounts for eighteen positions in the last DBR.⁵⁶ Second, it affects one of the core regulatory devices of the RPT Regulation, which has been implemented with the intent to ensure that conflicted transactions are entered into at fair conditions; the DBR's misunderstanding of the Italian regulatory framework is therefore much larger than what is shown by this single mistake. Third, this coding mistake reveals the challenges that the DBR evaluation encounters in balancing the objectivity of the evaluation while also carefully assessing peculiar solutions by individual jurisdictions.

Indeed, some of the procedural requirements in the RPT Regulation are admittedly unique. Therefore, it may be difficult to precisely allocate them into standardized legal framework models of the DBR simulation. That is the case with the special committee's binding advice on the RPT. The PII variable ascertains whether the corporate body provides sufficient legal 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 on the transaction 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 while "Mr James" is not permitted to vote; finally, a maximum score of three is granted if shareholders must vote on the transaction while "Mr James" has to 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 transactions. Based on the methodology, Italy receives one point under this questions."⁵⁷ The team therefore assigned to

⁵⁶ See *infra* Tbl. 6.

⁵⁷ See DBR TEAM, *Doing Business Project Response – Italy*, 13 (Jul. 19, 2011) (unpublished manuscript) (on file with the authors).

Italy a score of 1. The reported statement is inaccurate in describing the RPT Regulation and shows some misunderstandings on the functioning of its procedural safeguards. As clarified in section 4, the new regulation relies on the review of RPTs by a special committee of independent directors. Their power to veto the transaction is the primary tool for ensuring minority shareholder protection. More precisely, independent directors are involved in the negotiation. The board of directors' approval of the RPT is subject to binding favourable advice of a committee of independent directors. In other words, the committee of independent directors has a veto power on RPTs.⁵⁸

The requirement for independent committee's binding opinion neutralizes the disgraceful choice by Italian lawmakers in 2003 not to disqualify interested directors from voting.⁵⁹ Interested directors cannot be members of the special committee which can veto the resolution.⁶⁰

To conclude, according to the default regime, a negative advice from the independent committee of directors can block the RPT. Therefore, the appropriate score should be 2 instead of 1.⁶¹

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.

⁵⁸ The committee's binding advice is the default rule, but a double-majority quorum is required for opting-out companies. *See supra* note 42.

⁵⁹ C.c. art. 2391. 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: C.c. artt. 2368 and 2369, 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 E.U. Commission's proposal mandating shareholder approval is eventually to become law (*see supra* note 44 and accompanying text), Italy – as any other E.U. jurisdiction – will get 3 points for this variable.

6. THE DBR EVALUATION. METHODOLOGICAL ISSUES

The DB team's explanations⁶² show that the reason why the DBR assigns 1 to Italy despite the independent directors' veto power is twofold:

1. The case study assumes that the approval by the committee is a formalistic requirement (*see* part 2). The independent committee, therefore, does not have the final say on the RPT as the final approval is left to the board.
2. Interested parties may vote in the final decision of the board of directors.

Both points are formally correct. The DBR evaluation, however, fails to understand the regulatory mechanisms which underpin the Italian rules on RPTs. Indeed, according to this methodology, and to its implementation by the team, no difference exists between the current Italian regime and a regime where RPTs are approved by an ordinary vote of the board of directors. This is misleading because the two mechanisms – ordinary voting procedure and independent committee's veto – are unlikely to lead to the same outcome. Clear-cut categorizations always run the risk of misinterpreting regulations that do not perfectly fit into their classification (e.g. the Italian Regulation on RPTs). However, approaching law from a functional perspective seems more reasonable 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 RPTs, rather than who has the final say on their positive approval. These two functions are usually commingled because directors may either approve or reject the proposal by casting a single vote. As a consequence, DB's methodology is based on this common voting pattern. On the contrary, the procedure set forth by the RPT Regulation somehow splits these two phases. Once a negative vote has been expressed by the committee of independent directors, the board can no

⁶² DBR TEAM, Doing Business Project Response – Italy, 2 (Jul. 19, 2011) (unpublished manuscript) (on file with the authors).

longer vote on the same matter. In other words, for investor protection purposes, it is indeed relevant whether someone other than “Mr James” and the board of directors can say “no” to the transaction. The fact that the whole board, which includes “Mr James” as a voting member, may still decide whether to approve the transaction is irrelevant. Indeed, a subset of independent and disinterested directors has already assessed that the proposed transaction is fair and useful. Hence, the evaluation grid – or, rather, its application – improperly assume that only mandatory abstention may avoid improper influence by interested parties. The methodology indeed regards any regulatory mechanism which deviates from this standard as inadequate, regardless of whether it delivers equally effective results.⁶³

In Italy, only if the committee of independent directors has given its approval the board can still vote down the RPT. The approval by the committee is a governance device which is designed to ensure independent evaluation of the RPT’s fairness in the light of the company’s interest. The assessment exercise by regarding this approval as a preliminary authorization does not correctly evaluate regulatory strategies other than full board voting. The DBR evaluation, therefore, does not respect the principle, which is self-evident in comparative law, that different regulatory tools can achieve the same results.⁶⁴ According to the ill-founded interpretation of the DBR, when the vote is taken before and separately from the final approval of the RPT, investors are less protected when compared to regimes where the board approves the RPT without a dominant vote of the shareholders. It is true that any classification of legal rules requires a minimum level of

⁶³ Cf. Mathias Siems, *Measuring the Immeasurable: How Law Turns into Numbers*, in DOES LAW MATTER? ON LAW AND ECONOMIC GROWTH 115, 120-121 (Michael Faure & Jan Smits eds. 2011) (Djankov et al. methodology assumes that the same type of problem exists in all the jurisdictions considered, while this is far from obvious).

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., *supra* note 8, at 432). The assumption enables an unambiguous assessment of criteria such as those included in the director liability index (*see, 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., *supra* note 8, 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.

formalism, as a purely functionalist interpretation would pave the way to excessive subjectivity in the coding exercise.⁶⁵ On the other hand, by assuming that the positive approval by independent board members is a mere formality (i.e. regarding it as an irrelevant step in the voting process) rather than the first step of a multi-staged decision the team is also expressing a subjective opinion.

Moreover, although according to the RPT Regulation the special committee vote is the default mechanism it is also possible to opt for a double-majority quorum in the vote of the board of directors. Two logical consequences can be drawn from this information. First, no functional difference exists between the optional rule system where the two decisions, one by the plenum and the other by the majority of the independent committee, are merged into one and a system where these decisions are deferred to two separate moments. Therefore, because no one would ever regard the double majority requirement as a preliminary authorization with no practical value, the same should be true for functionally equivalent regulatory mechanisms. Second, by requiring “Mr James” to abstain the regulatory environment will be more effective – and here we come to the fact that interested parties are allowed to vote – because the board will not be able to approve resolutions in the presence of dissenting votes by the majority of independent directors.⁶⁶ Therefore, although according to the RPT Regulation interested directors may vote, the preliminary binding advice of the independent committee (i.e., vote) reaches the same outcome and goes even further. Indeed, even in systems where “Mr James” is not allowed to vote – and the methodology requires no more than that – his presence at the board meeting may significantly influence the resolution. The default device adopted by the RPT Regulation avoids this risk as non-independent directors

⁶⁵ See Armour et al., *supra* note 2, at 600-1 (suggesting to enlarge the set of relevant variables in order to reduce the risk that formalism prevails over functionalism).

⁶⁶ Note that the Djankov et al. paper requires, with respect to the general meeting approval, that “the transaction must be approved by disinterested shareholders” (*see* Djankov et al., *supra* note 8, 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.

cannot be members of the special committee.⁶⁷ If compared to regulations which merely require “Mr James”, as well as other non-independent board members, to abstain the Italian procedure for deliberating on RPTs ensures a higher level of protection. Indeed, at the special committee stage, directors who are disinterested in the specific transaction, but are still under Mr James’s influence, and are less likely to disregard his preferences when voting, cannot be members of the committee.

From a methodological standpoint, it is worth noting that the decision to disregard the role of the special committee is acceptable only if the applicable legislation is interpreted from an extremely formalistic perspective. Even by adopting a formalistic approach, the qualification of the committee’s approval as a normal authorization may still be questionable. Apparently, this formalistic approach wants to ensure that the evaluation is consistent across different jurisdictions. However, reliance on formalism to ensure consistency and objectivity can lead to mistaken conclusions. First, we have shown that formal classifications (e.g. the decision to classify the vote of independent directors as a preliminary authorization rather than as part of a multi-staged board decision) can also be arbitrary: arbitrariness and objectivity are hard to match. Second, by focusing on the qualification of procedural requirements rather than on their function, current coding practices could disregard essential features of corporate governance and misjudge the effectiveness of investor protection mechanisms.⁶⁸

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.

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* note 61 and accompanying text) granted to France as a consequence of the provision: cf. CODE DE COMMERCE [C.COM.] [COMMERCIAL CODE] Artt. L225-41 and L225-40 (Fr.) that enables shareholders to vote on RPTs authorized by the board of directors: see Int’l Fin. Corp. [IFC], *Doing Business 2014 – Economy Profile: France*, WORLD BANK.ORG, 65 (Oct. 29, 2013), http://www.wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/04/30/000260600_20140430162822/Rendered/PDF/828360France0FRA0Box0382098BooPUBLICo.pdf. 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 MAURICE COZIAN et al., *DROIT DES SOCIÉTÉS* 352 (2012); see also Enriques et al., *Related Party Transactions*, in REINIER KRAAKMAN et al., *THE ANATOMY OF CORPORATE LAW* 168 (2nd ed 2009, Oxford University Press). Second, the transaction is valid even in case shareholder approval is refused (see Organisation for Economic Co-operation and Development, *supra* note 35, cit., at 64) although the directors who approved it may be liable for damages ((C.COM) Artt. L225-41 and L225-42); PAUL LE CANNU & BRUNO DONDERO, *DROIT DES SOCIÉTÉS* 500 (2013)).

On the contrary, our analysis confirms that a functional approach⁶⁹ would make the DBR assessment more accurate.⁷⁰ This approach assumes –this assumption is not discussed upon in the present work – that the trust in benchmarking exercises helps fostering adequate legal reforms.⁷¹ A comparative law study, if properly conducted, would indeed refrain from easily stating that a jurisdiction lacks a specific legal tool just because of the peculiarity of its regime. 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.⁷² Other legal tools are at least as effective as mandatory abstention from voting⁷³ regardless of whether they operate before the transaction is brought to the plenary session of the board. Indeed, only independent directors, which also have no interest in the transaction, can participate to the independent committee. The evaluation should reflect the fact that different legislative tools may perform better than conflicted members' abstention without additional costs. 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?’”⁷⁴

⁶⁹ See, e.g., KONRAD ZWEIGERT & HEIN KÖTZ, *INTRODUCTION TO COMPARATIVE LAW* 32-47 (3rd ed. 1998).

⁷⁰ See Michaels, *supra* note 9; Michaels, *supra* note 16 (suggesting stronger integration between comparative economics and comparative law); Kerhuel & Fauvarque-Cosson, *supra* note 33, at 828. See also Ménard & Du Marais, *supra* note 4, 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, *The Functional Method of Comparative Law*, in *THE OXFORD HANDBOOK OF COMPARATIVE LAW* 339 (Mathias Reiman & Reinhard Zimmermann eds. 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 John Reitz, *How to Do Comparative Law*, 46 *AM. J. COMP. L.* at 621 (1998) (on comparative law methodology).

⁷³ *Id.* at 623 (each jurisdiction may conform in different ways to the ideal legal tool adopted as a term of comparison).

⁷⁴ ZWEIGERT & KÖTZ, *supra* note 69, at 34.

Comparative legal studies therefore necessarily entail some degree of generalisation. Searching for rules performing equivalent functions requires abandoning formal definitions in favour of broader categories which are capable of including rules which, though formally different from a formalistic perspective, achieve the same normative result.⁷⁵ 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 emphasizes the objective of the assessed regulation (sterilization of “Mr James’s” interests in board decision), rather than the external 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 influence national policies.⁷⁶ The DBR provides a diachronic perspective on legal reforms. Indeed, year-on-year changes highlight whether a country is committed to improve its regulatory environment.⁷⁷ Flat performances or lost ground in the rankings may indicate that policymakers are not paying attention to areas of law that are pivotal in boosting economic growth.⁷⁸ The DBR’s focus on trends in regulatory reforms therefore provides interested stakeholders with valuable

⁷⁵ Reitz, *supra* note 72, at 625 (comparative analysis ... forces the comparatist to articulate broader categories to accommodate terms that are ... functional equivalents).

⁷⁶ See DAVIS et al., *supra* note 8, at 11 (2012) (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 John Armour et al., *Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origin Hypothesis*, 6 J. EMPIRICAL LEGAL STUD 343, 350–353 (2009)).

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.”

information. Indeed, potential investors can compare legislations in different countries whilst having a full picture of the evolutionary stages within the same jurisdiction.

In this respect, the attribution of an erroneously high score to a country in a certain year may paradoxically entail an underestimation of subsequent reforms. Therefore, even when substantial improvements have been achieved the chart might still show that the legal system of a jurisdiction had no improvements. 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"⁷⁹). This means that respondents to the questionnaire 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 disclose the relations with their controlled, affiliated and controlling entities as well as with other entities under common control, the provision, according to the predominant interpretation, did not require a detailed disclosure of individual self-dealing transactions.⁸¹ Therefore, even after the implementation of IFRS the consistent accounting practice of listed companies was not to include detailed information on these transactions.⁸²

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 Luca Enriques et al., *Corporate Governance Reforms in Italy: What Has Been Done and What Is Left to Do*, 10 EUR. BUS. ORG. L. REV 477, 503-504 (2009).

⁸¹ See Giovanni Emanuele Colombo, *Il bilancio d'esercizio [The Financial Statement]*, in TRATTATO DELLE S.P.A. 157 (Giovanni Emanuele Colombo & Giuseppe Benedetto Portale eds., UTET 1994).

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, 140 (2007). Companies used to aggregate related party transactions in their annual reports before the RPT Regulation entered into force (see CONSOB (2008), Consultation document on the regulation of related party transactions).

The RPT regulation has later specifically required annual, as well as the half-yearly financial reports to disclose,⁸³ self-dealing transactions falling above the materiality threshold.⁸⁴ Before the regulation was enacted, 0 would have been the appropriate score.

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 information⁸⁶ 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 the Buyer’s would be very likely to fall within the scope of the ongoing disclosure obligations.⁸⁷ Therefore, the proper rating would have been 1 (as no disclosure of Mr James’s conflict of interest was explicitly mandated). According to Art. 71-II of Consob Issuer Regulation, the conditions for triggering an obligation to disclose were so hazy that very few transactions had been made public under the rule. More specifically, only transactions which could have jeopardized the issuer’s financial stability or the reliability of its financial account – according to the issuer’s own judgment – had to be disclosed. As the case study is not assuming that these conditions are met, it cannot be established whether “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, when disseminating price sensitive information, are required to declare relationships with the other parties of the transaction

⁸³ For interim financial reports, Council Directive 2007/14, art. 4, 2007 O.J. (L 69) 27 (EC), implementing Council Directive 2004/109, art. 5(4), 2004 O.J. (L 390) 38 (EC), 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 RPT Regulation, *supra* note 35, art. 5(8) (listed companies shall provide information, in the interim and annual reports, on each material transaction entered into during the reporting period).

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* note 47 and accompanying text.

⁸⁷ See *supra* note 47 and accompanying text.

⁸⁸ See RPT Regulation, *supra* note 35, art. 6(1)(a).

which might result in a conflict of interest.⁸⁹

Once the suggested coding corrections 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

Table 1

	<i>Extent of Disclosure Index (Sub-Variables)</i>	<i>2011 Adj.</i>	<i>2012 on Adj.</i>
1	What corporate body provides legally sufficient approval for the transaction?	1	2*
2	Whether disclosure of the conflict of interest by Mr James to the board of directors is required?	2	2
3	Whether immediate disclosure of the transaction to the public and/or shareholders is required?	1**	2
4	Whether disclosure of the transaction in published periodic filings (annual reports) is required?	0**	2
5	Whether an external body must review the terms of the transaction before it takes place?	0	0
	Extent of Disclosure Index	4	8

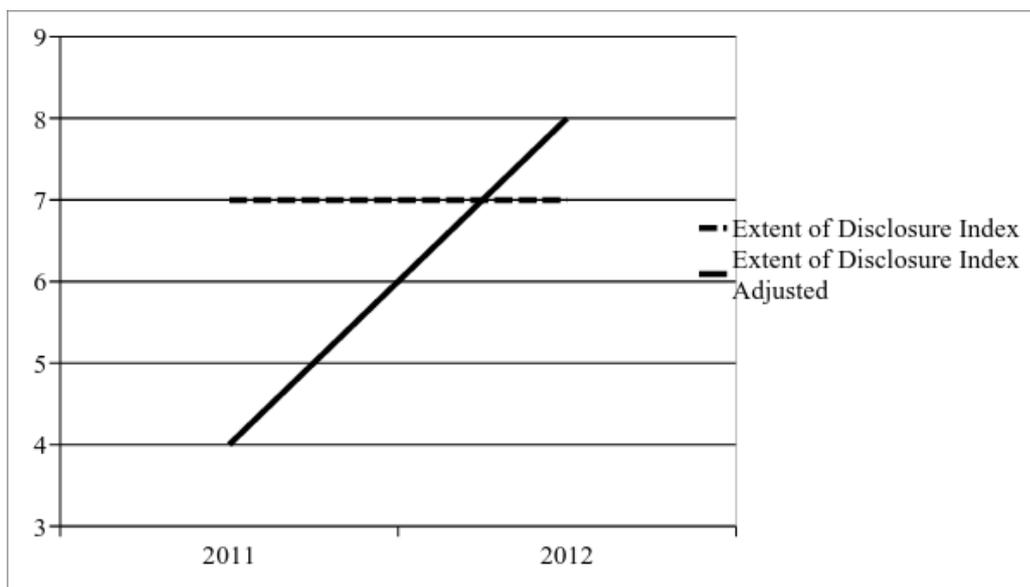
* The variable is adjusted to reflect the role of the binding opinion by the independent directors' committee (see parts 5 and 6).

** The variables are adjusted to reflect the situation prior to the full RPT Regulation's entry into force (Jan., 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.

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 (*see supra* note 49 and accompanying text; *see* RPT Regulation, *supra* note 35, art. 5(1) and (3); *see also* RPT Regulation, *supra* note 35, Annex 4). Although such information is more detailed than that provided for under RPT Regulation, *supra* note 35, art. 6(1)(a), 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 seventy-two hours after the transaction is approved (*see supra* note 49 and accompanying text).

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

Figure 1



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 2012, when the benefits of the Regulation were to be assessed for the first time (29th instead of 65th), as well as in the last available survey at the time of writing (2014: 32nd instead of 49th).

Table 2

	<i>2011 Original</i>	<i>2011 DBR Corr.</i>	<i>2011 Adj.**</i>
Protecting Investors (rank)	59th	44th	93rd
Extent of disclosure index	7	7	4
Extent of director liability index	4	4	4
Ease of shareholder suits index	6	7*	7
Strength of investor protection index	5.7	6	5

Table 3

	2012	2012 DBR Corr.	2012 Adj.**
Protecting Investors (rank)	65th	46th	29th
Extent of disclosure index	7	7	8
Extent of director liability index	4	4	4
Ease of shareholder suits index	6	7*	7
Strength of investor protection index	5.7	6	6.3

Table 4

	2013	2013 Adj.**
Protecting Investors (rank)	49th	32nd
Extent of disclosure index	7	8
Extent of director liability index	4	4
Ease of shareholder suits index	7	7
Strength of investor protection index	6	6.3

Table 5

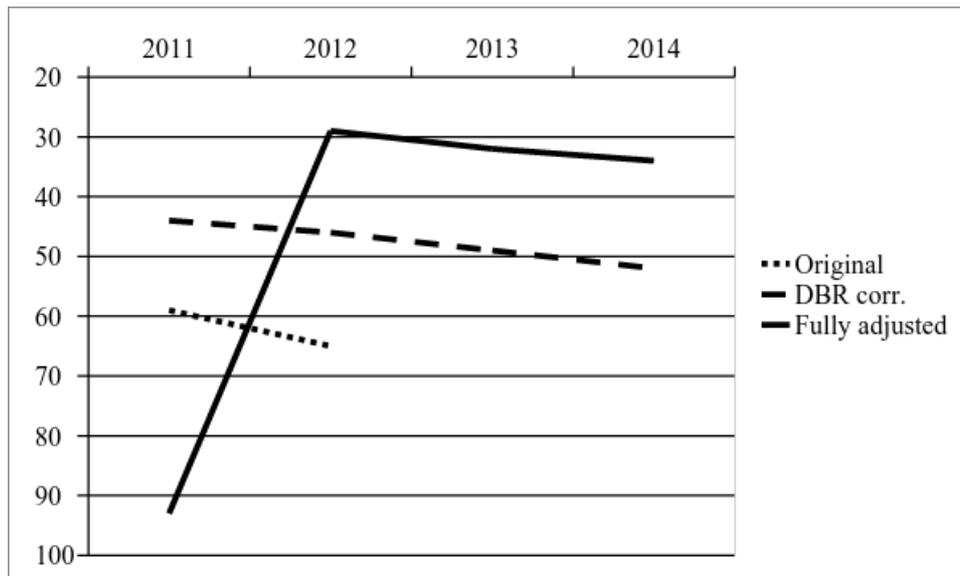
	2014	2014 Adj.**
Protecting Investors (rank)	52nd	34th
Extent of disclosure index	7	8
Extent of director liability index	4	4
Ease of shareholder suits index	7	7
Strength of investor protection index	6	6.3

* 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 supra* note 34 and accompanying text).

** 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 fifty-nine 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

<i>Investor protection Index</i>	<i>Original Ranking (1)</i>	<i>DBR Corr. Ranking (2)</i>	<i>Adj. Ranking (3)</i>	$\Delta (3) - (1)$	$\Delta (3) - (2)$
2011	59 (5.7)	44 (6)	93 (5)	- 34	- 49
2014	n.a.	52 (6)	34 (6.3)	n.a.	+ 18
Variation (positions)	n.a.	- 8	+ 59	n.a.	+ 67

8. CONCLUSIONS: FUNCTIONAL APPROACH AND TRANSPARENT ASSESSMENT

The DBR has provided developing and developed countries with incentives to adopt more effective economic regulation by persuading policymakers that sound rules may enhance competitiveness and that cutting back on regulatory costs and red tape are key ingredients of economic 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 interpretations of the applicable rules (e.g. the scoring on the mandatory individual RPTs disclosure in the annual accounts) (part 7). Others are methodological (e.g. the identification of the body providing legally sufficient approval for the transaction). Indeed, they fail to recognise that the procedural guarantees set forth by the Consob RPT Regulation are, in fact, more effective than the relevant DBR variables on board approval (part 6).

No ranking system can be perfect, as quantitative evaluations require a certain degree of simplifications.⁹² However, some strategies may be adopted so as to improve the accuracy of the DBR assessment, as well as the shortcomings which affect the evaluation of the Italian legal framework for RPTs transactions. There is room for improving the coding process in the formulation of these indicators. Although the DBR assessment is already following 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 provisions⁹³), its transparency is still insufficient when it comes to justifying unclear coding decisions.⁹⁴

⁹¹ See, e.g., Ménard & Du Marais, *supra* note 4, 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); INDEP. EVALUATION GRP., *supra* note 5, at 44 (same).

⁹² See Siems, *supra* note 2, at 529.

⁹³ Other organizations providing indicators are not equally transparent: for a sample review see Nikhil K. Dutta, *Accountability in the Generation of Governance Indicators*, GOVERNANCE BY INDICATORS. GLOBAL POWER THROUGH QUANTIFICATION AND RANKINGS 43, at 449–450 (Kevin E. Davis et al. eds. 2012).

⁹⁴ See INDEP. PANEL, *supra* note 9, at 5 (suggesting publication of contributors' submissions so as to allow external users to gauge the level of uncertainty associated to each index).

Furthermore, the reliability of the rankings may improve by providing for external review of the decisions of the DBR. This would reduce the risk that institutional inertia, as well as confirmation biases, could produce inaccurate final indicators even when the outcome of the process is prone to clerical rather than methodological errors.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. By focusing on the function of the rule under scrutiny rather than on its formal features the highlighted drawbacks could be substantially reduced. In particular, this approach would introduce at least two improvements. Firstly, before rankings are made a more accurate knowledge of the societal context of the assessed jurisdictions would have to be obtained.⁹⁶ By assessing the scrutinized rules in coordination with other legal and economic features the concerned jurisdictions may deliver more complete results. Indeed, in order to perform a statistical analysis the DBR relies on an unrealistic set of rules that make it prone to simplification.⁹⁷ Second, any set of regulatory standards will be unlikely to include all relevant investor protection laws: complete information would be difficult to collect and to handle. In this scenario, a functional approach can improve the quality of the assessment by avoiding the risk of circularity which is one of the major flaws of the formalistic approach. Indeed, the latter relies on the assumption that only specific legal devices can assure effective investor protection, and therefore it disregards the alternatives which do not fit into the grid.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 pass regulations that reflect the evaluation grid of the DBR even if investors have no benefits from the reform. For instance,

⁹⁵ See Dutta, *supra* note 93, at 440. According to INDEP. PANEL, *supra* note 9, at 5, 29–30 miscoding might be more easily avoided if risk-mitigation devices, such as external reviews, were included in the assessment process.

⁹⁶ On the epistemic role of a functional approach see Michaels, *supra* note 16, at 3–4.

⁹⁷ See *id.*, at 12, on a statistical reductionism.

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 *supra* note 31 and accompanying text).

Italy would gain a number of positions in the PII ranking by amending a small number of legal provisions in a fashion that would not substantially improve the current level of minority protection. For instance, mandated abstention for “Mr James” could be introduced. As we have shown, this reform would have almost no impact on his ability to influence the company’s decision. Secondly, as long as the DBR focuses on default rules,⁹⁹ Italy’s performance would further improve by requiring shareholders to approve the transaction, while still granting companies the possibility of opt-outing and of granting independent directors a veto power.¹⁰⁰ Once more, there is no evidence that this would strengthen investor protection. Controlling shareholders could easily circumvent the default rule by amending the charter. Thirdly, as the Consob RPT Regulation allows independent directors to appoint an external adviser of their choice but does not mandate it,¹⁰¹ imposing fairness opinions would boost Italy’s performance.¹⁰² However, the legal and economics literature often has doubts about the reliability of board-appointed external experts.¹⁰³ For this reason, their appointment is not compulsory.¹⁰⁴

⁹⁹ See *supra* note 61 and accompanying text.

¹⁰⁰ A similar solution would be ruled out, though, if the E.U. Commission’s proposal on the approval by general meeting of significant related party transactions were adopted (see *supra* note 44 and accompanying text). In the proposal, shareholder vote is mandated with no possibility of opt-outing.

¹⁰¹ See *supra* text accompanying note 41.

¹⁰² See Tbl. 1, line 5.

¹⁰³ See, e.g., Jonathan R. Macey, *The Regulator Effect in Financial Regulation*, 98 CORNELL L. REV. 621 (2013) (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); Darren J. Kisgen et al., *Are Fairness Opinions Fair? The Case of Mergers and Acquisitions*, 91 J. FIN. ECON. 179 (2009) (finding evidence that fairness opinions in M&A transactions provide little value to shareholders of target firms, while results are mixed for acquiring firms’ shareholders); Steven J. Cleveland, *An Economic and Behavioral Analysis of Investment Bankers When Delivering Fairness Opinions*, 58 ALA. L.R. 299 (2006) (reputational concerns provide weak constraints on investment bankers having an incentive to align their opinion with their clients’ wishes).

¹⁰⁴ Macey, *supra* note 103, at 622–3 absent Delaware courts’ de facto mandate for fairness opinions, these would perform their function better); Nina Walton, *Delegated Monitoring: When Can Boards Rely on Outside Experts?*, 14 AM. L. & ECON. REV. 271, 276–277, and 295 (2012) (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 have hypothesized above were introduced, Italy's Extent of Disclosure Index could reach 10.¹⁰⁵ The PII would subsequently jump to 7,¹⁰⁶ and, *ceteris paribus*, the DBR for investor protection ranking Italy would be 16th in the DBR ranking. As shown, investor protection would not substantially improve.

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. Therefore, it discourages the implementation of new legal devices which would lower the costs of implementation whilst ensuring the same level of investor protection. In other words, homologation trumps experimentation.¹⁰⁷ By contrast, a functional evaluation would increase flexibility,¹⁰⁸ which is pivotal in the field of investor protection because tunneling techniques change over time in accordance with the relevant legal framework.¹⁰⁹ Therefore, like in a cops and robbers game, it requires the continuous testing of new legal strategies.

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 Larry Ribstein & Bruce Kobayashi, *An Economic Analysis of Uniform State Laws*, 25 J. LEGAL STUD. 131, 140-141 (1996) (uniform laws determine a lower degree of experimentation).

¹⁰⁸ On the role of functionalism in the production of rules see Michaels, *supra* note 16, at 4. INDEP. PANEL, *supra* note 9, at 23, suggests reviewing the Indexes periodically in order to reduce selection biases.

¹⁰⁹ Vladimir Atanasov et al., *Law and Tunneling*, 37 J. CORP. L. 1 (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).