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COVID-19 pandemic: impact on business contracts in Italy

Introduction: the Italian pandemic-related legislation

The current coronavirus pandemic is certainly an unprecedented event for all countries. This is even more true for Italy, where the Constitution does not expressly rule any “state of emergency” nor any general statutory instrument was in force specifically governing the management of a future pandemic.

When the first locally transmitted COVID-19 case was detected on 21 February 2020, the legal framework had to be swiftly adapted. This originally occurred by means of Law Decree no. 6/2020 of 23 February 2020. As for any Law Decree, this instrument was adopted by the Government and became immediately applicable, subject to its conversion into law by Parliament within 60 days (which eventually occurred). Law Decree no. 6/2020 outlined – on a non-exhaustive basis – the measures which could be adopted for the containment of the epidemic (e.g. limitation of the freedom of movement, suspension of commercial and manufacturing activities, closure of schools etc.). Although now replaced by Law Decree no. 19/2020 of 25 March 2020, its essential features are unchanged.

The containment measures are adopted, from time to time, by means of specific decrees of the Prime Minister (so-called DPCM), which do not request to be approved by Parliament. Several such decrees were passed, creating a quite complex framework. In particular, on 8 March 2020, a lockdown (stay-at-home order, closure of several commercial activities) was imposed in Lombardy and in 14 other provinces - the said measures were extended to the whole nation the following day. On 11 March several commercial activities were suspended. Moreover, on 22 March, all the industrial and commercial activities, exception made for a list of activities identified as essential, were suspended.

Several instruments are being passed in order to try to mitigate the economic impact of the pandemic as well as of the containment measures (e.g. Law Decree no. 18/2020 of 17 March 2020), granting subsidies and financial help to businesses.

Possible consequences on contracts

Unexpected circumstances, such as the ongoing coronavirus pandemic, which was completely unimaginable just some months ago, often have disruptive consequences on contracts between companies. Indeed, it is possible that the obligations of one party may become impossible, e.g. if their performance is prohibited, or are anyhow become more burdensome than they were when the contract was entered into.

It can also occur that the activities performed by one party turn out to be of little if no use to the other party. Just to make an example, in a contract whereby one party provides advertising in relation to tourism services, this activity is nearly useless in the current situation, due to the complete paralysis affecting the sector.

It is therefore worth wondering what remedies are available to companies whose contracts have now become unfavourable or even impossible to perform. In this respect, it is worth noting that the Italian legislator – who is providing grants and financial aid to companies – appears to be refraining from directly intervening through special civil law provisions, so that relationships between the parties of business contracts still need to be appraised mainly by recourse to the general rules and principles.

Impossibility of performance

In cases where obligations have become impossible to perform, in the vocabulary of international contracts reference is often made to the notion of force majeure.

The Italian civil code, however, does not make use of this expression, but mentions the impossibility of performance (*impossibilità sopravvenuta*), ruled by sections 1256 ff. Section 1256 provides that an obligation is extinguished when the relevant activity/service becomes impossible for a reason not attributable to the debtor, who is therefore not liable and does not have to pay damages. Section 1463 rules the consequences of impossibility in bilateral contracts, i.e. the contracts, such as nearly all business contracts, envisaging an exchange of activities: if the activity of one party becomes impossible, the contract is terminated by law. As a consequence, the consideration cannot be claimed and – if already paid – it must be returned.

Which features must accompany the impossibility in order to exempt from liability the affected party, and possibly lead to the termination of the contract?

First of all, the impossibility must be unexpected at the time when the agreement was entered into. If the impossibility were already existent or certain (e.g. sale of a good already lost, performance of an activity already prohibited), the contract would be null and void.

The impossibility must also be absolute and objective. Absoluteness should be intended as impossibility to perform in any way, whereas objectiveness means that the performance should be impossible for anybody and not only for the party.

The impossibility may be intended also in a legal way – and not necessarily in a physical one: if an activity is prohibited by a statutory or administrative instrument, force majeure generally applies. Significant examples in this respect are administrative orders, quite frequent in the current situation, preventing the export of certain drugs or medical devices. Similarly, the suspension of certain business activities may be material, e.g. the one provided by the Decree of the Prime Minister dated 22 March 2020, which affected all the industrial and commercial activities except for the ones considered as essential.

The obligation to pay money (e.g. rents), as a general rule, can never be considered as impossible, neither in a situation of serious economic difficulty. When exceptional events occur, it is however possible that public authorities may suspend certain payment terms (e.g. loan instalments, utility bills etc.). In relation to the current emergency, the rules are still evolving.

However, it seems that the prevailing approach is to provide gratings and subsidies to companies in order to allow them to fulfil their obligations, and not suspend payment terms between private entities.

Hardship

Exceptional events, such as disease outbreaks, can more often lead to difficulties in the performance than to an absolute impossibility.

In this respect, if the obligation of a party has become excessively burdensome (hardship or, in the Italian legal language, *eccessiva onerosità sopravvenuta*), it is possible to request the termination of contract pursuant to section 1467 of the Italian civil code. In order to prevent termination, the other party can offer to fairly amend the terms and conditions of the contract (section 1467, paragraph 3).

Termination for hardship is subject to three conditions, all to be met:

- (i) the contract must be a long-term contract or a contract whose performance is not immediate;
- (ii) after the execution of the contract, the obligation of one party must prove excessively burdensome if compared to the one of the other party;
- (iii) the difficulty in performance must be caused by extraordinary and unforeseeable events.

The current pandemic – with the related measures limiting several rights, such as free movement and the freedom of commerce and industry – may be qualified as an extraordinary and unforeseeable event.

On the contrary, it may be difficult to demonstrate that an obligation has become excessively burdensome, since this should be appraised in light of the obligation of the other party. Disputes may therefore easily arise as to whether this criterion is actually met.

Termination is however possible only following a request in court: as a consequence, a statement whereby one party declares to the other to consider the contract as affected by hardship and represents the willingness to terminate the contract, would not be sufficient. In any case, a careful appraisal as to whether all the criteria are met is highly recommendable. It is also worth noting that court proceedings are suspended as a further lock-down measure, leading to an uncertainty until courts will resume their activities (current lock-down until 15 April that will presumably be extended to 11 May).

Contractual clauses

Impossibility and/or difficulty in the performance are often ruled by specific clauses, which are absolutely common in international contracts, and frequently very detailed, both in relation to the circumstances amounting to force majeure and to the mechanisms ruling the management of the relevant consequences.

Albeit detailed, those clauses are sometimes not carefully appraised in advance, and this may lead to interpretation uncertainty and disputes between the parties. More significantly, it may occur that force majeure clauses fail to mention epidemics among the so-called acts of God

events: litigation may therefore arise already as to the mere applicability of the clause in the current situation.

Conclusions

The party willing to invoke the impossibility of performance or hardship should first appraise whether the contract contains clauses ruling force majeure events.

Lacking any such clauses, only statutory provisions should be relied upon.

In any case, the parties retain the possibility to suspend, renegotiate and/or terminate the contract by mutual agreement. Indeed, this approach may be convenient – both in terms of costs and of time – in the current context of uncertainty, and is consistent with the opinion of a significant part of the legal literature which maintains the existence of a duty to renegotiate clauses if unforeseeable events occur.

Before embarking on any negotiations, however, it is advisable to carry out a careful legal analysis of the relationship between the parties, in order to better understand their strengths and weaknesses and consequently try to obtain the best possible result.

This document was drafted by Jenny.Avvocati exclusively for information and divulgation purposes. The Firm's professionals are at clients' disposal for the analysis of specific issues.