QUORUM
Studio Legale e Tributario Associato

COVID-19 EMERGENCY

The impact on contractual obligations

INTRODUCTION

The spread of the Covid-19 virus and the resulting emergency measures issued by the Italian authorities are having and will have a decisive impact on the ability of companies to meet their obligations regularly.

The purpose of this summary is to provide some general indications regarding the rules that apply in this context, in the contractual and liability area, with some suggestions.

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The centrality of art. 1218 of the Italian Civil Code and the concept of Force Majeure

The analysis can only start from art. **1218 of the Italian Civil Code**, which represents the key rule on liability in case of failure by the debtor to perform a certain service

«the debtor who fails to perform exactly what is due, shall be liable for damages if he/she does not prove that the non-performance or delay is determined by the impossibility to perform deriving from a ***cause which is not attributable to him****»*

The term "cause not attributable to him" generally refers to an objective, extraordinary and unpredictable event, strictly and causally linked to the defaulting conduct. In this context, it is commonly referred to as an event of **«FORCE MAJEURE»**, even if it is not precisely defined in the Italian legal system. However, Art. **1256 of the Italian Civil Code** also refers to the impossibility that characterizes the Force Majeure situation, in which it is highlighted that:

*«the obligation is extinguished when, for "**cause not attributable to the debtor**", performance becomes "**impossible**".*

When confronted with a «cause not attributable to the debtor»:

It certainly does not cover every factor that made it impossible for the debtor to perform the contract, but only those that:

1) Are **far more reaching than the diligence due** by the debtor in performing the contract;

2) Have **consequences that the debtor cannot counter** with the same diligence.

These are essentially factors which can be defined as **extraordinary and unforeseeable events**, i.e., which do not fall within the normal scope of the contract.

Extraordinary and Unforeseeable Events

EXTRAORDINARY:

The extraordinary nature must be assessed **«objectively»**, having to be qualified based on the frequency of the event, dimensions, intensity, etc.

UNFORESEEABLE:

This, instead, has a **«subjective»**, with reference to the knowledge, i.e., the capacity of the contracting party to predict/know at the time of conclusion of the contract.

Temporary or Permanent Impossibility

TEMPORARY

The law merely **excludes** the liability of the debtor for the delay in performance as long as this impossibility persists. Therefore, generally, once the impossibility has ceased to exist, the debtor must always fulfil the obligation, irrespective of any other economic interest which he may claim, where possible, from the point of view of the excessive burden incurred. The above applies unless, in relation to the title of the obligation or the nature of the object, the debtor of the service can no longer be considered obliged to perform the service, or the creditor of the service no longer has an interest in receiving it, with consequent extinction of the obligation.

PERMANENT

In this case **the total release of the debtor** of the performance may occur only if and to the extent that it is objectively impossible to perform the service itself, and in the absence of the subjective element of fault on the part of the debtor in determining the event that made the service impossible.

Impossibility of the service in «contracts for consideration»

TOTAL Impossibility (art. 1463 Civil Code):

the party that has been freed due to the impossibility of performance ***cannot claim compensation***, and must return what it has already received, in accordance with the rules on recovery of undue payment.

PARTIAL Impossibility (art. 1464 Civil Code):

where performance by one party has become only partially impossible, ***the other party is entitled to a corresponding reduction in the performance due by it*** and may also withdraw from the contract if it has no appreciable interest in partial performance.

«Contracts for continuous or periodic performance»

art. 1467 c.c.

According to this provision, the debtor is granted the possibility to request the termination of the contract if the performance he owes has become "**excessively onerous**" due to extraordinary and unforeseeable events beyond his control, the assessment of which must be carried out:

according to the parameters of the event frequency, size, intensity, etc., if reference is made to the ***extraordinary nature.***

depending on the knowledge capacity of the contracting party at the time of conclusion of the contract, if reference is made to ***unpredictability.***

Orders and Prohibitions from the Authorities

Among the causes that can be invoked for the purposes of the aforementioned "impossibility of performance", are also the **orders** or **prohibitions** issued by the administrative and/or legislative authority, the so called "legislative authority".

"Factum Principis"

These are, in concrete terms, legislative or administrative measures which make it objectively impossible to provide the service, irrespective of the behaviour of the obligor.
In short, it is a circumstance which acts as a ***waiver*** of the debtor's liability irrespective of the contractual provisions in force.

Of considerable importance, at this particular moment in history, given the emergency legislation issued to deal with the Covide-19 crisis, is what can have a direct and concrete impact in terms of "***exemption from liability***".

On the basis of the above, as well as according to the doctrine and jurisprudence on the point, the concept of "***force majeure***" can consist of :

Natural Events
(e.g. earthquakes, tsunamis, floods, etc.)

Human Events
(e.g. wars, riots, pandemics, etc.).

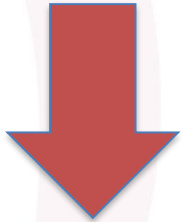
which, because of their **unpredictable** and **extraordinary nature** are, in fact, uncontrollable, as they are beyond the control of the parties.

Decree Law no. 18 of 17 March 2020, the so-called "Cura Italia"

In addition to specific provisions in certain areas (e.g. in travel contracts, sports or cultural events, etc.), the emergency regulations of recent weeks have generally laid down the following:

Art. 91, paragraph 1 «**Compliance with the containment measures referred to in this decree is always asses: sed for the purposes of exclusion, pursuant to and for the effects of articles 1218 and 1223 of the Italian Civil Code, of the debtor's liability, also with regard to the application of any forfeiture or penalties connected with delayed or omitted performance».**

Essentially, the legislator intended to reiterate, if ever in doubt, that compliance with the Covid-19 pandemic disqualification and containment measures constitutes a possible **cause of exclusion of the debtor's liability**.



Also specifying that the impossibility of the faithful and timely performance of the service determined by the obligation to comply with the disqualification and containment measures of the Covid-19 pandemic may be invoked in order to **prevent the accrual of disqualifications or penalties.**

Non automatic effectiveness of the above forecasts

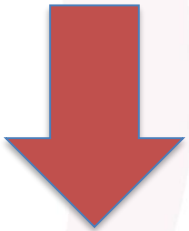
Given the general concepts expressed both by the code-based provisions and the recently enacted emergency legislation, verification of the possibility of exempting the debtor from any liability for non-performance or incorrect/delayed performance must necessarily be carried out on a

«case by case base»

That is, the mere existence of the Covid-19 pandemic does not lead to an automatic effect of legitimate suspension of the reciprocal contractual performances.

Contractual Provisions

However, it is possible that the parties have already included **specific clauses** in the contracts that regulate the management procedures in the event of such unforeseeable events.



THE SO-CALLED RENEGOTIATION CLAUSES

- «Force majeure» clauses;
- Excessively onerous or «*Hardship*» *clauses;*
- «Adverse Material Change» clauses.

RENEGOTIATION CLAUSES – FORCE MAJEURE

Force majeure clauses, normally:

- Define what is meant in the relationship between the parties by Force Majeure, even with a list of specific cases;
- They define a priori the consequences on contractual services that have become impossible, or partially or temporarily impossible, **due to significant events that have occurred and are unforeseeable;**
- determining, in the event of total and definitive impossibility, the termination and the effects of the termination for the benefit of those who have performed the services;
- or, in case of temporary or partial impossibility, a legitimate suspension of the reciprocal services, or a redefinition of the respective services in order to safeguard the contractual relationship.

RENEGOTIATION CLAUSES - HARDSHIP

Hardship clauses normally:

- Are used in international commercial contracts that have an extended duration;
- The purpose of these clauses is to regulate any problems that may arise during the execution of a contract of duration, making its execution more onerous (not even "excessively" onerous) for one of the parties.
- With these clauses the parties regulate the possible remedies to be applied to recourse to one of these circumstances, providing for the opening of a phase of renegotiation of the contract aimed at adapting the conditions of the contract to the new situation that has arisen, thus restoring reciprocal contractual dependency.

RENEGOTIATION CLAUSES - M.A.C.

Material Adverse Change clauses (or similar), are normally:

- Used in "sale and purchase agreements", in cases where the execution of the sale is deferred until after the subscription;
- The M.A.C. clause provides, in general, for the right of the purchaser to withdraw from the contract, or to request a revision of the contractual conditions if, before the performance of the services (the so-called closing), a so-called "significant negative event" occurs, i.e. an unforeseeable and extraordinary circumstance, not attributable to the parties, which significantly impacts on the contractual services on the basis of certain economic/financial indicators specified by the parties.

Based on how the M.A.C. clause is formulated, the consequences of the COVID-19 could trigger the remedies provided by the clause itself.

Effects on public contracts: Suspension of execution

The performance of public contracts shall be subject to the same rules on the impossibility of performance as those laid down in

- the Civil Code;
- clauses included in each contract.

The Code of Public Contracts introduces only one institution of a temporary nature: the suspension of performance (art. 107).

- It may only be ordered by the contracting authority for 'special circumstances which temporarily prevent the work from proceeding smoothly and which cannot be foreseen when the contract is concluded'.

- It must be a case of force majeure which cannot be foreseen or avoided by the parties with the use of ordinary diligence (in this case, the impossibility is determined by an act of public authority - the so-called factum principis or legal impossibility).

- A report must be drawn up, if possible, with the intervention of the perpetrator, indicating the reasons for the interruption, the progress of the services, the remaining activities and the precautions taken for conservation purposes to allow proper management during the detention. In the minutes, the executor may make objections to the suspension, otherwise he must make express reservations in the accounting register.

- The suspension must last as long as is strictly necessary and, as soon as the cause of action has ceased, execution must be resumed with the new contractual term being identified at the same time.

- By blocking the time limit for performance, no party is considered to be late or in default. The executor cannot obtain any compensation or termination of the contract due to non-fulfilment or impossibility (except in the case in which the impeding circumstance becomes final, applying the civil law).

CONCLUSIONS

Therefore, the incidence of force majeure/impossibility of the service will have to be assessed in concrete terms in relation to:

- the type of contractual relationship;
- the actual situation or conduct of the parties;
- the provisions contained in the specific contract;
- applicable legislation (Italian or foreign).

Without forgetting, as a last resort, certain general principles that apply to all contracts:

- the general clause of **good faith** (Articles 1366 and 1375 of the Civil Code);
- the principle of **additional fairness** (Article 1374 of the Civil Code);

On the basis of which, in any case, it is the right of the party that suffers events, to renegotiate the terms of the contract and, obviously, for the other party, the obligation to behave in good faith and fairness in order to redress the contractual reciprocal dependence.

Q&A

What to do if the contractual obligations cannot be faithfully fulfilled in the absence of renegotiation clauses?

A company which, due to the Covid-19 emergency, is objectively unable to perform a contractual service must promptly notify the other party of this impediment, specifying whether it is a partial or absolute, temporary or permanent impediment.

Such notification is part of the burden of conduct in good faith, regardless of the law applicable to the relationship.

It is also appropriate that, in such a case, the undertaking should, where possible, propose alternative solutions so that the creditor may have an alternative, subject to diligent conduct.

What to do when you are waiting to receive the benefit from the other party and you are not certain as a result of the Covid-19 emergency?

Firstly, it will be necessary to verify whether the contract contains renegotiation clauses regulating Force Majeure/Surplus impossibility and relative consequences on the reciprocal services.

If this is not the case, then it is be advisable to ask the other party to confirm fulfilment of the contractual obligations and/or acceptable alternative solutions as soon as possible.

In the event, then, that counterparty declares its impossibility, partial impossibility or temporary impossibility to perform the service without proposing valid alternatives, after verifying that the requirements have been met in order to consider a legitimate exemption of liability on the part of counterparty in the concrete case, it will be possible to assess whether to proceed with the request for termination of the contract based on the objective relevance of the exact and timely performance for the recipient.

What to do if the customer cancelled the order without a reason?

Also in this case it is necessary to check what the contract, or the general conditions of sale, establish regarding the cancellation of orders.

If the cancellation is not allowed, or if the terms for exercising it have expired, you may proceed by challenging the customer in a timely manner, warning him/her not to evade the obligations undertaken, such as payment of the agreed amount.

If, on the other hand, a generic reason has been communicated, basing the withdrawal solely on the existence of the Covid-19 emergency, it will be appropriate to ask the customer to justify the impossibility in concrete terms and, in the absence of an actual impossibility, or simple reconsideration or decision taken only on the emotional wave of the situation, insist and warn the customer to comply.

What to do if you are in negotiations to conclude an important cooperation agreement?

In such cases, in fact, it is possible that, on one hand, you do not want to frustrate the efforts made so far and, on the other hand, you should take a precautionary approach in order to be able to withdraw from negotiations or the contract if the situation becomes extremely unfavourable, without (excessively) negative consequences.

In the light of the above, in such cases it is advisable that specific provisions relating to the potential impact on the conclusion of the contract or its performance of the issues related to the Covid-19 outbreak are included immediately in the negotiations, i.e. that the negotiations should not continue.

In particular, in international contracts, it is also fundamental to carefully formulate the Force Majeure, Hardship, or M.A.C. clause.

Are there special rules for public contracts?

No, the provisions of the Civil Code (art. 30, paragraph 8 of the Public Contracts Code) and the clauses provided for in each individual contract apply to the stipulation of the contract and to the execution of public contracts.

Can I demand a stay of execution from the public client...?

Suspension of execution is a “faculty" for the contracting authority and is an institution provided to protect the contracting authority and not the executor. As a result of the suspension, in fact, the executor cannot obtain any compensation or termination of the contract due to non-fulfilment or impossibility (unless the cause of the impossibility becomes final).

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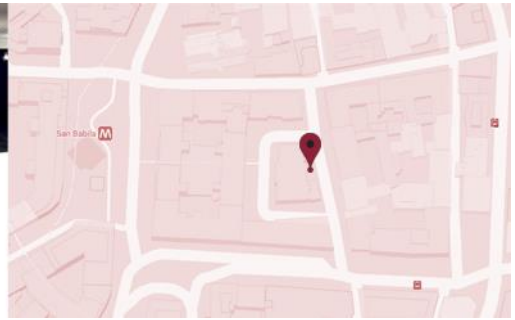

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