LEGAL RULES, SHAREHOLDERS AND CORPORATE GOVERNANCE. THE EUROPEAN SHAREHOLDER RIGHTS' DIRECTIVE AND ITS IMPACT ON CORPORATE GOVERNANCE OF ITALIAN LISTED COMPANIES: THE TELECOM S.P.A. CASE

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Abstract

This paper investigates the role that shareholders may play in corporate governance by analysing the European Shareholder Rights' Directive n. 36/2007/EC and the consequences of its implementation upon general meetings and ownership structure of Italian listed companies. It summarises the rules introduced by the n. 36/2007/EC Directive in European company law aiming at strengthening shareholders' voice in general meetings on the assumption that this is a prerequisite for sound corporate governance. It then presents data of Italian general meetings from 2010 through 2014 to highlight a rise in attendance and voting in particular by foreign institutional investors especially on certain items (such as directors' remuneration, election and dismissal, and approval of financial statements). Finally the study presents the Telecom S.p.a. case to show that the new provisions can overturn the ownership structure of Italian companies when there is a de facto control and, at the same time, may play a significant role in improving corporate governance by balancing the power of dominant shareholders.

Keywords: Shareholders' Voice, Corporate Governance, European Shareholder Rights' Directive n. 36/2007/EC, Telecom S.p.a.

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1 Introduction: Italian ownership structure and the growing presence of foreign investors

The paper focuses on the role that shareholders may play in corporate governance by analysing the European Shareholder Rights' Directive[6] and the consequences of its implementation upon general meetings and ownership structure of Italian listed companies. Incidentally the paper highlights the role that general meetings may play even in typically insider financial systems, such as Italy[7]. Italian listed companies have a concentrated model of ownership: at the end of 2013 almost 70% of companies (about 64% of market capitalisation) were controlled by a single shareholder (holding more than half of the ordinary shares) or by a shareholder playing a dominant role even if owning a stake lower than 50% (so called, de facto control)[8]. As average, the single largest shareholder held 47% of ordinary shares[9].

In recent years globalisation have affected the ownership structure of listed companies in all financial systems, insider and outsider. The result has been the rise of foreign institutional investors everywhere[10]. In

[6] E.g. 2007/36/EC, 2007 O.J. (L184) 17.

[7] A summary of the terminology for financial systems is given by E. Berglöf, A Note on the Typology of Financial Systems, in K.J. Hopt - E. Wymeersch (Eds.), Comparative Corporate Governance, Berlin, Walter de Gruyter, 151-164 (1997). Depending on the authors' focus, the terms used vary among the different publications. The most prominent pair of expressions is "insider – outsider" (see, e.g., Organisation for Economic Co-operation and Development (OECD), Corporate Governance environments in OECD countries, February 1, Paris, OECD, 1995, as well as J. FRANKS- C. MAYER, Ownership and Control, in H. Siebert (ed.), Trends in Business Organization: Do Participation and Cooperation Increase Competitiveness?, Tübingen, Mohr Siebeck, 1995).

[8] See CONSOB, Statistics and analyses. 2014 Report on corporate governance of Italian listed companies, December 2014, p. 11.

[9] Ibidem.

[10] See S. Bruno – E. Ruggiero, Introduction, in Public Companies and the Role of Shareholders. National Models towards Global Integration, The Netherlands, 2011, p. 4 ff. Observations in the book refer to Italy, France, Great Britain, Germany, United States. It is argued that the trend of globalisation in all financial systems is probably blurring the traditional distinction between insider and outsider financial systems: in both cases an ever growing presence of foreign institutional investors and a decrease of shares held by individuals (so called retail investors) can be observed. For example, in United Kingdom fifty years ago, the majority of share capital of listed companies used to be held by individuals whereas at the moment (data refer to 2012) they hold just 11% as average while domestic pension funds and insurance companies hold, as average, 20% of share capital and shareholdings by foreign investors (including sovereign funds) exceed, as average, 40% of share capital; the most recent change has been the sharp reduction – in favour of foreign investors - in holdings by British pension funds and insurance companies that during the nineties used to reach

Italian listed companies the percentage of shares held by foreign major institutional investors has grown from an average of 19.47% of the share capital in 2005, to 28.56% in 2012, to 31.98% in 2013[11].

2 The implementation of the Shareholder Rights' Directive in Italy: summary of core provisions

The Shareholder Rights' Directive n. 36/2007/EC was enacted with the intention of strengthening shareholders' voting rights in general meetings of listed companies on the assumption that effective shareholder control is a pre-requisite to sound corporate governance. It has been implemented in Italy by Legislative Decree N. 27 of 27th January 2010 whereby the following main new rules have been introduced to amend the Legislative Decree N. 58 of 24th February 1998 (regulating financial markets and listed companies) and some provisions of the Civil Code: the threshold required to call a special meeting has been reduced (halved from 1/10 to 1/20 of the share capital); the mandatory blocking of shares before the general meeting - which was a condition for voting under Italian law - has been prohibited and, symmetrically, the record date has been introduced which in Italy has been fixed at 7 days before the general meeting; shareholders have been expressly granted the right to table draft resolutions for items on the agenda while the right to add items on the agenda was already provided – in both cases the threshold required is 1/40 of the company's share capital; single shareholders have been recognised the right to ask questions related to items on the agenda while companies shall give them answers; the processes of proxy voting and its solicitation have been deregulated by abolishing the legal reserve previously existing in favour of financial intermediaries and relaxing authorization procedure (under the previous cumbersome regime, introduced in 1998, there have been, as matter of fact, no proxy solicitations in Italy). In addition, other (only apparently) minor rules have been introduced to: extend time for release of relevant information before the general meeting and require the translation of documents into English (which, of course, is fundamental if more and more shareholders are foreign – see below - and want to exercise voting rights)[12].

It is interesting to note that the new provisions mainly consisted of a set of procedural technical rules: this is perfectly coherent with all Directives so far issued by the European Union to deal with company law issues, such as nullity of companies, publicity, share capital, financial statements, mergers and demergers etc. The general policy has so far aimed at harmonising, among European countries, certain fundamental guarantees in the relationship between companies vìs-a-vìs third parties while whenever the European Union attempted to address the internal organization of companies and the allocation of powers within it, it failed as the Proposal of Fifth Directive - under discussion since 1970 but never enacted – clearly showed[13]. However the Shareholder Rights Directive n. 36/2007/EC makes a step forward: it introduced the summarised procedural technical provisions in order to pursue a "political" goal, that is fostering shareholder voice in general meetings of listed companies deemed as a prerequisite to sound corporate governance.

3 Effects of the new rules on Italian general meetings: data from 2010 through 2014

The first general meetings of Italian listed companies where the new regime has been applied have been those held in 2011. The analysis of the data referring to 2010 (when old rules were in force) through 2014 shows a steady increase in attendance and voting: participation has never been so high in Italian general meetings. The fulcrum of the new regime has probably been the introduction of the record date to replace the previously existing blocking of shares - during the time before the general meetings - that deterred institutional investors, in particular foreign, from voting. In addition, also the relaxation of the proxy voting rules fostered voting considering that, for example in 2013, 95.8% of shareholders voted by proxy while only 4.2% voted in person[14]. The sample takes into consideration 32 out of 40 companies listed on the main index, FTSE MIB[15]. In 2010 the average of shareholders attending general meetings has been 52.3% of the share capital; in 2011, it has been 61.73%; in 2012, 64.6%; in 2013, 65.2%; in 2014 66.6%[16]. Therefore the increase in attendance,

almost half of share capital of UK listed companies: see Kay Review of UK Equity Markets and Long-Term Decision Making, Final Report, in http://www.bis.gov.uk/kayreview, July 2012, p. 29, Tables 7 and 1.

[11] The sample takes into consideration 32 out of 40 companies listed on the main index, FTSE MIB: see S. Bruno - F. Bianconi, FTSE Mib: Proxy Season 2013. Evoluzione degli assetti proprietari ed attivismo assembleare delle minoranze, in http://archivioceradi.luiss.it/ricerca-ceradi-georgeson/, p. 11.

[12] Prior to the implementation of the Shareholder Rights Directive n. 36/2007/EC, it was required to publish all documents related to the items of the agenda (including financial statements, directors' report etc.) not less than 15 days before the general meeting: but considering that foreign institutional investors do not vote in person but through the so- called voting chain (that includes various custodians and proxy voting agents), everybody can see that 15 days is not enough to get and digest information, very often from various companies simultaneously, and give instructions for voting (the requirement is now 30 days with some exceptions: see Art. 125-bis of Legislative Decree N. 58 of 24th February 1998). On the voting chain: see B.E. Eckbo – G. Paone – R. Urheim, Efficiency of Share-Voting Systems: Report on Italy, in http://ssrn.com/abstract=1431733, p. 84.

[13] See M. Cassottana – A. Nuzzo, Lezioni di diritto commerciale comunitario, Torino, 2006, 7 ss.; and on the Proposal of Fifth Directive, N. De Luca, ivi, 125 ss.

[14] See S. Bruno - F. Bianconi, FTSE Mib: Proxy Season 2013. Evoluzione degli assetti proprietari ed attivismo assembleare delle minoranze, cit., p.18.

[15] In particular, cooperative companies and foreign companies have not been included.

[16] See S. Bruno - F. Bianconi, FTSE Mib: Proxy Season 2013. Evoluzione degli assetti proprietari ed attivismo assembleare

comparing 2010 and 2014, has been of 14.3% of the share capital: the main aim addressed by the Shareholder Rights Directive can be said to have been accomplished.

It is worth analysing who are the classes of shareholders who have, in particular, increased attendance and voting in general meetings. The breaking up of data shows that core (or majority) shareholders confirmed almost the same percentage of voting: in 2010, they reached 41.6% of the share capital; in 2011, 42.4%; in 2012, 43%; in 2013, 44.1%; in 2014, 41.2%[17]. The same consideration applies to retail shareholders who reached in 2010, 0.5% of the share capital; in 2011, 0.6%; in 2012, 1.7%; in 2013, 0.4%; in 2014, 0.8%[18]. On the contrary, the class of shareholders that shows to have been mostly affected by the new rules has been that of institutional investors, namely the foreign: as average, in 2010 the percentage was 10.2% of the share capital; in 2011, it jumped to 18.7%; in 2012, it reached 19.9%; in 2013, it was 20.7%; and in 2014, it was 24.6%[19]. These data refer to institutional investors in general: if we break up numbers to distinguish between Italian and foreign institutional investors we can observe that the first category actually decreased their average voting from 2009 to 2014 - from 4.4% of the shareholders who voted in the general meeting to 2.0% - while the latter more than doubled their voting in the same years - from 14.8% as average of the shareholders who voted in 2009 general meetings to 34.9% as average in 2014[20].

The data highlighting the rise in voting by foreign institutional investors furthermore confirms that the Shareholder Rights' Directive has been actually successful in making cross-border voting rights able to be exercised. In this respect it identified, addressed and solved real problems, of mainly technical nature, in the exercise of shareholders' control through voting in general meetings of European listed companies whose shareholdings appear to be more and more globalised over the past years[21]. These numbers also show that the traditional theories on rational apathy, free rider and collective action problems - that would justify shareholders' lack of interest in attending and voting in general meetings - do not adequately represent any more the current situation if one just looks at the new shape of ownership structure of listed companies showing a rise of professional institutional investors everywhere: even though holding minority shareholdings, they have shown to be increasingly keen to attend and vote (especially on certain items, such as directors' remuneration, election of minority independent directors and approval of financial statements[22]) after certain procedural and technical pre-requisites have been met by the European legislation.

4 The Telecom S.p.a. case

The mentioned findings can be summarised by stating that, since 2011, the once lifeless Italian general meetings have been vigorously shaken-up by enhancing minority shareholders' voice. This happened just by amending mainly procedural provisions. Attendance of Italian general meetings has never been so high and, more importantly, also so relevant to improve corporate governance by balancing the power of dominant shareholders and the directors nominated by them. For example, considering Italy is an insider financial system, the only dissenting votes with reference to directors' remuneration have been in the past years just expressed by foreign institutional investors: the majority always approved the remuneration policy report. Examining only minority shareholders' voting, in 2014, 73% of them approved remuneration policy reports, while the remaining voters (foreign shareholders) dissented showing a misalignment between institutional investors' expectations and the actual remuneration practices adopted by Italian companies; the dissent manifested in the preceding year was even more significant when 65% of minorities supported the resolution on remuneration while, in 2012, the percentage was even lower at 56%[23]. These findings confirm the international literature according to which institutional investors are more active in foreign rather than in their own domestic countries where they show to be more "loyal" to management also because conflicts of interests' situations may more easily occur[24].

In addition to the improvement of corporate governance, from the above mentioned data we can infer a potential change in the ownership structure of Italian issuers where there is a de facto control. It is obvious, by contrast, that if core shareholders own the majority of share capital no possible practical influence can derive from the increased voting power of minority shareholders. However, it will be shown that, at least potentially, the new procedural rules may increase competitiveness of Italian companies in

delle minoranze, cit., p. 16 s. for data up to 2013; F. BIANCONI, Proxy Season 2014. Partecipazione ed attivismo delle minoranze, 2nd July 2014, in http://www.georgeson.it., slide n.3.

[17] Ibidem, slide n. 4.

[18] Ibidem.

[19] Ibidem.

[20] Ibidem, slide n.5.

[21] See whereas n. 5 of the Shareholder Rights Directive n. 36/2007/EC.

[22] Italian legislation requires, among other items, shareholders' approval of financial statements; it also provides for the election of a certain number of directors (depending on the company's capitalisation) by minority shareholders: see S. Bruno, Il ruolo dell'assemblea di s.p.a. nella corporate governance, Padova, 2012, p. 60 s.

[23] See: S. Bruno - F. Bianconi, FTSE Mib: Proxy Season 2013. Evoluzione degli assetti proprietari ed attivismo assembleare delle minoranze, cit., p. 40; F. BIANCONI, Proxy Season 2014. Partecipazione ed attivismo delle minoranze, cit., slide n. 17. In addition, see also: S. Bruno - F. Bianconi, Il voto assembleare sulle politiche di remunerazione degli amministratori: procedura, risultati, prospettive, in Rivista delle Società, 2014, p. 1269-1307.

[24] See R. Aggarwal– M. Ferreira– P. Matos, Does Governance Travel around the World? Evidence from institutional investors, in Journal of Financial Economics, 2011, p. 154.

situations of de facto control and ease the possibility of having real public companies. The case study is Telecom S.p.a. by showing data referred to the 2011 and 2013 general meetings.

At the 2011 general meeting the massive attendance by foreign investors was, since then, going to overturn the majority held by the core shareholder, Telco S.p.a., and to transform Telecom S.p.a. into a real public company. The general meeting was convened to vote on the election of directors. Telecom share capital, at that time, was composed of: Telco S.p.a., core shareholder holding 22.5% and institutional investors holding, all together, 23.5%. Shareholdings were almost equivalent in numbers between the two mentioned classes but intentions of voting were opposite on slates of candidates: each class filed one slate. At the general meetings almost 90% of institutional investors were present and voted, following the instructions received by proxy advisors, for one slate; Telco voted its 22.5% shares for another slate. In those conditions the minority shareholder, Findim S.p.a., with its 5% could have made the difference. If all minority shareholders, including Findim S.p.a., had found an agreement on the slate of candidates to file and support, they would have reached majority of votes and could have elected 4/5 of members in the board of directors (made of fifteen members), as provided under Telecom S.p.a. bylaws, thereby overturning Telco S.p.a.'s voting power[25]. However, after some uncertainties, Findim S.p.a. decided to file its own slate of candidates instead of supporting the slate presented by institutional investors (both Italian and foreign). The result was that Telco appointed 4/5 directors in the board and institutional investors the minority directors (in number of two). That general meeting was very important also because in the slate of candidates filed by Telco S.p.a. a clause was inserted stating that the election of those candidates would have implied the shareholders' authorisation - for two of them - to be exempted from the prohibition for directors of carrying out activities that may compete with those carried out by their company provided under Article 2390 of the Italian civil code. Under the mentioned Article the exemption is subject to shareholders' meeting approval. The clause referred to two candidates who were also directors in the Spanish company, Telefonica - one of Telco's shareholders - , which definitely was a competitor for Telecom S.p.a. in South American markets. However the request of shareholders' authorisation was not filed as a separate item of the agenda of the general meeting; rather, it was added as a note, marked by an asterisk, in the document presenting the slate of candidates nominated by Telco. At the meeting therefore the institutional investors were not even aware of the issue because there was no specific discussion (it was not an item but a footnote) and did not vote on it. The consequence was that all candidates nominated by Telco S.p.a. were elected by majority (22.5%), including the two directors of Telefonica, and automatically and implicitly authorised them to carry out competing business with Telecom. From that election various conducts allegedly in conflict of interests were undertaken to favour or not to displease Telefonica by the board of directors (with dissenting votes just by the two minority directors) with particular reference to the business in South America (i.e. Tim Brazil and Telecom Argentina) and to the issuance of a convertible bond subscribed by Telefonica itself[26]. This situation led to the call of a special meeting by one of the minority shareholders to dismiss those members of the board of directors previously nominated by Telco, that, is 13 out of 15. This has been one of the few cases ever occurred for an Italian listed company - definitely the first one of such relevance - for which a request to dismiss directors was filed.

Such result could not have happened without the Shareholder Rights' Directive n. 36/2007/EC for, at least two reasons. First, the minority shareholder Findim S.p.a., holding 5% of share capital, could request the board of directors to convene the general meeting just because the threshold was halved from 10% to 5% as consequence of the implementation of the European Directive: prior to the Directive the shareholder could not have the right to call a general meeting. Secondly, at the general meeting held in December 2013 - because of the record date and all the other new rules enhancing attendance and voting – there was (again, like in 2011) a massive presence of foreign institutional investors. After one of the first ever Italian proxy fights, numbers reached at that meeting were similar as in 2011: the share capital attending the meeting was 54.6% of share capital (a record for Italian general meetings): 27.29% - held by Telco - voted against the proposal to dismiss directors; 23% - among which 16% held by foreign institutional investors - following proxy advisors' instructions, voted in favour of the dismissal; 7.4% shareholders abstained.

Dismissal was rejected by majority shareholders but just by a tiny percentage and could have been easily approved instead: predictions - the days before the general meeting - have been uncertain until the very last moments and all but one international proxy advisors recommended to vote "for". In any case, the initiative by a minority shareholder of one of the most important Italian listed companies to call a special meeting to dismiss directors was a historical event for Italian financial market. Those directors were under

[25] According to Telecom S.p.a. bylaws in force at that time, shareholders who get majority of votes have the right to appoint 4/5 members of the board (i.e. 13 out of 15 directors) while minority shareholders have the right to appoint up to two directors.

[26] Italian financial press was full of information on such transactions during those days: see A. Olivieri, Glass Lewis: no al convertendo, in Il Sole 24 ore, 7th December 2013, p. 29; G. Ferraino, Telecom, il convertendo? Per Telefonica, Black Rock e l'hedge fund Och Ziff, in Corriere della Sera, 7th December 2013, p. 55; G. Pons, I passi falsi del bond Telecom. Glass Lewis: "Revocate il cda", in La Repubblica, 7th December 2013, p. 28; C. Gatti, Telecom, ecco i verbali sull'Argentina, in Il Sole 24 ore, 19th November 2013, p. 34.

public eyes and scrutiny for days; there was a big echo on financial press and they have been basically sacked by the market and the public opinion. Just the request to convene the meeting triggered the following events: i) the two Spanish directors, members of Telefonica board, resigned before the date of the general meeting; ii) a debate on how to improve corporate governance in Telecom S.p.a. by amending its bylaws started; iii) Telco S.p.a. autonomously replaced all directors and presented new candidates for the subsequent general meeting held in April 2014; iv) the voting agreement linking various companies in Telco was subsequently resolved in June 2014[27].

As result Telecom has become a public company, widely held. This outcome could not have been achieved without the legal rules recently introduced by way of implementation of the Shareholder Rights' Directive n. 36/2007/EC that introduced a new philosophy which fosters shareholders' voice over exit. The consequence is that the seed of the public company has been planted in Italian insider financial system by legal rules at least in those companies where there are no core shareholders holding majority of voting rights but there is a de facto control.

5 Conclusions

The legal rules introduced by the Shareholder Rights' Directive n. 36/2007/EC, despite being procedural in nature, planted the seed of the public company in insider financial systems. This is not a value by itself but certainly may open insider financial systems to market. The paper also shows that activism of minority shareholders may depend upon legal rules. It highlights the role that shareholders could and should play to improve corporate governance. From this respect the paper advocates those authors according to whom increasing and facilitating minority shareholders' power and intervention is necessary to enhance corporate governance[28]. The new idea of this paper is that it shows that increasing shareholder voting may improve corporate governance even in insider financial systems where minority shareholders, in particular, may balance dominant shareholders' powers through general meetings - with reference to "hot" items, such as directors' remuneration, election and dismissal, approval of financial statements and related-party transactions - regardless of the votes' results. It is the general meeting of listed companies that plays a fundamental role in corporate governance even in firms with controlling shareholders: there is no distinction, in this respect, with firms where there is no controlling shareholder (outside financial systems). Notwithstanding the results of the resolutions minority shareholders may contribute to take, or not to take, the items for which the general meeting is called attract the scrutiny by public opinion and financial press and trigger a disciplinary effect. The general meeting of listed companies, in other words, is proven to be a catalyst for transparency and market control as the Telecom S.p.a. case confirms.

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[27] See L. Fornovo, Telecom, finisce l'era Telco: ai soci costa ancora tre miliardi, in La Stampa Economia, 27th June 2014.

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