CASE 5–6

In re Elettronica Sicula, S.p.A.

United States v. *Italy*

International Court of Justice, 1989.
International Court of Justice Reports, vol. 1989, p. 15 (1989).

The United States initiated this proceeding against Italy before a Chamber of the International Court of Justice. The US claimed that Italy violated its international obligations under the Treaty of Friendship, Commerce and Navigation concluded by Italy and the US in 1948 ("the FCN Treaty") in connection with Italy's treatment of two American companies, the Raytheon Company ("Raytheon") and one of Raytheon's wholly-owned subsidiaries, Machlett Laboratories Incorporated ("Machlett"). Raytheon and Machlett were the owners of an Italian subsidiary, Raytheon-Elsi, S.p.A. (previously known as Elettronica Sicula, S.p.A. ("ELSI")), that operated a plant in Palermo, Sicily. ELSI employed some 900 workers who manufactured microwave tubes, cathode-ray tubes, semiconductor rectifiers, X-ray tubes and surge arresters. For a variety of reasons the venture was not successful. ELSI's management blamed a major part of its lack of success on its having trained and employed an excessively large workforce, and the opposition of a local employees union to its attempts to reduce that workforce. It had also incurred large debts (to one US and several Italian banks) in an attempt to modernize and expand its plant. Additionally, it had had little success in penetrating the Italian electronics market. As a consequence, between February 1967 and March 1968, it solicited the help of the Italian government, the Sicilian government, and the private sector to find an Italian joint venturer with economic power and influence that would make it both more competitive and more likely to obtain development assistance from the Italian government.

MAP 5–7 ▫ Italy (1989)

The efforts to work out a mutually satisfactory arrangement between the Italian officials and the companies proved impossible, and Raytheon and Machlett immediately began planning to liquidate ELSI. On March 6, 1968, they notified ELSI that neither of them would subscribe to any further shares of ELSI's stock. On March 16, ELSI's board of directors shut down the operation of the plant and, effective March 29th, terminated all commercial activities and employment contracts. On April 1, representatives of ELSI met with representatives of its bank creditors in an attempt to work out an orderly liquidation. The banks were unwilling to cooperate. That same day the mayor of Palermo issued a decree requisitioning ELSI's plant for a period of six months, citing "grave public necessity" and the possibility of rioting by ELSI's employees. An administrator took over the operation of the plant on April 6th. ELSI protested the requisition order and sought relief in a local court, to no avail. In May, it filed for bankruptcy. In the bankruptcy proceeding, creditors filed claims against ELSI totaling some 13 billion lira and the court ordered that ELSI be liquidated. The liquidation only realized some 6.4 billion lira.

Raytheon had guaranteed ELSI's indebtedness to several banks; and on ELSI's bankruptcy, it was accordingly liable for, and paid, 5.8 billion lira to the banks in accordance with the terms of the guarantees. Raytheon and Machlett then sought the assistance of the United States to press a claim against Italy for the loss of their subsidiary. The US then brought suit in the International Court of Justice. The US claimed that Italy had deprived Raytheon and Machlett of their ownership and control of ELSI in violation of the US-Italian FCN Treaty.

JUDGMENT: . . .

Article III of the FCN Treaty is in two paragraphs. Paragraph 1 provides for rights of participation of nationals of one High Contracting Party, in corporations and associations of the other High Contracting Party, and for the exercise by such corporations and associations of their functions. Since there is no allegation of treatment less favorable than is required according to the standards set by this paragraph, it need not detain the Chamber. Paragraph 2 of Article III is, however, important for the applicant's claim; it provides:

> The nationals, corporations and associations of either High Contracting Party shall be permitted, in conformity with the applicable laws and regulations within the territories of the other High Contracting Party, to organize, control and manage corporations and associations of such other High Contracting Party for engaging in commercial, manufacturing, processing, mining, educational, philanthropic, religious and scientific activities. Corporations and associations, controlled by nationals, corporations and associations of either High Contracting Party and created or organized under the applicable laws and regulations within the territories of the other High Contracting Party, shall be permitted to engage in the aforementioned activities therein, upon terms no less favorable than those now or hereafter accorded to corporations of such other High Contracting Party controlled by its own nationals, corporations and associations.

. . . [T]here is no allegation of treatment of ELSI according to standards less favorable than those laid down in the second sentence of the paragraph. The allegation by the United States of a violation of this paragraph by Italy relates to the first sentence.

In terms of the present case, the effect of the first sentence of this paragraph is that Raytheon and Machlett are to be permitted, in conformity with the applicable laws and regulations within the territory of Italy, to organize, control and manage

ELSI. The claim of the United States focuses on the right to "control and manage"; the right to "organize" apparently in the sense of the creation of a corporation, is not in question in this case. Is there, then, a violation of this Article if, as the United States alleges, the requisition had the effect of depriving ELSI of both the right and practical possibility of selling off its plant and assets for satisfaction of its liabilities to its creditors and satisfaction of its shareholders? . . .

The essence of the applicant's claim has been throughout that Raytheon and Machlett, which controlled ELSI, were by the requisition deprived of the right, and of the practical possibility, of conducting an orderly liquidation of ELSI's assets. . . .

The crucial question is whether Raytheon, on the eve of the requisition, and after the closure of the plant and the dismissal, on 29 March 1968, of the majority of the employees, was in a position to carry out its orderly liquidation plan, even apart from its alleged frustration by the requisition. That plan, as originally conceived, contemplated that the disposal of plant and assets might produce enough to pay all creditors 100 percent of their dues, with a modest residue for the shareholders. In one of the affidavits [submitted on behalf of the applicant] it is stated: "If the assets had been disposed of at book value all liabilities, including those payable to Raytheon Company, would have been paid in full. . . .

Nevertheless . . . the possibility of paying creditors in full depended upon putting the orderly liquidation plan into operation in good time. Time was running out because money was running out. As the position worsened daily, the moment might at any time arrive when liabilities exceeded assets, or default resulted from lack of liquidity. ELSI's management had prepared the assessment of . . . [a] "quick-sale value" . . . which was markedly less than book value, being aware that the sale of the company's assets might fail to provide sums approximating to book value. There were plans also to approach the large bank creditors in the hope of securing their agreement to settlements of 50 percent.

Did ELSI, in this precarious position at the end of March 1968, still have the practical possibility to proceed with an orderly liquidation plan? The successful implementation of a plan of an orderly liquidation would have depended upon a number of factors not under the control of ELSI's management. Since the company's coffers were dangerously low, funds had to be forthcoming to maintain the cash flow necessary while the plan was being carried out. Evidence has been produced by the applicant that Raytheon was prepared to supply cash flow and other assistance necessary to effect the orderly liquidation, and the Chamber sees no reason to question that Raytheon had entered or was ready to enter into such a commitment. Other factors governing the matter, however, give rise to some doubt.

First, for the success of the plan it was necessary that the major creditors (i.e., the banks) would be willing to wait for payment of their claims upon the sale of the assets released to settle them; and this applied not only to the capital sums outstanding, which may not at the time have yet been legally due for repayment, but also the agreed payment of interest or installments of capital. Though the Chamber has been given no specific information on this point, this is the essence of such a liquidation plan: the creditors had to be asked to give the company time. If ELSI had been confident of continuing to meet all its obligations promptly and regularly while seeking a buyer for its assets, no negotiations with creditors, and no elaborate calculations of division of the proceeds, on different hypotheses, such as have been produced for the Chamber, would have been needed.

Secondly, the management were by no means certain that the sale of assets would realize enough to pay all creditors in full; in fact, the existence of the calculation of a "quick-sale value" suggests perhaps more than uncertainty. . . .

Nor should it be overlooked that the dismissed employees of ELSI ranked as preferred creditors for such sums as might be due to them for severance pay or arrears. In this respect Italy has drawn attention to the Sicilian regional law of 13 May 1968, providing for the payment

> for the months of March, April and May 1968, to the dismissed employees of Raytheon-ELSI of Palermo of a special monthly indemnity equal to the actual monthly pay received until the month of February 1968.

From this it could be inferred, said Italy, that ELSI did not pay its employees for the month of March 1968. Further it was conceded by the former Chairman of ELSI, when he appeared as a witness and was cross-examined, that the cash available at 31 March 1968 ("22 million in the kitty") would have been insufficient to meet the payroll of the full staff even for the first week of April ("at least 25 million"). . . .

Thirdly, the plan as formulated by ELSI's management involved a potential inequality among creditors: unless enough was realized to cover the liabilities fully, the major creditors were to be content with some 50 percent of their claims; but the smaller creditors were still to be paid in full. . . . According to the evidence, when in late March 1968 ELSI started using funds made available by Raytheon to pay off small creditors in full, "the banks intervened and said that they did not want this to happen as that was showing preference." Once the banks adopted this attitude, the whole orderly liquidation plan was jeopardized. . . .

Fourthly, the assets of the company had to be sold with the minimum delay and at the best price obtained—desiderata which are often in practice irreconcilable. . . .

Fifthly, there was the attitude of the Sicilian administration. The company was well aware that the administration was strongly opposed to a closure of the plant, or more specifically, to a dismissal of the workers. . . . The company's management had been told before the staff dismissal letters were sent out that such dismissals would lead to a requisition of the plant.

All these factors point towards a conclusion that the feasibility at 31 March 1968 of a plan of orderly liquidation, an

essential link in the chain of reasoning upon which the United States claim rests, has not been sufficiently established. . . .

It is important, in the consideration of so much detail, not to get the matter out of perspective. Given an undercapitalized, consistently loss-making company, crippled by the need to service large loans, which company its stockholders had themselves decided not to finance further but to close and sell off because, as they were anxious to make clear to everybody concerned, the money was running out fast, it cannot be a matter of surprise if, several days after the date at which the management itself had predicted that the money would run out, the company should be considered to have been or virtually in a state of insolvency for the purposes of Italian bankruptcy law.

If, therefore, the management of ELSI, at the material time, had no practical possibility of carrying out successfully a scheme of orderly liquidation under its own management, and may indeed already have forfeited any right to do so under Italian law, it cannot be said that it was the requisition that deprived it of this faculty of control and management. Furthermore, one feature of ELSI's position stands out: the uncertain and speculative character of the causal connection on which the applicant's case rests. There were several causes acting together that led to the disaster to ELSI. No doubt the effects of the requisition might have been one of the factors involved. But the underlying cause was ELSI's headlong course towards insolvency; which state of affairs it seems to have attained even prior to the requisition. There was the warning loudly proclaimed about its precarious position; there was the socially damaging decision to terminate the business, close the plant, dismiss the workforce; there was the position of the banks as major creditors. In short, the possibility of the solution of orderly liquidation, which Raytheon and Machlett claim to have been deprived of as a result of the requisition, is purely a matter of speculation. The Chamber is therefore unable to see here anything which can be said to amount to a violation by Italy of Article III, paragraph 2, of the FCN Treaty. . . .

THE CHAMBER . . .

By four votes to one, *finds* that the Italian Republic has not committed any . . . breaches . . . of the Treaty of Friendship, Commerce, and Navigation between the parties signed at Rome on 2 February 1948. . . .