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COVID-19 IMPACT ON THE PERFORMANCE OF AGREEMENTS

The measures set out by the Italian Government to contrast the Covid-19 pandemic have a direct impact on the performance of companies and enterprises' agreements given that their activities have often been interrupted or suspended.

As a matter of fact, performance of the companies' obligations may be impossible or companies may no longer have any interest in the continuation of the contractual relationship, having considered the changes in the economic scenario or of the conditions which determined their entrance into the agreement.

The possible measures to be adopted with respect to the specific agreements require a case by case analysis, taking into account the type of agreement, the areas in which the company operates, the performance milestones reached and the parties' interest in the prosecution of the contractual relationship.

Below is an overview of the instruments which may be available both under Italian law and under the relevant agreement to avoid possible litigation.

I – Contractual remedies

Any opinion on the continuation of an agreement requires a preliminary detailed analysis of its clauses as well as of the conditions which determined the parties to enter into the agreement and parties' interest to the continuation of the contractual relationship.

In particular, the analysis shall initially assess whether the text of the agreement includes any material adverse change ("**MAC**") or force majeure clauses.

The MAC clause is typically included in companies or businesses sale and purchase agreements to protect the purchaser from adverse events which may occur between signing and closing, granting the same the right not to close the transaction.

The extension of such clauses may significantly change depending on the wording agreed by the parties. In general, MAC clauses list a series of events which may compromise, more or less significantly or directly, the operations and profitability of the target company. Usually MAC clauses also include a number of exceptions (as "changes in the general market conditions") which won't allow the purchaser to trigger the application of such clause.

Whether the lockdown determined by the measures adopted due to the Covid-19 emergency may trigger the application of a MAC clause clearly depends on the extension of the clause and on the evolution of the outbreak. In general, the purchaser should have the right not to close the transaction if the Covid-19 measures structurally (and permanently) compromise the target

company's operations. To the contrary, it will be difficult to enforce such right if the lockdown only caused operations to slow-down without having a significant effect on target's profitability and future activities.

In addition to the MAC clause, agreements (in particular those with international counterparties) often include a force majeure clause. Such a clause has the effect of excluding the non-performing party's liability in case its non-performance is due to extraordinary and unforeseeable events. In the context of the current Covid-19 pandemic force majeure clauses may have a significant role in determining the continuation of a contractual relationship or the liability of the party which does not perform – or delays performance – of its agreed obligations.

Since Italian legislation and international treaties have not defined the meaning of "force majeure", the actual effects of such clause will be determined by the two following elements:

- The wording used. In particular whether: *(i)* pandemics (or similar events) are included in the list of events which trigger the application of the clause and *(ii)* the list is exhaustive or not; and
- Applicable law. Without a uniform regulation at the international level, it is essential to determine the law applicable to the contract in order to assess the remedies available to the parties under such legislation. Application of Italian law, for example, will allow the parties to apply the remedies described in the following paragraph, while application of common law would not allow the contractual provisions to be integrated by the law. As a matter of fact, under common law systems parties' will be bound only by the provisions explicitly included in the agreement reached, with the exclusion of any further legal remedy potentially applicable.

In any case, the emergency measures' impact on the various economic sectors is still to be defined and will depend on the duration and extension of the legal provisions currently in force.

II – Legal remedies

The remedies provided for under Italian legislation to exempt a party from the liability deriving from delay in performing, or failure to perform, its obligations are based on the concept of "impossibility".

Article 91 of law decree no. 18 of 17 March 2020 (the "**Cura Italia decree**") provides that "*Compliance with this decree's*[1] *containment measures is always evaluated to exclude, pursuant to article 1218 and 1223 of the civil code, the obliged party's liability, also in relation to possible forfeitures or liquidated damages connected to the failure or delay in performing its obligations.*"

[1] Law decree no. 6 of 23 February 2020, converted into law no. 13 of 5 March 2020, providing for the measures to contain and manage the Covid-19 pandemic emergency, which art. 91 integrated with the provision mentioned in the text.

It is therefore a sort of "authentic interpretation" provided by the Government, which qualifies the measures adopted to contain the Covid-19 pandemic as force majeure events.

The provision recalled by art. 91 of law decree 18/2020 is art. 1218 of the civil code which exonerates from liability a party that has not performed, or delayed performance of, his obligation, if such party can prove that "*failure or delay to perform was due to the performance becoming impossible for a cause not attributable to the same party*".

In addition, pursuant to art. 1256 of the civil code, the obligation ceases to exist, if performance thereof becomes impossible for a cause not attributable to the obliged party; if performance becomes impossible only for a limited period, the obliged party, during such period, is not liable for the delay in performing the obligation. However, the obligation ceases to exists if – taken into account the kind of obligation and nature of the performance - the "impossibility" lasts for a period after which the obliged party can no longer by required to perform or the counterparty lost interest thereto.

Orders or prohibitions set out by public authorities certainly are causes for claiming that performance of an obligation has become impossible (so called, "*factum principis*"): as quite obvious, they are legislative or administrative provisions, based on public interests, which prohibit or – *de facto* – do not allow performance of a certain obligation, regardless of the obliged party's behavior. Such circumstances therefore exonerate the obliged party from liability regardless of the contractual provisions.

If it is impossible to perform an obligation only for a **limited period** of time, art. 1256 of the civil code excludes the obliged party's liability for delayed performance for the duration of such period. Therefore, in general, the obliged party shall always perform his obligation, when the said period has ended, regardless of his possibly different economic interests which, although, may be relevant to determine if performance has become excessively burdensome (see below).

The same principles also apply to contracts with reciprocal obligations: in particular, art. 1463 of the civil code provides that the party exempted from performing an obligation which has become impossible may not require the correspondent obligation to be performed and shall return what has already been received. In addition, if an obligation may only be performed in part, the other party has the right to a reduction of the corresponding obligations, without prejudice to the right to terminate the agreement if such party does not have a material interest in such partial performance (art. 1464 of the civil code).

Also, even if the Covid-19 emergency provisions did not prohibit a certain activity or render its performance practically impossible, performing certain contracts providing for continued or periodic obligations, may have become excessively burdensome: in such cases the party having to perform the obligations may request that the agreement is terminated, unless the other party does not renegotiate the agreement's terms (art. 1467 of the civil code).

Finally, to claim termination of a certain agreement it is not sufficient that performance thereof is no longer convenient or has become too burdensome, but it is necessary that such performance has become **impossible** or that the balance among the parties' rights has been altered once and for all (a circumstance difficult to prove in this moment considering the governmental measures are temporary).

In addition, to claim termination of an agreement due to its obligations becoming impossible to perform there must be a **direct link** between the impossibility to perform a certain activity and the provision (in our case, the governments measure) prohibiting the activity.

For example, there are no doubts that delivery of goods to a country that closed its borders is impossible, hence exempting the supplier's liability for the failure to perform his obligation. In a similar case, a Serie A soccer team sponsoring agreement cannot be performed due to FIGIC's decision to suspend the championship. On a different stand, the delays in the supplies of materials for the production of "essential goods" do not exempt the producer from liability, if such materials can be differently sourced. Possible additional costs borne by the producer to perform the agreement may, however, justify the renegotiation of the economic terms of the agreement ("hardship").

With respect to international transactions, the Ministry of Economic Development, with a note of last 25 March, provided that the Chambers of Commerce may release a specific English language certification attesting the Covid-19 emergency upon request of companies needing to enforce a force majeure clause and evidence the circumstance to their counterparties.

The note specifies that failure to deliver such a certification, required in many supply agreements with foreign counterparties, "*may immediately damage national enterprises that may see their contract terminated, receive claims for payment of liquidated damages and not be able to cover the costs already borne in relation to the supply*". Such a certification is meant to strengthen the position of companies required to prove the existence of a force majeure event to their counterparties, in particular in the context of common law international agreements. Italy's choice to authorize Chambers of Commerce to issue the emergency state certificate follows the path of other countries, such as China, pending recognition of the Covid-19 pandemic, also by other international institutions, as a global force majeure event.

III – Specific agreements

The Cura Italia decree also provided for specific kinds of agreements, indicated herebelow:

a) short stay contracts and obligations under contracts for public performances of any nature, including motion picture and theatrical ones, for access to museums and other cultural venues, may be terminated pursuant to art. 1463 of the civil code having the performance thereof become impossible (art. 88 of the Cura Italia decree);

b) suspension of rentals, customs duties and other payments due by road transportation and people public transportation companies (art. 92 of the Cura Italia decree);

c) suspension until 31 May 2020 of rentals and concession fees due for sport centers by sport companies and associations and by sport promotion entities (art. 95 of the Cura Italia decree).

A tax credit has been granted in relation to the rentals for stores and boutiques (C/1 category) due for the month of March 2020, equal to 60% of the rental amount. In addition, should the current measures be extended and assume a certain degree of stability, the "serious reasons" which allow termination of leases provided for under art. 27, para. 8, of law 392/1978 may be triggered.

IV – What to do

Some practical suggestions:

1) which are the company's strategic agreements?

2) are there any MAC, force majeure provisions? What is the applicable law and are there any derogations thereto?

3) is the performance of the obligations impossible or has it become excessively burdensome due to the new legislation?

4) request renegotiation of the contractual terms or suspension of the performance of the obligations due, while awaiting developments of the measures adopted;

5) as to contracts currently being drafted, carefully distribute the risks among the parties, specifying if the effects of the pandemic have an impact on the performance of the agreement (e.g. including or excluding the pandemic from the force majeure events, including certain effects of the Covid-19 in the definition of MAC, etc.), provide for clauses aimed at "managing the emergency" in order to maintain the contractual relationship in place before having to request its termination (e.g. including specific information requirements, an observation period before claiming its termination, hardship clause, price revision mechanisms, etc.);

6) assess the insurance policies currently in place and evaluate whether acquiring additional ones to cover the risks deriving from the pandemic;

7) always act according to correct and good faith standards, in order to avoid abusing of the contractual or legal instruments which may trigger liability vis-à-vis the other party.