The decision to adopt defensive tactics in Italy

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Accepted 6 September 2000

1. Introduction

The issue of defensive tactics lies at the very heart of the debate over tender offer. This is not surprising, as few policy choices imply trade-offs as drastic as the ones implied in this area: Allow too much resistance, in hypothesis resistance without limits, and managers will dig trenches outside their offices and play cards inside; Allow too little resistance, in hypothesis no resistance, and takeovers will resemble a private taking, thus intuitively clashing against the protection of property rights.

In a somewhat more technical way, excessive resistance by targets might negatively affect the overall level of takeover activity, which in turn would mean less external monitoring of firms and increased managerial slack. On the other hand, preventing or seriously restraining the targets’ ability to resist a hostile bid appears at odds with the idea that owners of assets are usually entitled to bargain with potential acquirers of those assets.

Defensive tactics regulation thus suffers from the underlying tension between these diametrically opposing interests. It is not surprising that different scholars, emphasizing one or the other aspect of resistance, have reached radically different conclusions on the wisdom of allowing defensive tactics. The issue has been extremely debated in the American literature, where the spectrum of opinions runs the full gamut from the “absolute passivity” advocated by Easterbrook, Fischel, and Schwartz,1 to the cry in favor of “just saying no” of Lipton.2

Italy has recently seen a rather radical change in the legal regime of defensive tactics. The first comprehensive regulation of tender offers, implemented in 1992,3 introduced a rule of “absolute passivity.” In 1998, this rule was abandoned in favor of a rule that states that once

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a hostile bid has been launched any initiative that makes a hostile acquisition more difficult must be approved by shareholders. This paper seeks to evaluate, from a legal and economic perspective, the effects of such a rule over the functioning of the market for corporate control.

The rule adopted in Italy is not completely unknown to legal systems. A similar rule exists in the UK “City Code” on takeovers and in the proposed thirteenth European Union Directive. The legal and economic environment in which the rule is going to operate, however, is radically different from the one we find in the United Kingdom. The distinguishing features of Italian corporate governance raise interesting questions concerning the efficiency of the rule.

The Italian regime presents a clear “enabling” aspect, allowing for a great degree of flexibility. Firms can thus, at a general level, “privately” choose the level of resistance they deem appropriate. When, on the other hand, agency costs hinder the functioning of private arrangements, the law steps in, providing a mandatory rule that prohibits the independent adoption of defensive tactics by managers. I posit that a regime centered on the attribution to shareholders of the exclusive power to decide whether or not to implement defensive tactics in the face of a hostile bid has undoubtedly positive features, that appear to lead to the adoption of an overall efficient level of resistance. In short, the Italian legal regime of defensive tactics aims at preserving the benefits while at the same time reducing the costs usually associated with resistance.

The paper proceeds as follows. Paragraph 2 provides a sketch of Italian corporate governance and an overview of the regulation of tender offers. Paragraph 3 examines the costs and benefits that are generated by resistance to a hostile bid. Paragraph 4 tackles the policy question, that is, what type of rules is more efficient in this context. In paragraphs 5 and 6 I examine the ability of Italian corporations to devise an efficient long-term resistance policy and the mandatory feature of the Italian regime. Paragraph 7 considers (and refutes) the objection that “rational apathy” and collective action problems might in fact prevent an effective operation of shareholders’ vote. In paragraph 8 I underscore possible shortcomings of the Italian regime (that is to say, the possibility that the incumbent managers and controlling shareholders might abuse defensive tactics) and the legal response aimed at solving them. Paragraph 9 concludes. In the epilogue, paragraph 10, based on the conclusion that the Italian regime is overall efficient, I suggest arguments for an evaluation of the recently advanced theory that unitary systems may tend to produce efficient takeover regulation.

A final caveat is required. An evaluation of any kind of regulation of defensive tactics is obviously influenced by the author’s view of the takeover phenomenon. This paper is based on the premise that while empirical evidence is most consistent with efficiency explanations of the phenomenon and most notably with the disciplinary role of takeovers, we still lack decisive evidence to rule out the possibility that value-decreasing takeovers take place. A balanced approach to regulation seems thus required; that is to say, an approach that while recognizing takeovers to be generally beneficial, acknowledges that there are instances in which takeovers may in fact be value-decreasing.
2. A primer of Italian corporate governance

Italy presents corporate governance mechanisms that cannot be homogenized into any of the usually studied Anglo American, German or Japanese models. The Italian economic and industrial system presents striking peculiarities. Small firms dominate the scenario, with a limited number of even medium size firms. Various factors have helped small firms obtain remarkable results. Firms are often clustered in the same area, the “industrial district,” where they exploit externalities of various nature. They are linked through stable interfirm relationships that mimic the productive structure of larger firms. Finally, these small firms have shown a notable tendency to invest in research and development.6

“Public companies,” in the Anglo-Saxon sense of the expression are extremely rare. Ownership is concentrated, possibly as a result of weak protection of minority shareholders.7 This limited amount of separation is achieved especially through the use of pyramidal structures, often backed by implicit and fiduciary relations among investors.8 At the same time, the system differs from other continental European systems, most notably the German one, given that banks and institutional investors play a limited role.9

The presence of strong blocholders implies that “first generation” agency costs, in the tradition of Jensen and Meckling,10 that is, costs that arise out of separation of ownership and control, are not the main issue in Italian corporate governance. Firms are not ordinarily run by professional managers unaccountable to shareholders. Rather, firms are usually run by managers that are the expression of controlling shareholders, whose interests are likely to be different from those of the minority shareholders.11 Empirical studies have found extremely large premia attributed to the voting shares of Italian listed corporations, thus suggesting that there are high private benefits stemming from control, and that these benefits are not shared with outside shareholders.12 Italian corporations present a weak relationship between turnover of managers and performance, a finding that confirms that the agency problem between top managers and controlling shareholders is small.13

The described equilibrium between shareholders and managers is reflected in the balance of power established by corporate law. Italian corporate law assigns control over fundamental aspects of the life of the corporation to shareholders. The rules that require any modification of the articles of incorporation, the bylaws, or the corporation’s capital structure to be approved by the general meeting of shareholders are an example of paramount importance in the area of hostile takeovers. A more in-depth analysis of this point is deferred to paragraphs 5 and 6. For now it is important to note that many defensive measures require shareholders’ approval regardless of whether a hostile bid has been tabled. Most defensive measures cannot—ex ante a hostile bid—be implemented without shareholder approval.

Not surprisingly, in a scenario of concentrated ownership takeovers have so far played an extremely limited role. Takeovers are infrequent and rarely hostile.14 The degree of concentration is often so high that changes of control must be consensual.15 A rule that requires shareholders’ vote on defensive tactics, like the one that is going to be examined in this paper, is obviously relevant only in the context of a hostile bid. Therefore, the analysis will be conducted under the assumption that a hostile takeover is at least in theory possible, that is to say, that no single shareholder or group of shareholders is able of stymieing a hostile bid on its own.
These observations are of obvious relevance in the context of an analysis of defensive tactics regulation. As we shall see, much of the debate over the issue revolves around the existence of aggravated agency costs and whether there exists the possibility for firms to deal effectively with these costs. In effect, the peculiarities of the Italian governance structure show up quite clearly even in this context. In the context of hostile takeovers, the higher concentration of ownership and the consequently reduced weight of agency costs translates—at least in so far as it does not determine the impossibility of a hostile takeover—into the firms’ increased ability to handle the issue effectively.

Notwithstanding the limited role played so far by hostile takeovers in Italy, however, at least two interrelated issues make the study of Italian tender offer regulation interesting. First of all, the entire legal framework of rules designing the governance structure of Italian listed corporations has recently been subject to a comprehensive reform. In a study of Italian corporate governance conducted, from an “American perspective,” before this reform, Macey\(^{16}\) observed the lack of all basic features of a well-functioning system of corporate governance. These critics probably capture only part of the story, because—as argued by some authors - Italian corporate governance need not necessarily be interpreted as “bad.”\(^{17}\) The need for a substantial redefinition of the corporate governance legal framework was indeed apparent. Recognizing such a need, a major reform of corporate governance mechanisms of listed companies has been implemented.\(^{18}\) Within this framework of reform, the creation of a robust market for corporate control has obviously been at center stage. Testing, at the theoretical level, the policy choices that have been made allows for a tentative evaluation of the success of the reform in devising an efficient system of corporate governance.

The second issue that is likely to increase the importance of tender offer regulation is that we may well see a higher number of takeovers in the future. Another peculiarity of the Italian economic system was a very strong presence of public enterprises, both in the industrial and in the financial sector, through a largely public banking system.\(^ {19}\) However, the importance of State economic intervention has dramatically decreased over the past decade and is still decreasing. Pressure from the European Union has severely curtailed the State’s ability to inject money into the public sector. This pressure, together with a mounting consensus on the necessity of reducing the role of the State in the economy, has ignited a major privatization program of the industry, the banking system, and the stock exchange itself.\(^ {20}\)

The ongoing retreat of the State from active intervention in the economy has determined the appearance of new large corporations that are obviously expected to play a fundamental role in the future development of the Italian economy. The ownership structure of these new economic agents is unlikely to be particularly concentrated thus making them potentially exposed to hostile bids. Two cases are not nearly enough to constitute empirical evidence, but the Telecom Italia and bids over INA show well that things are changing.

The subject matter of this paper is a specific aspect of tender offer regulation, that is to say, the regulation of defensive tactics. This aspect, however, cannot be evaluated in a vacuum. Tender offer rules interact with each other, and an outline of the system of rules set forth by the Legislative Decree 58/98 and by the regulations adopted pursuant the decree by Consob, the Italian securities and exchange commission, seems necessary. The offeror must inform the target, the market, and the Consob of its intention to launch a bid. The bidder must also transmit to Consob a prospectus that, after review by the commission, is diffused within the
public. The target must diffuse any data that helps to assess the offer and take a position concerning the offer. Section 104 of the Decree provides the rule that is the main subject matter of this paper. Any initiative that may obstruct the offer has to be authorized by target shareholders representing at least thirty percentage of the corporation’s stock. Section 120 provides the “early warning system”: The threshold above which a new acquirer has to report the purchases to Consob and to the issuer of the shares is set at two percentage. Both the pro rata and the best price rules are provided. Offers have to be kept open for a minimum period. Moreover, the law provides a series of hypotheses in which launching a bid is mandatory. Section 106 provides the most important case: The acquirer of at least thirty percentage of the stock of a corporation has to launch a bid over the remaining stock.

A full examination of this system is beyond the scope of this paper. For purposes of the analysis of defensive tactics it is however important to stress that the regulation presents a clear pro-auctioneering tilt, the minimum offer period and accumulation disclosure requirements being the basic tools against the implementation of “Saturday Night Specials.”

### 3. The costs and benefits stemming from resistance

Devising an overall efficient regulation of defensive tactics is an exercise that requires a careful balancing of opposing interests. A full evaluation of the Italian regime requires, first of all, an exam of the costs and benefits stemming from resistance.

Specifically, two sources of cost can be identified. First, targets’ resistance generates an externality that negatively affects other firms. All other factors being equal, resistance increases the premium that a bidder must pay in order to gain control of the target. Other firms can free ride on the search conducted by the first bidder and can make a concurrent bid. The need to pay a higher price for the target reduces the expected profit of the first bidder. This translates into a lower level of search for targets by potential bidders. At the margin some bids will not be made in the first place. The reduction in the overall level of takeover activity implies less external monitoring of firms and thus determines higher managerial shirking.

The second cost generally associated with resistance is originated by the increased wedge that hostile takeovers drive between the interests of shareholders and those of managers. In the majority of hostile takeovers incumbent managers are removed. Incumbent managers will thus react to the bid by trying to save their position and perquisites. The risk is higher in the context of takeovers driven by the need to decrease agency costs, where the very existence of a hostile takeover testifies that incumbent managers have been managing the firm inefficiently. Indeed, “the less effective they have been as managers, the greater their interest in preventing a takeover.” Apart from their deterrent effect, defensive tactics are thus detrimental to the functioning of the market for corporate control because they can be used not to generate higher gains for shareholders but rather to secure incumbent managers’ positions.

At the same time, resistance also generates some benefits. Haddock, Macey, and McChesney, building on the role of bargaining in the theory of property rights, underscore the beneficial effects of resistance. These authors observe that opposition to the right of resisting
an offer is troubling because assets’ owners are usually entitled to bargain with potential acquirers of those assets. Within the theoretical framework set forth by Calabresi and Melamed, Haddock et al. observe that “property rules” rather than “liability rules” usually protect owners of assets. To be sure, at the moment of the exchange between the buyer (i.e., the bidder) and the seller (i.e., the target), resistance is a zero-sum game, in that it influences only the way gains are shared between the parties in the exchange. In other words, the higher premium usually generated by resistance hides a mere wealth transfer from bidder shareholders to target shareholders.

Bargaining is however in the long run beneficial. It provides the correct incentives to increase the magnitude of gains to be divided between seller and buyer. In the takeover context, bargaining increases the gains to be divided in two distinct ways. First of all, while corporate acquisitions require investment in search, it is not only bidders who search. Some firms search for potential bidders. Firms might be undervalued because certain assets should be reallocated outside the firm itself. Managers may know this, and may look for an external remedy. A rule preventing potential targets from obtaining some share of the gains would reduce the target’s incentive to inform potential bidders of the possibility that their shares are undervalued. Furthermore, firms may encounter opportunities to make value-increasing investments, the full returns from which may only be realized in a future takeover. For example, some computer software companies may plan to be the target of a takeover with the successful creation of merely one software package. Again, a rule banning resistance would seriously reduce the incentive to make these investments in the first place.

A further positive effect of bargaining has to be taken into account. Bargaining protects firm-specific human capital. In order to cope with firm-specific risk, managers must make investments in firm-specific human capital. These investments are specific to assets owned by others, namely the shareholders, and are therefore not readily transferable. Managers are thus exposed to the risk of opportunistnic behavior. The possibility to resist a hostile bid helps to preserve managers’ incentives to make these investments in the first place. In other words, if managers are not able to resist a hostile bid, a suboptimal level of firm-specific investment would result.

4. The policy question: blanket rules or flexibility? The mixed nature of the Italian system

The first questions that should be asked in approaching the regulation of defensive tactics are those regarding policy: What type of rules is required? Is it necessary to devise blanket rules which, for example, either ban resistance altogether or allow it without limit? And moreover, is there any need for mandatory rules, or is a default rule, from which firms can opt out, sufficient?

The policy-maker faces at least two possibilities. Mandatory rules that set a binding standard for corporations form one extreme of the spectrum. One clear example is the rule of absolute passivity that Italy adopted between 1992 and 1998. Firms could not opt out of the rule, and were thus externally forced to a no-resistance policy. Another example would be a system under which firms cannot renounce to the ability to resist. At the other extreme,
we find “default” rules that firms can choose as they are, “off the rack,” or which they can modify. This is clearly not the setting for a discussion of what type of rules, enabling or mandatory, best serves the goals of an efficient corporate law. Nonetheless, in the context of defensive tactics regulation, at a minimum there are strong arguments against the adoption of mandatory blanket rules that set the level of resistance that firms may implement. Regulation of defensive tactics implies a trade-off between the costs and the benefits referred to above. At the theoretical level, formulating a conclusive judgment on the issue is extremely difficult. Only empirical evidence could supply a definitive word regarding regulation of target corporations. At the current state of empirical research, however, there is no evidence that points definitively in one direction or another. Some event studies found no reaction to the introduction of antitakeover measures; others found negative stock price reactions; finally, recent large sample event studies found that resistance has not deterred takeovers and, to the contrary, has increased the size of premia paid.

The difficulty in evaluating the external costs generated by resistance and the existence of evidence showing the benefits that shareholders can gain from resistance mandate a cautious approach to regulation. There is apparently little room in this area for blanket rules aimed at setting the level of resistance, as the risk of error, that is, the risk of adopting a too stringent or a too lenient rule, is high. At the theoretical level, the policy question regards whether shareholders as a group would ex ante prefer a higher probability of a takeover but with a lower premium (a presumable consequence of a “low resistance” regime) or a lower probability of a takeover but with a higher premium. (correspondent to a “high resistance regime”) However, rather than attempt to guess what shareholders would prefer, a guess which has an obviously high risk of failure, a sound public policy should let the shareholders, whose wealth is at stake, decide.

Allowing firms to choose different strategies spurs competition between firms. The quest for optimal regulation is thus shifted from lawmakers to firms. The latter suffer the consequences of their mistakes and thus have the correct incentives to try to strike an efficient equilibrium in the mentioned trade-off between the amount of premium that shareholders receive in the face of a hostile bid and the probability that a bid materializes in the first place. “One-size-fits-all”-type rules, by contrast, constrain all firms to adopt the same level of resistance. The likelihood that the chosen level, whatever it may be, suits the needs of all firms is close to zero. The needs of firms differ, even substantially. Different firms will demand different levels of external monitoring, thus modeling different resistance policies. It is likely that firms will then prefer to “optimize, rather than eradicate,” the use of resistance.

The first step is thus taken towards the design of a theoretically wise framework of rules. The favor for an enabling provision relies heavily on the assumption that corporations are able to devise an efficient contractual solution to both the externality and the agency cost problems associated with resistance. In fact, contracts do not always work. In general terms, the costs of devising a contract capable of dealing with the problems faced by the corporation may be so high as to prevent a private solution. When such a possibility materializes, public law is apt to dominate. The task of defining with precision the amount of resistance adequate for each firm is extremely difficult. Therefore, even in a world
with no agency costs, where managers faithfully try to identify the optimal level of resistance for the firm they manage, the possibility of error is high. This error can result in either too much or too little resistance relative to the optimal level. In either case the result damages shareholders. In case of too much resistance the likelihood of replacing inefficient managers decreases. In case of too little resistance the corporation would change hands for too little a price. It is, however, very difficult \emph{ex ante} to predict which type of error will occur more often. If we introduce in the discussion agency costs, on the other hand, error will most likely systematically show a bias toward “too much” resistance. What matters is whether firms are able to overcome the natural bias of the system\textsuperscript{39} in favor of resistance.

Agency costs may, in certain instances, hamper the ability of firms to devise efficient contracts. When the burden imposed by agency costs becomes excessive, mandatory rules should step in, preventing the system from being skewed too much in favor of resistance. In other words, the general case for an enabling defensive tactics regulation does not necessarily imply that private solutions will always work. Recognizing the possible failure of private solutions points to the need for mandatory rules.

We find a similar pattern in the Italian regulation of defensive tactics. The Legislative Decree n. 58/98 presents, firstly, a clear enabling aspect. The act does not impose over firms a predefined amount of resistance, mandating that firms can never resist or that they always have to resist. Firms are granted a great degree of flexibility, thus ensuring the possibility for diversity to flourish. Beyond this fundamental enabling aspect, the Italian regime also presents a mandatory aspect: In short, Italian defensive tactics regulation enables corporations to decide the level of resistance that best suits their needs; at the same time, however, once a hostile bid has been launched and the ensuing aggravated agency costs prevent private solutions from being effective, the rule mandates that all defensive tactics have to be approved by shareholders rather than managers.

In other words, requiring shareholders’ approval aims at controlling “vertical” agency costs in the relation between shareholders and managers. As noted above, however, “horizontal” agency costs, in the relation between controlling shareholders and outsider shareholders, are of great importance in Italian corporations. The requirement that defensive tactics be approved by shareholders representing at least thirty percentage of the corporation’s stock, therefore, aims at controlling this other source of agency costs.

5. The \textit{ex post} and \textit{ex ante} interests of shareholders. The long-term “resistance policy” of the corporation

It seems useful to start the analysis with a static evaluation of Section 104 of the Legislative Decree 58/98,\textsuperscript{40} one that focuses on its \emph{prima facie} meaning.

Assume that a corporation makes a tender offer for the shares of another corporation. What will be the target’s probable reaction? Section 104 states that initiatives that might obstruct the realization of the offer must be authorized by target shareholders. Section 104 contains nothing, however, that restrains the target’s ability to resist, thus appearing to be an almost irresistible invitation to adopt defensive tactics. \textit{Ex post} an offer, triggering an auction is clearly in the shareholders’ interest. Once a bid materializes, the shareholders’ decision
does not involve any trade-off between the size of premia and the probability of takeovers. Once the bid has been launched, it is the size of the premium that concerns the shareholders. Target shareholders prefer auctions for the possibility of increasing the size of the premium received. 41 Indeed, the existence of an obvious ex post interest of shareholders in triggering auctions paves the way for great risk of ex post opportunism. 42 A firm’s unchecked ability to behave opportunistically ex post an offer would seriously restrain a potential bidder’s incentive to make the bid in the first place, thus exacerbating the weight of the externality that resistance imposes on firms other than the target itself.

The possibility of shareholders’ ex post opportunism does not, however, appear sufficient to oppose the regime introduced by S. 104. Any rule that goes short of absolutely banning defensive tactics is capable of generating ex post opportunism. As emphasized above, however, an absolute ban is unlikely to be efficient. Rather, it is necessary to verify whether rational shareholders are able to devise self-constraint devices to prevent the risk of ex post opportunism.

Shareholders’ ex post preference for auctions has thus to be balanced against the ex ante incentive to devise clauses that maximize the value of the shares. Shareholders bet their wallets on the value of the shares. Ex ante, they must trade the probability of a higher premium against the lower probability that a bid materializes. When hostile takeovers are a mere future possibility, rational shareholders recognize the direct threat of ex post opportunism to the trade-off between size of premia and probability of bids.

The real issue, in other words, is whether Italian corporations have the ability to precommit against the risk of opportunism. From this perspective, section 104, far from being the starting point in the search for a regulation of defensive tactics, becomes the final stop in a journey that starts well before the bid materializes. Section 104 addresses exclusively the moment in which the company implements its policy on defenses, be it a no resistance policy or what we could call a “to the last man to the last round” policy. That policy, however, will have been implicitly or explicitly chosen long before then. The decision regarding the amount of resistance that the corporation intends to implement in case of a hostile bid is indeed more usefully thought of as a continuum that goes from the day the articles are drafted to the moment the “barbarians” are at the gates. “Takeovers are not discrete events that begin at the moment the first bid materializes. All firms are ‘in play’ from the day they are created [. . . ].” 43

With this respect, Section 104 has a much less ambitious goal than might, at first glance, appear. The rule merely states that if and only if the firm chooses, in the face of a hostile bid, to adopt defensive tactics, they must be approved by shareholders. Clearly enough, the rule says nothing about the decision to adopt defensive tactics in the first place, a decision that might lengthily predate the launch of a hostile bid. 44

Some features of the Italian legal and economic system appear to permit firms to precommit. At the time of the initial public offering of securities there is no agency problem. Shareholders who draft the articles want to sell their shares and have thus the incentive to adopt value-maximizing clauses in the articles of incorporation. Inefficient clauses translate into lower share prices. This threat pressures the founding shareholders to adopt efficient clauses. If shareholders consider no-resistance clauses beneficial, they would pay higher
prices for shares of firms that banned or restrained the use of defensive tactics. At least the founding shareholders, therefore, have the correct incentive to devise efficient clauses.45

A separate question is whether, once the firm has gone public, there exist forces that will lead to a repeal of the efficient clauses adopted at the time of the initial public offering. Managers and controlling minority shareholders are the most obvious source of pressure for the removal of clauses aimed at limiting firms’ ability to resist. They could thus try to repeal the clauses originally adopted at the time of “going public.” This is a serious concern in an atomized corporation, where full separation of ownership and control allows managers to regain complete control over the resistance policy of the firm after incorporation.46

The high level of concentrated ownership that characterizes Italian governance structures greatly reduces this concern.47 A low level of separation of ownership and control corresponds to greater shareholders’ involvement over the management of the corporation. A more detailed analysis of shareholders’ incentive to get involved in the decisions concerning the “resistance policy” of the corporation is contained in paragraph 7. Suffice it here to say that concentrated ownership makes shareholder activism possible. Separation of ownership and control goes hand in hand with “rational apathy.” By contrast, as shareholdings increase, “rational activism” starts to make economic sense.

There seem, therefore, to be no insurmountable constraints to the adoption of clauses that make resistance more difficult once a bid has been launched. Firms can devise, for example, supermajority requirements for the adoption of certain obstructive measures. They might state a delay period for the modification of certain clauses of the bylaws. Such a provision would be particularly effective. Time is of the essence in contests for corporate control. A clause that states that the corporation will not take initiatives that might stifle the bid, coupled with a delay period for its repeal, would seem particularly effective. Within this theoretical framework, therefore, even the absence of any initiative aimed at introducing ex ante limits to the ability to resist acquires a rather specific meaning. A corporation will implicitly signal to the market that it does not intend to renounce the possibility to resist. Given the ex post interest of shareholders, this signal will bring along a high possibility that the corporation will indeed resist.

A final observation on this issue is required. As it has been emphasized in paragraph 4, we lack conclusive empirical evidence that shows whether resistance is beneficial or detrimental for firms as a whole. The conclusion that corporations can credibly precommit to a no-resistance policy, however, paves the way for drawing theoretical elements in favor of one or another side of the debate.

Italian corporations have so far been largely immune from the risk of hostile bids.48 The threat is becoming real and corporations will react to this threat. The pattern that will emerge could be telling. Perhaps takeover jargon will be enriched by new expressions. We do know of threatening expressions like “shark repellents” and “poison pills.” We have not heard yet of “sitting duck bylaws,” that is to say clauses that signal to potential bidders the complete no-resistance policy of the corporation. Perhaps such clauses will remain confined to papers in which the author tries to be funny, and if it will be so, the pro-resistance side of the debate will obviously gain momentum. If, on the other hand, we come to hear of this type of clauses the antiresistance side of the debate will be in a better position. The issue is, of course, moot, as it is too early to analyze corporate charters in search of emerging trends. Casual
empiricism suggests however that a possible “Telecom effect” is already at work. Enriques\(^49\) reports that as a result of the successful hostile bid for “Telecom Italia,” corporate lawyers are already drafting “shark repellents” for Italian corporations.\(^50\)

6. Resistance in the heat of the battle: agency costs and the mandatory feature of the Italian regime

Corporations have many possibilities for obstructing a hostile bid: From merging with a competitor of a potential acquirer, thus posing antitrust concerns to the latter, to issuing special classes of stock, via the sale of valuable assets. Most of the obstructive measures that a corporation can put in place require the approval of shareholders even before a hostile bid has been launched. Quite evidently, section 104 adds little to this respect. A merger with a competitor of the hostile bidder, for example, would require shareholders’ approval even had section 104 not been adopted. This is a fundamental observation: the structure of Italian corporate law—that foresees the shareholders’ role in fundamental aspects of corporation management—reduces managers’ ability to devise—\textit{ex ante} the bid—preventive defensive measures.

The \textit{raison d’être} of the rule has obviously to be found with regard to other kinds of defensive measures, namely defensive measures that do not already require, by virtue of general clauses of corporate law, a shareholders’ vote.

The previous paragraph has shown that the approach taken by the legal system relies heavily on the ability of firms to choose an efficient level of resistance. The mere fact that the previously followed “absolute passivity” regime has been abandoned in favor of a more flexible system that does not altogether reject the possibility of adopting defensive tactics implies faith in private solutions. When the law defers the choice of defensive tactics to each corporation, it takes the view that firms can credibly precommit to a no-resistance policy, thus reducing the threat of \textit{ex post} opportunistic behavior. The legal system might thus in theory entrust private solutions even with the task of limiting the extent to which agency costs can plague the efficiency of the resistance policy of firms. We observe everyday powerful contractual devices aimed at aligning interests of shareholders and managers. Maybe private solutions might therefore constrain managers and reduce the incidence of agency costs even in this context. In fact, under section 104, the launch of a hostile bid triggers a mandatory ban over the unauthorized adoption of defensive tactics by managers.\(^51\)

The appearance of a mandatory feature in an otherwise enabling regime needs to be explained. Why does a protection against managerial abuses require a mandatory rule when the bid has been launched? Why, in other words, is such a rule specified by the state, rather than by the investors as part of the contract establishing the firm and hiring the managers? The shift from an enabling to a mandatory approach should be justified on the ground that a market failure prevents successful private solutions.

Two obvious observations represent a useful starting point. First, managers can take a course of action that is capable of making a successful hostile bid more difficult. Second, managers need discretion in order to run the firm efficiently. Eliminating completely the risk of abuses without negatively affecting managers’ discretion is simply not possible. Another
trade-off therefore emerges. Anything that limits managerial discretion and prevents abuses of defensive tactics reduces the weight of agency costs but reduces, at the same time, the ability to run the firm efficiently. Similarly, greater discretion goes hand in hand with greater risk of decisions regarding resistance plagued by agency costs.

Virtually any business decision can be bent to serve an entrenchment purpose. A merger requires shareholders’ approval, but an agreement to cooperate with a competitor does not. Similarly, a sale of crown jewels, that is, of valuable assets that make the firm a potential target, does not require shareholders’ approval.

Therefore, even decisions taken by managers when a hostile bid has not yet been launched might in fact serve an entrenchment purpose. In theory, therefore, all decisions taken by managers, both before and after a bid has been launched, could be subject to a scrutiny meant to avoid decisions excessively plagued by agency costs. In effect, under Italian law, power over fundamental decisions having a “high resistance” potential is vested in shareholders even before the bid, as already noted. Mergers and spin-offs, issuance of special class stock, more generally any operation that affects the capital structure of the corporation, repurchases of shares, the issue of debt capital, all these decisions need approval of the shareholders. Fundamental decisions potentially exposed to abuses are therefore subtracted from independent managerial decision-making.

Of the remaining set of possibilities available to managers in stifling a bid, only the subset constituted by the possibilities that arise after the bid has been launched is subject to a mandatory approval of shareholders. Section 104 might have been expected to require shareholders’ approval for the validity of all decisions that could obstruct a hostile takeover, regardless of whether the bid is on the table. Let us suppose arguendo that this is the case, that section 104 calls for a requisite of shareholders’ approval with regard to any obstructive measure.

Before a hostile bid has been launched, an involvement by shareholders implies an evaluation of ordinary business decisions merely because those decisions might have adverse effects on potential bids. This evaluation, in turn, implies that shareholders are capable of deciding whether the possible adverse effects are a collateral effect of an otherwise beneficial decision for the corporation or, to the contrary, are the underlying rationale of the decision. The difficulties of such an evaluation are apparent. Furthermore, in the long run, encroachment of managerial prerogatives by shareholders would negatively affect the corporation’s performance. Managerial flexibility and discretion are values that need to be preserved.

Rather than relying on a mandatory requirement of shareholders’ approval, a more balanced approach would seem preferable. In the ordinary course of business, private solutions appear to be capable of aligning the interests of managers and shareholders. Before the bid has been launched, corporations can rely on the usual array of devices aimed at reducing the risk of managerial shirking.

This solution has obvious costs, as some business decisions that might in fact be aimed at intentionally stifling a (future) hostile bid will not be detected. This cost is easily perceived for actions taken in the context of an imminent bid. With hindsight, such decisions might raise concerns: Maybe managers had superior information; maybe they were aware that a takeover loomed. On the other hand, the costs of a different solution, that is, of a day to day control by shareholders over each and every decision that might have the effect of stymieing
a future hostile bid would be enormous. The trade-off is, in this context, easily resolved in favor of managerial discretion.

Of course, the more the threat of a hostile bid becomes real, the higher the risk that agency costs will plague even everyday business decisions. The question is obviously one of “line drawing.” The Legislative Decree 58/98 has chosen to draw the line at the moment a bid materializes. This solution appears reasonable. Once a hostile bid has materialized, there is reasonable ground to suspect that if a managerial initiative adversely affects the bid, it is because managers are pursuing an entrenchment strategy.

The situation in which a hostile bid has been launched seems a paradigm situation in which, absent regulation, the natural bias of the system towards excessive resistance will manifest itself short-circuiting the potential of private solutions. No matter how detailed contracts are, clever managers, spurred by the threat of losing their jobs, could rather easily exploit their discretion in order to pursue an entrenchment strategy. The inescapable incompleteness of contracts, joined with the aggravated situation of conflict between the interests of the corporation and the managers, make private solutions too costly. Public law is then required, in the form of a ban of the independent adoption of obstructive business decisions by managers.

7. Shareholders’ incentives and collective action in a world of concentrated ownership

A regime that relies heavily on the incentives of shareholders to participate actively in the design of the firm’s resistance policy must face objections founded on the well known “passivity story.” Shareholders, the story goes, do not care much about voting and they will either not vote or follow the herd and vote with the management. The technical explanation of such passivity is also well known. When many are entitled to vote, no one expects her vote to be decisive. Consequently, no one has the correct incentive to spend resources to study the issue to be voted and, as a result, vote intelligently. This means, in the context of defensive tactics, that shareholders might not have adequate incentives to evaluate the bid and therefore make an efficient decision regarding the adoption of defensive tactics.

Evaluating a bid is not without cost, and each shareholder would not be able to capture a proportionate share of the gains (stemming for example from an auction triggered by defensive tactics). This creates the usual free rider problem in collective decision-making. “Rational apathy” might thus lead to an inefficient outcome, because shareholders might not have the correct incentives to evaluate a hostile bid and campaign in favor of or against defensive tactics.

To be sure, short of a one hundred percentage shareholding, no shareholder will have the correct incentive to vote. At the same time, however, the larger the stake in the corporation, the greater the incentive to study the bid and the higher the probability that “informed voting” will take place. “Apathy makes exponentially less sense as shareholdings grow.” In a textbook Berle and Means corporation, therefore, “rational apathy” is a concrete possibility. In a system characterized by concentrated ownership, like the Italian one, this possibility is much lower. Concentration, most notably blocholder control, has its obvious costs and these
will be examined in the next paragraph. However, concentration is positively related to efficient involvement of shareholders as long as, beyond the existence of a blocholder, we do not find a perfectly atomized ownership structure.

In the United States, conventional wisdom, at least until recently, stated that shareholders have no “voice” and follow a simple rule: “Just vote with the management.” Even in such a context, however, the picture is changing. The recent rise in shareholders activism is apparent even in the context of defensive tactics. The clearest example is the already mentioned attempt to partially detoxify poison pills through “shareholder rights bylaw.” These developments show that shareholders, especially institutional investors, may find adequate incentives to intervene and pressure management to limit the use of defensive tactics.

8. Antitakeover rhetoric, the power of the agenda setter, and the dark side of concentrated ownership: dealing with the limits of shareholders’ vote

To sum up the argument so far, the system introduced by S. 104 seems to strike an efficient equilibrium in the trade-off between costs and benefits stemming from resistance. However, no rule can be a panacea. Even a rule that relies heavily on shareholders’ involvement has shortcomings, and time has come to underscore them.

Notwithstanding the provision of a check on the adoption of defensive tactics, there is still the possibility that managers, backed by their controlling blocholders, will abuse defensive tactics in order to pursue an entrenchment strategy.

It is almost by definition in the interest of incumbent managers to reject the offer or, at least, to negotiate the takeover with hostile bidders. Controlling blocholders have similar incentives. The creation of an alternative controlling bloc, revolving around the bidder, might jeopardize the incumbents’ ability to extract private benefits from control.

Indeed, it is the very feature that lowers, in the Italian context, the risk of “rational apathy,” that is to say, the higher degree of concentration, which may, at least under certain circumstances, lead to an abuse of resistance. Concentrated ownership may show its dark side, because the existence of a controlling bloc of shares may constitute the bridgehead for the adoption of defensive tactics. Incumbent managers may thus try to polarize around the controlling blocholder a sufficient number of votes to approve the implementation of defensive tactics. Managers and the incumbent controlling group might in the first place try to obtain the shareholders’ vote on defensive tactics.

They obviously need to gain the consensus of some outside shareholders. The possibility of insider shareholders gaining outsiders’ votes might, at first glance, seem to require a certain degree of irrationality from the latter. By definition the outsiders do not share the private benefits of control that the controlling shareholders enjoy. By contributing to a successful campaign of resistance outsiders abandon the premium that the bidder offers, to the apparent advantage of the incumbents.

The controlling blocholder has, however, at least two ways of winning over some outside shareholders to the cause of resistance. The first means is probably less effective, but its potential should not be underestimated. Takeovers are rarely popular events. Emotional
language invariably tends to depict the battle for control in terms of “good guys” and “bad guys,” and we all know who’s who in takeover vocabulary, don’t we? Incumbents can, therefore, try to affect the outcome of the vote exploiting the usual populist antitakeover rhetoric and its panoply of raiders, bust up takeovers, looting, myopic markets, and so forth. These claims are largely unfounded, but in a country where the financial culture of ordinary investors is not fully developed, it is not easy to rule out the possibility that such a claim may affect the outcome of the vote.59

The second and more effective instrument that incumbents have at their disposal is the possibility of bargaining with outsider shareholders for an enlargement of the controlling group. Insiders may try to buy the votes of one or more outsiders offering in exchange the possibility of entering an enlarged controlling group, which would grant the latter some portion of the private benefits of control. As long as the expected pay-off from this participation exceeds that of a successful bid, the outsiders will join the controlling bloc and vote in favor of defensive tactics.

The Legislative Decree 58/98 tackles the issue by introducing a minimum threshold of thirty percentage of the corporation’s stock for the approval of defensive tactics to be valid.60 The possibility of a hostile acquisition requires, at a minimum, the possibility of going over the head of the “owner.” In the Italian context, this might be prevented by the fact that a single blockholder or coalition of blockholders has the ability to decide the adoption of defensive tactics independently. For corporations where control is in the hands of a blockholder, a minimum threshold requirement limits the blockholder’s ability to adopt defensive tactics for the purpose of protecting his rent-seeking activity. The minimum threshold aims, in other words, at putting in place a constraint that parallels the ban on independent managerial adoption of defensive tactics. A ban of the adoption of defensive tactics by managers aims at reducing the burden imposed by aggravated “vertical” agency costs created by a hostile bid. A minimum threshold requirement helps to reduce the weight of “horizontal” agency costs in the relation between insider and outsider shareholders.61

The possibility that managers might manipulate the outcome of the vote is further strengthened by the risk of “cycling” within the group of shareholders. Cycling refers to a process in which each option selected by majority vote can in turn be defeated by another option preferred by another majority coalition. When voters cycle, there is simply no single majority and rules of voting will matter.62 More specifically, in the context of defensive tactics, managers’ power over the agenda can determine the outcome of the vote over the adoption of defensive tactics.63

The paper has so far described the possibility that incumbent managers may be able to obtain the ability to resist through a vote that, without managerial initiative, shareholders would not have taken. A different issue is instead posed by managerial abuses of a decision that would otherwise be efficient. For example, shareholders may have voted in favor of “mild” resistance in order to trigger an auction, under the assumption that the price offered is too low and that there is room for concurrent bids.

The decision to adopt defensive tactics will necessarily imply a delegation of power to managers. The unavoidable (and necessary) discretion that accompanies delegation shows that while agency costs may have been reduced by the adoption of a shareholders’ vote, they might still pose problems in this phase. Like a sorcerer’s apprentice, shareholders risk to
unleash forces that are difficult to control. The distinction between bona fide auctioneering and entrenchment, while sharp in theory, blurs in practice. Shareholders might have thus delegated managers to stimulate the appearance of a white knight. Managers may employ defensive tactics claiming to gain time for a concurrent bid to materialize, while in fact they pursue an entrenchment strategy. If such a concurrent bid does not materialize and the initial bid fails because of defensive tactics, there seem to be no insurmountable difficulties in justifying the absence of concurrent bids.

The Legislative Decree 58/98 seems to recognize the possibility of abuses of defensive tactics. Section 104 provides that managers are liable for the initiatives taken in pursuance of the authorization granted by shareholders. However, the above mentioned difficulty in distinguishing, in practice, entrenchment from auctioneering appears to limit, de facto, the protection against the most serious abuses.

This leaves us with an almost unavoidable possibility of inefficient resistance, that is to say resistance for entrenchment purposes. There is still the possibility, although limited, of abuses in defenses. The risk of abuses should not, however, be interpreted as an argument in favor of a repeal of Section 104. The existence of several trade-offs implies that whatever the rule chosen, costs will have to be borne. Even an “absolute passivity” regime would have its costs, as pointed out in paragraph 3. The real question is not whether there exists a rule without costs, but rather which rule strikes the most efficient equilibrium, and the “mixed” solution adopted in Italy might appear to be an effort in this direction.

9. Conclusion

This paper examined the impact, on the amount of resistance, of a regime centered around two principles: a) an enabling provision allowing firms to choose the level of resistance that they deem appropriate; b) a mandatory ban over the adoption of defensive tactics by managers without shareholders’ approval, triggered by the launch of a hostile bid. This system seems to strike an overall efficient equilibrium in the trade-off between the costs and benefits stemming from resistance.

Whether the adoption of an efficient regulation of defensive tactics is capable of increasing the so far limited role played by the market for corporate control in Italy is a fully separate question. The ongoing wave of privatizations is bringing along the appearance of corporations potentially exposed to the threat of hostile tender offers. With regard to these firms, efficient tender offer regulation should translate into higher external monitoring than previously experienced.

With regard to firms “dominated” by controlling blockholders, however, tender offer regulation alone, no matter how efficient, is probably not enough. The recent reform of corporate governance rules, centered, among other things, on increased minority rights protection might reduce the weight of agency costs in the relation between “insiders” and “outsiders.” If La Porta et al. (1997a) are right, however, increased protection of minority rights should, in the long run, determine higher fragmentation of ownership patterns. This, in turn, may increase agency costs à la Jensen and Meckling, those in the relationship between managers and shareholders. Some of the positive features that appear to be asso-
associated with the Italian regime rely on the existence of non purely atomistic ownership structures. From this standpoint, therefore, the assessment of the efficiency of the regime that I have tried to outline may depend on the long-run equilibrium that will be reached as a result of the recently implemented corporate governance reform.

10. Epilogue: some reflections upon a tentative “public choice” explanation of the Italian regime

The adoption of a regime that seems to strike an overall efficient equilibrium between the interests in favor of and against resistance suggests an interesting comparison with United States’ adoption of state antitakeover statutes.65 Two American scholars have recently argued, although from different points of view, that unitary systems like the Italian one can lead, under certain circumstances, to the adoption of takeover legislation that is more “efficient” than the American homologue.66 The adoption in Italy of an overall efficient regime of defensive tactics seems to confirm the prediction that state takeover regulation would be more efficient under a unitary system. A brief comparison with the evolution of defensive tactics regulation in the United States will help clarify the point.

When the wave of hostile takeovers in the United States gained momentum, in the early ‘80s, the employment of defensive tactics by managers incurred certain legal limits. The system that resulted provided, on balance, a useful checking mechanism that permitted a conspicuous number of successful bids while adding some friction to the regime.67 By the mid ‘80s, however, managers struck back. In 1987, the Supreme Court’s “CTS” decision,68 that upheld the Indiana antitakeover statute against “Commerce Clause” challenges, paved the way for the wave of “second generation” antitakeover statutes, usually interpreted as a result of interest group pressure. The invention of the poison pill and the Delaware courts’ endorsement of the “Just say no defense” eventually helped incumbent managers obtain full control over the tender offer mechanism.69

The first Italian comprehensive regulation of tender offers, implemented in 1992, adopted a rule of “absolute passivity”: Target corporations had to abstain from any act or operation that might prevent the bid from being successful. At the theoretical level, this system was clearly dangerous for managers, because it banned defensive tactics altogether. A puzzle seems to emerge. Public choice predicts that in the legislative process small, easy to organize groups should prevail over large, dispersed, groups. At the same time, other things being equal, a group that has something to lose from a certain piece of legislation will fight more vigorously than a group that has something to gain from that same piece of legislation. Managers should thus prevail on both counts over shareholders. Why, then, did managers accept the rule adopted in 1992? Did they fight against it?

The answers might be rooted in the circumstance that, at that time, the threat of hostile takeovers was largely theoretical. A large slice of the economic sector was still in the hands of the State, as the privatization process mentioned in paragraph two was just beginning. The intervention of the state in the economy could take two forms. Some firms were organized as “public entities,” thus being takeover-proof as a matter of law. Alternatively, State
intervention in the economy was accomplished through control over entities that were organized as corporations. Control over these firms, however, was firmly in the hands of the State and therefore, again, there was no real possibility of mounting a hostile takeover.\textsuperscript{70} With regard to the private sector, firms in the hands of a stable controlling group, most of the time controlling more than fifty percentage of the stock, dominated the scenario.

Within this framework, non-negotiated changes of control were virtually unknown, thus making the risk of hostile tender offers basically nonexistent. This might explain, from a public choice perspective, why managers did not oppose the adoption of the “absolute passivity” rule above described. They just did not feel the “bite” of the rule.\textsuperscript{71}

The situation has, however, profoundly changed in recent years. The modifications in the economic landscape described in paragraph two have made the threat of hostile takeovers real, as the hostile takeover of Telecom Italia shows. The developing perception that hostile takeovers are a real threat might explain the reaction from managers as a group. It does not seem to be a coincidence that the recognition of the legality of defensive tactics has occurred in a statute that has been claimed to be the gateway through which Italian financial markets will enter the global scenario. In such a context, the regulation of tender offers is meant to play a pivotal role in the developing of well functioning corporate governance mechanisms. Much of the debate about tender offer regulation has obviously revolved around the importance of hostile bids as a disciplinary device.

It would not be surprising to find that, just like in the United States, tender offer regulation has been a central battleground between managers and other interest groups. The shift from a rule of “absolute passivity” to a much less stringent regime of defensive tactics is thus probably not immune from interest group pressure.

What makes, however, the comparison between Italy and the United States interesting, is precisely the rather different path taken by state regulation. The regime now introduced in Italy does not completely eliminate the possibility of abuses by managers and incumbent controlling blocholders, but at the same time it seems to be overall efficient, especially if compared to a rule that grants absolute discretion to managers. In Italy, managers have been able to obtain the ability of resisting tender offers, but they have to share this ability with shareholders. By contrast, in the United States, managers have obtained almost complete control over tender offers. Beyond the screen of the business judgment rule, they have won the right to “just say no.”

Notes

2. Lipton, 1979.
4. Another positive feature of the Italian regime lies in its ability to help shareholders overcome the collective action problems that plague the decision to tender or not to tender.

As it is well known, target shareholders find themselves in a classic “prisoner’s dilemma,” because the offer is addressed to each target shareholder, who has to make a decision
without knowing the decision of other shareholders and without communicating with them in order to coordinate a response to the bid. (Carney, 1983. The identification of the problem in the literature, although not in explicitly game theoretical terms, dates at least as back as Brudney and Chirelstein, 1974. For an introduction to the “prisoner’s dilemma” and its implications for legal analysis, see Baird et al., 1994. On the “pressure ” see Bebchuk, 1987).

A rule that gives shareholders the final word over the adoption of defensive tactics expands the strategic space of shareholders, thus alleviating the pressure.

The shareholders may sustain defensive tactics without fear of being ultimately worse off because of other shareholders’ decisions. The decision regarding defensive tactics is disentangled from the decision to tender or not to tender. If the shareholders believe that they will be individually better off, if the bid fails or if an auction takes place, they can vote in favor of defensive tactics regardless of what they believe other shareholders will do. Even if defensive tactics are not approved, shareholders that sustained them will still have the opportunity to tender their shares. The reverse is also true, that is to say, if defensive tactics are approved, shareholders that voted in favor can obviously still tender their shares. In other words, each shareholder evaluation concerning the wisdom of defensive tactics will be conducted on the basis of each shareholder’s evaluation of the bid and will not be influenced by individual beliefs concerning others’ decisions.

Section 107 of the Legislative Decree 58/98 has a parallel effect on the pressure. Section 107 provides an exemption from the “mandatory bid” regime, for bidders that launch a bid in compliance with a series of conditions. In short, section 107 requires, among other things, that the validity of the offer be conditioned on the approval of the majority of shareholders, without taking into account shares detained by the offeror. This feature of section 107 clearly aims at creating an incentive for potential bidders to relieve shareholders from pressure in exchange for an exemption from the “mandatory bid rule.” From this standpoint, Section 107 presents an antipressure capability comparable to that expressed, in the United States, by “control share acquisition” second generation statutes, see Bebchuk and Ferrell, 1999. On the effect of section 107 on the “pressure,” see Enriques (1999a).

7. La Porta et al., 1997a. For a model that explains, at the theoretical level, their findings, see Bebchuk, 1999.
8. Bianco et al., 1996, Bianchi and Casavola, 1996. The pyramidal model allows the entrepreneur to spread the voting rights of minority shareholders over a large number of corporations, and concentrate those of the entrepreneur in the corporation at the top of the pyramid, Barca, 1996.
11. La Porta et al., 1998b.
15. This is, however, a more general problem, one that leaves hostile acquisitions with a small role to play in the governance equilibrium of Italian corporations. Legal rules may obviously play a paramount role in fragmenting ownership as argued, although from different perspectives, by La Porta et al., (1997a) and Roe (1994). However, the regulation of hostile acquisitions appears to have little to say regarding this issue.


18. In 1996 the government was delegated by the parliament the task of adopting a set of legislative decrees with the goal of reforming the regulation of listed companies. The final result is the Legislative Decree on Financial Markets and Listed Companies of 1998. (Law n. 58 of 2/24/1998).

19. On the role and the limits of State ownership as a device to separate ownership and control see Barca, 1996.

20. The process started very slowly in 1990, but its effects are being felt only now. In 1996 the share of state owned firms represented approximately 30% of the Italian stock market capitalization; in 1997 the share of the state was 13% and it was expected to further decrease in 1998, see Bianco, 1999.


22. On the pro-auctioneering capability of minimum offer periods and accumulation disclosure requirements, see Bebchuk, 1982a.


32. The policy-maker’s goal, according to authors like Easterbrook and Fischel, (1991) is that of mimicking the rule that the parties involved would have drafted had transaction costs been zero. Legal default rules thus provide a transaction costs economizing device, helping firms to avoid the costs of drafting an efficient rule. Ayres and Gertner, 1989, criticize the “would have wanted” approach and attempt to introduce a more general theory of “default rules.”

33. The position of American scholars with regard to the optimal regulation of defensive tactics and more generally of target corporations is diverse. If we limit the survey to authors with an economic perspective, we find that Easterbrook and Fischel, (1981, 1982, 1991) and Schwartz, (1986, 1988) favor an “absolute passivity” rule as well as a repeal of the minimum offer period and accumulation disclosure requirement introduced by the Williams Act. In other words, they favor a system reminiscent of the pre-Williams Act “Saturday Night Special” regime. Bebchuk, (1982a, 1982b) and Gilson, (1981, 1982) sustain a rule of managerial passivity. This proposal is however
linked to a favor for auctioneering, which allow incumbent managers the opportunity to secure higher gains for target shareholders through auction. Haddock, Macey, and McChesney, (1987) observe that resistance may, in the long run, be beneficial and that defensive tactics need not be “bad.” They sustain a rule which permits the shareholders to decide through the usual “contracting” activity between existing shareholders, managers and potential shareholders. Carney rejects both the contract and the regulatory approaches. He argues that markets address the agency costs problem embedded in the use of defensive tactics by managers. However, “last period” problems require the increased role of courts, to serve as a proxy in settling up in extreme hypothesis of managerial opportunism. (1988).

34. DeAngelo and Rice, 1983.
35. Bhagat and Jefferis, 1991, Jarrel and Poulsen, 1987. This result is consistent with recent studies that using CEO compensation data found that antitakeover charter amendments reduce shareholder wealth by reducing takeover likelihood and entrenching managers, Borokhovich et al., 1997.
38. Haddock et al., 1987, at 739. Giammarino et al., 1997, for example, provide a model of “optimal defensive measures” based on a combination of ex ante and ex post defensive mechanisms.
40. Where we find the only express mention of defensive tactics.
43. Haddock et al., 1987, at 711.
44. At the theoretical level, different devices can be used by the legal system to meet the “precommitment needs” of corporations. For example, in the United States even the choice of the state of incorporation might be read as part of the decision regarding a firm’s resistance policy. The diversity of American law helps firms precommit to a certain level of resistance by choosing a state of incorporation.
45. Haddock et al., 1987, Easterbrook and Fischel, 1991. See however Bebchuk, 1989, for the opportunity to set limits to the “contractual” freedom of corporations even with regard to “initial charters.”
Daines and Klausner (1999), however, empirically challenge the view that we should not observe antitakeover protection in IPOs.
46. In the United States, managers can thus modify the articles of incorporation or issue poison pills that do not require a vote of the shareholders.
47. As pointed out in paragraph 2, this is obviously true only for corporations whose ownership structure allows for the possibility of a hostile takeover.
48. See paragraphs 2 and 10.
49. Enriques 1999b.
50. Of course the interpretation of any future development depends heavily on the initial assumption concerning a firm’s ability to precommit. It is perfectly possible to turn
the argument on its head and argue that the lack of self-constraining clauses merely means that firms cannot precommit and that therefore a mandatory ban over defensive tactics is necessary to address this market failure. However, the theoretical grounds for the conclusion that precommitment is feasible seem solid enough to sustain a reading of the future patterns of the type suggested above. In the American context Haddock et al., 1987, argue that the lack of similar clauses means that they are not efficient, while Gilson, 1981, and Easterbrook and Fischel, 1991, argue that we do not observe such clauses because of a market failure.

51. This mandatory feature, in effect, is of a “procedural” nature, because it is not per se related to the corporation’s level of defenses. Rather, it sets a specific procedure for the adoption of defensive tactics, but it leaves unaffected the “substantial” decision over defenses.

52. Macey, 1999.

53. To be sure, attempts can be made at devising contractual solutions aimed at aligning the interests of managers and shareholders even in the face of a hostile bid. For example, empirical studies of American firms have found that boards with a majority of independent directors are more likely to use resistance strategies to enhance shareholders’ wealth. (Cotter et al., 1997) The use of outside directors is however extremely limited in Italy. (Brunello et al., 1999, summarizing the findings of a study that reports the limited role of outside directors in Italian corporations).


57. Typical “rights bylaw” imply that a company’s poison pill expires automatically whenever there is an all-cash tender offer for all the company’s stock at a price at least 25% above market price. The legal dispute over the validity of the rights bylaw is not over, and the outcome is uncertain. The “rights bylaw” generates legal concerns with regard to state statutory provisions that formally sanction separation of ownership and control, giving the board of directors the power to manage firms. Macey, 1998b; Gordon, 1997.

It is indeed important to stress that Italian corporate law is already structured in a fashion capable of accepting activism by shareholders. The law is characterized by widespread recourse to shareholders’ voting, often as a means of controlling managerial initiative. The legal framework thus lowers the probability that shareholder efforts to set limits on managerial discretion in the field of defensive tactics might be rejected on legal grounds.

58. Although some of these shortcomings may negatively affect all the decisions taken by the corporation with regard to the resistance policy, the focus of this paragraph is on the possible limits of shareholders’ voting once the bid is on the table.

59. The “emotional language” strategy could obviously be employed also in order to affect the decision to tender or not, rather than the decision to adopt defensive tactics. In the context of the latter decision, however, the threat posed by antitakeover rhetoric appears greater, because managers can disguise their entrenchment strategy behind the possibility of obtaining, through resistance, a larger premium.

60. For possible alternative solutions see Enriques, 1999b.
61. To be sure, if a blocholder controls more than thirty percentage, the threshold will not limit his power over defensive tactics. This is more than just a possibility in Italy. However, where the percentage of stock detained by the controller is such that she will be able to decide the adoption of defensive tactics, regardless of the reaction of other shareholders there is little that the regulation of defensive tactics can do to affect the position of the controller. Again, however, as paragraph 2 pointed out, this is a negative by-product of concentrated ownership, but there appears to be little that tender offer regulation can do to address this problem.


63. The possibility of cycling between shareholders that vote over defensive tactics cannot be ruled out.

The decision over defensive tactics does not imply a simple “yes or no” answer, a situation which would prevent the possibility of cycling.

Broadly speaking, there are at least three possible attitudes that shareholders can take in the face of a hostile bid. They can decide to remain inert, to implement “mild” resistance, that is to say resistance that aims at triggering an auction, or to implement “stiff” resistance, that is to say resistance that aims at stifling the bid altogether.

The “defense” side of the decision tree faced by shareholders can, in turn, be implemented in numerous manners. Shareholders may vote in favor of a merger, of the search for a white knight, of issuing new securities, and so on.

Shareholders may have different goals. Even shareholders that share the view that a sale is the best course of action may have different reservation prices, thus parting company on the issue of how much resistance is adequate.

Quite apparently, the objection grounded on the possibility of cycling is really an objection against all hypotheses of votes by shareholders. Indeed, it has been argued that managerial discretion might be a response to precisely this sort of problems (Gordon, 1991). That managerial discretion is a solution to voting pathologies is questionable in general. Even small groups, like the managers, can cycle. In any event, managerial discretion as a response to “cycling” may work well in the ordinary course of business of the corporations. The aggravated situation of agency costs, however, makes managerial discretion a dangerous response to the pathologies of shareholders’ vote in the context of a defensive tactics adoption. In the face of a hostile bid, managers will most likely not cycle, this is easily predictable. But this is so because their interests push them all towards resistance! Of the three positions that a potential decision-maker can take in the face of a hostile bid, managers will most likely rule out the hypothesis of surrendering without resisting. Cycling is thus avoided, but this comes at high (agency) costs. The possibility of cycling does not appear, therefore, to be a valid objection to shifting the decision-making authority from managers to shareholders.


65. A comprehensive “public choice” analysis of Italian tender offer regulation would require a full study of its own. Defensive tactics regulation is just a segment of the regulation and it might well be that interest groups recover in other segments of the regulation what they loose with regard to defensive tactics. The aim of this paragraph
is therefore merely to point to lines of inquiry that might result useful in a broader context.

66. In short, according to Macey, (1999) United States state legislation shows a clear pro-managerial bias because in-state managers are able to exercise an almost unopposed pressure over the legislature of their state of incorporation. In effect, they confront a constituency of largely out-of-state shareholders that also has, beyond the usual difficulties that large, dispersed groups face in bargaining over legislation, the problem that they really have no means of influencing each state’s political process. By contrast, ownership patterns in Europe are more localized, meaning that in each country managers face a constituency of in-state shareholders. This different pattern may thus lead to the adoption of legislation less skewed in favor of managers.

An alternative position, advanced by Miller, (1998) builds on the observation that, other things being equal, managers would tend to support antitakeover rules if their corporation were likely a target and to oppose them if their firm were likely a bidder. Miller has argued that, in the United States, the existence of fifty different states and the distribution of firms throughout these states with, however, a higher concentration in Delaware, create a peculiar incentive structure that results in state legislation’s clear antitakeover tilt for states other than Delaware. In Delaware we find instead a more mild approach to antitakeover legislation. In unitary systems, by contrast, potential targets will have roughly the same political influence as potential bidders, thus resulting in regulation with no intrinsic bias.

Miller compares antitakeover regulation in the United States and the United Kingdom. A similar comparison is attempted by Bebchuk and Ferrell, 1999: “The British experience suggests that the federalist structure of corporate law might not be as powerful a force for desirable corporate rules as some pro-state competition advocates contend,” id. at 41. Bebchuk and Ferrell argue that state competition is likely to result in inefficient takeover regulation, thus reaching conclusions comparable to those reached by Miller. Bebchuk and Ferrell, however, appear to attribute the higher efficiency of UK regulation to its self-regulatory nature.

Note, however, that the advantage of unitary systems needs not be extended to all areas of corporate law. Rather it seems arguable that state competition within a federal system might have virtues with respect to some corporate law questions but perform badly with respect to others. (Bebchuk 1992)


69. See Bebchuk and Ferrell, 1999, for a comprehensive story of the Delaware case law on defensive tactics.

70. To be sure, the privatization process had already started at the time the 1992 law was implemented. However, it was not at all clear that the program of privatization would have been successful, as it faced strong political opposition. It has taken several years before the program could be perceived as “for real.” There is some irony in the commonly made distinction between “formal” and “substantial” privatization. The former merely means that what used to be public entities have been transformed into corporations. The latter is a much more ambitious concept and refers to the State’s
abandonment of control of those entities. While in 1992 the phase of the “formal” privatization had already started, “substantial” privatization had at that time a very long way to go.

71. The existence of a few firms potentially exposed to the threat of hostile takeovers does not appear to change the analysis. The interest group interested in obtaining the ability to resist an offer was extremely small, thus limiting the pressure they might exert over the legislative body.

Acknowledgments

Opinions are exclusively those of the author and are not necessarily endorsed by the Banca d’Italia.

I thank Judge Frank H. Easterbrook and Professor Roberto Pardolesi, for the suggestions they gave me, respectively, while I researched the subject matter of this paper at the University of Chicago Law School and throughout the drafting. I also thank Luca Enriques, Carmelo Salleo, participants at the 16th EALE Conference, held in Castellanza on 16 September 1999, and three anonymous referees for their comments on an earlier draft.

I bear full responsibility for remaining mistakes.

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