**European Perspective**

# Italian Supreme Court Recognizes That Judiciary Has Limited Powers to Review Arrangements With Creditors

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During the last few years, Italian bankruptcy law has been shifting from a traditional "procedural/judicial" model, based on the central role of courts called upon to safeguard the "public interest" involved in bankruptcy by actively directing the procedure and making the most important decisions, to a model that recognizes the private interests of creditors. Under the new paradigm, creditors are conferred with decisional powers, while courts maintain a principally supervisory role.

The turning point was in 2005, when the Italian legislature significantly reformed the fundamental statute on bankruptcy (Royal Decree No. 267 of March 16, 1942; the "Bankruptcy Law"), in an effort to achieve a more modern and flexible insolvency-law system based on private rather than judicial initiative (sometimes referred to as "deregulation" or "privatization" of the bankruptcy law), with creditors as the real engine of the insolvency proceedings. The reform, in particular, brought new life to "agreed" insolvency procedures as an alternative to bankruptcy. Previously, bankruptcy proceedings had been heavily regulated, burdened with strict legal requirements, and subject to the pervasive direction of the courts—and thus were rarely attractive and seldom used in comparison with other legal systems. The existing insolvency-procedure alternative to bankruptcy (an arrangement with creditors, or *concordato preventivo*) was revised beginning in 2005, and a new procedure (the restructuring agreement, or *accordo di*

*ristrutturazione dei debiti*) was introduced, all in accordance with the principles of freedom of contract and private initiative.

Courts, however, have been reluctant to cede center stage to creditors. Since the reform, several decisions have been issued by lower courts in which the law has been interpreted to extend the authority of the judiciary to review private actions. The rationale underlying these rulings (***i.e.***, allowing courts to prevent abuse that "strong" creditors may commit) was to a certain extent appropriate. However, the reviewing authority of the judiciary in the wake of the reforms has, in the opinion of many, overstepped the intentions of legislators in enacting the reforms.

This "attitude" of the judiciary, however, may change, thanks to a recent decision of the Italian Supreme Court concerning *concordato preventivo* procedures. In *Industrial Lift Technology* (Decision No. 21860 of October 25, 2010), the Supreme Court recognized the predominance of private interests and limited the authority of the judiciary to review arrangements with creditors.

## Arrangements With Creditors in Italy

To better explain the significance and possible consequences of *Industrial Lift Technology*, it may be useful to summarize the main features of the Italian *concordato preventivo*.

The *concordato preventivo* is one of the insolvency procedures made available to entrepreneurs in a state of financial crisis or insolvency by the Bankruptcy Law. The aim of the procedure is to avoid a declaration of bankruptcy, which may be detrimental to both the debtor and its creditors, by permitting the parties to reach an agreement on the rescue or liquidation of the business, with limited court supervision.

In summary, the procedure is structured as follows:

- A draft arrangement with creditors is prepared by the debtor. The draft has the form of a "take it or leave it" contractual proposal addressed to creditors. In practice, the terms of the proposal are informally negotiated with, at a minimum, the most important creditors (and may also be amended following requests made by the court or creditors after the original proposal has been filed). Unlike in a U.S. chapter 11 case, where the debtor has exclusivity for a limited time period, only the debtor is entitled to propose an arrangement.

- The proposed arrangement is based on a "plan" that may provide for any of the following: (i) restructuring of indebtedness and settlement of creditor claims by any means, including the sale of goods, the assumption of debt, or the transfer of stock, bonds, or other financial instruments to creditors; (ii) sale of the business to a third party; (iii) division of creditors with similar legal positions and economic interests into classes; and (iv) different treatment among classes.

- The feasibility of the arrangement plan is certified in a report by a professional (such as a chartered accountant) enrolled in the auditors' register.

- A request for admission to the *concordato preventivo* procedure, accompanied by supporting documentation (including the professional's report on feasibility), is then submitted to the local court of first instance (*Tribunale*). The court reviews the documentation and, if all the requirements are met, admits the proposed arrangement and declares the procedure open.

- During the pendency of the procedure, precautionary or enforcement actions of creditors are stayed. The business is still managed by the debtor, but under the supervision of a court-appointed official and the superintendence of a delegated judge.

- Thereafter, the provisionally approved arrangement is submitted to creditors for approval. At a creditors' meeting, the arrangement is approved with a favorable vote by creditors representing the majority of the claims eligible to vote (and, if divided into classes, with a favorable vote by the majority of the classes). Dissenting creditors may file an objection with the court under limited circumstances.

- After having certified the voting procedures and ruled on objections by dissenting creditors, the court will approve the arrangement. At this juncture, the arrangement becomes effective and final and therefore binding upon the debtor and all creditors.

Beginning in 2005, the Italian legislature reformed the *concordato preventivo* with the intention of creating a flexible instrument that the parties involved may adapt to the actual circumstances

of the case in order to safeguard their interests. The law, however, has reserved a supervisory role for the courts. In addition, as discussed below, a debate among judges and scholars has been growing during the last few years on the extent and significance of the courts' role.

## Reviewing Powers of the Courts: Interpretation Issues

Since the 2005 reforms, one of the hot topics has been the extent of the reviewing powers of the courts with respect to the merits of a proposed arrangement plan certified by a professional and submitted by the debtor to the *Tribunale*, together with a request for admission to the *concordato preventivo* procedure.

The reformed Bankruptcy Law does not expressly grant the *Tribunale* the power to deny admission to the procedure if the arrangement (notwithstanding being certified by a professional) is deemed unfeasible by the court. The statutory provisions defining the court's reviewing powers, however, are rather obscure and open to different interpretations. Before *Industrial Lift Technology*, two conflicting interpretations had emerged.

Under the first interpretation, the court would be entitled to review the feasibility—and therefore the merits—of the arrangement plan proposed by the debtor, and to deny admission to the procedure, if the court deemed the plan infeasible. This interpretation has been endorsed by most of the lower courts and by certain commentators. It is premised upon the rationale that the courts are entrusted by law with the role of independent protectors of the "public interests" involved in insolvency procedures and, as such, must ensure that an arrangement plan is not used as an instrument by majority creditors, possibly in collusion with the debtor, to commit abuses against

minority creditors, who may receive less in a *concordato preventivo* than in an "ordinary" bankruptcy.

Under the second interpretation, which is cited with approval by the majority of legal scholars, any evaluation of the feasibility of an arrangement is to be undertaken solely by creditors, and courts should limit their review to formal and procedural aspects. This approach emphasizes that the feasibility of an arrangement is certified by a professional expert who has extensively investigated the affairs of the business, whereas the judge, at that stage of the procedure, lacks necessary knowledge of the background to assess the feasibility of the plan. This approach is also consistent with the spirit of deregulation that inspired the 2005 reforms.

In this context of conflicting approaches, *Industrial Lift Technology* strongly rejected the first interpretation and embraced the second.

### ***Industrial Lift Technology*: Facts and First-Instance Decision**

Industrial Lift Technology, an Italian limited liability company, filed an application for admission to a *concordato preventivo* procedure with the *Tribunale* of Macerata in May 2009. The arrangement plan, duly certified by a professional, provided for the sale to third parties of the company's assets (including receivables and inventories).

The court rejected the application, having reviewed the plan and the expert report and concluded that the arrangement, as proposed, was not feasible. The ruling was based on the court's view that, notwithstanding the certification of the feasibility of the arrangement plan, the report of the

professional had failed to consider issues such as the actual existence of receivables, the degree of difficulty in collecting them, and the difficulty in liquidating the inventories in the market.

### *Industrial Lift Technology*: The Supreme Court's Decision

Industrial Lift Technology appealed the decision of the *Tribunale* directly, as provided by the Bankruptcy Law, to the *Corte di Cassazione* (Italian Supreme Court), arguing that by performing an assessment of the feasibility and merits of the plan, the *Tribunale* exceeded its statutory authority insofar as its duties were limited to verifying the correctness of the application.

Called upon for the first time to decide the issue, the Supreme Court reversed the decision of the *Tribunale*, holding that courts are not allowed to assess the feasibility of an arrangement plan submitted by the debtor and duly certified by a qualified professional.

In its opinion, the Supreme Court emphasized that the legislature in 2005 clearly intended to make the *concordato preventivo* a contractual and private procedure. The amended law, the Court explained, is clear that any decision concerning the appropriateness of convening a *concordato preventivo* is reserved for creditors, who express their views by voting for or against a proposed arrangement at the creditors' meeting. Because the law does not allow the court to undertake such a review, it cannot be entitled to evaluate the feasibility of the plan (which in any case is independently certified by a professional) when deciding on admission to the procedure. Should the court be permitted to deny admission to the procedure on the basis of the nonfeasibility of the plan, the Supreme Court explained, creditors would be de facto deprived of the opportunity to decide whether to accept or refuse the debtor's proposal.

## *Industrial Lift Technology*: Expected Consequences

*Industrial Lift Technology* limits the power of the courts to review the contents of arrangements with creditors. Given the Supreme Court precedent (and despite the absence of *stare decisis* in Italian civil-law jurisprudence), lower courts called upon to decide on applications for *concordato preventivo* procedures will almost certainly be more careful in deciding whether to extend their review to matters that pertain to the merits of the arrangement. On the basis of *Industrial Lift Technology*, courts are now expected to be more inclined to limit their scrutiny to a principally formal review of the requirements for the commencement of the procedure, such as verification of the debtor's state of distress and the completeness of the filing documentation.

The decision will likely be welcomed by parties who have more to fear from any pervasive reviewing authority of the courts, such as "strong" creditors with large claims, and by parties more likely to exercise significant influence regarding the terms of a proposed arrangement plan, such as banks.

In addition to making progress toward a solution to the dispute over the extent of court scrutiny regarding a debtor's admission to a *concordato preventivo* procedure, *Industrial Lift Technology* is significant because the Supreme Court effectively endorses the philosophy underlying the Bankruptcy Law, which prioritizes private interests and grants a pivotal role in the procedure to the private parties involved. It is difficult to predict whether this decision will be followed by other courts (if not overruled, in a legal system where it is not uncommon to find different solutions to the same issues by different chambers of the Supreme Court). In any case, *Industrial*

*Lift Technology* has moved the Italian bankruptcy system—at least temporarily—a little closer to "Anglo-Saxon" systems based on the predominance of private initiative.