

CORONAVIRUS OUTBREAK AND ITS EFFECTS ON CONTRACT PERFORMANCE: A PRACTICAL GUIDE UNDER ITALIAN LAW

THE OUTBREAK OF THE NOVEL CORONAVIRUS IN ITALY AND OTHER COUNTRIES AND THE CONSEQUENTIAL MEASURES INTRODUCED BY NATIONAL GOVERNMENTS MAY TRIGGER ONE OR MORE ISSUES IN THE CONTRACTUAL RELATIONSHIPS BETWEEN NATIONAL AND INTERNATIONAL PARTIES.

Although a fact-specific analysis is necessary to address issues that arise on a case-by-case basis, we set out below an initial check-list of items that may be taken into consideration to assess the effects, if any, of the pandemic on a contract.

1. What is the nature of the relevant contractual relationship and the type of contract involved (e.g., finance, insurance, construction, sale, *etc.*), the performance due under the contract, as well as the cause of the alleged breach—whether actual or merely possible—(e.g., compliance with the regulations enacted by the relevant government to address the pandemic, consequence of the default of a third-party, *etc.*)?
2. Is the contract between private entities or does it involve a public administration? Is it part of an investment in a foreign State?
3. Does the contract contain an applicable law clause? Where is the seat of the contracting parties?

4. Does the contract contain a force majeure clause? If so, does the relevant circumstance fall within the definition of force majeure in the contract? Is there sufficient causation between the force majeure event and non-performance? What are the obligations of the non-performing party affected by the force majeure event?

Force majeure is a French law concept; if used in an English-law contract, it must be expressly defined. Both a general definition of force majeure and a specific list of force majeure events are often included in international contracts.

- Some force majeure clauses may expressly list or include epidemic and/or pandemic as a force majeure event. A specific analysis should nevertheless be performed to assess whether a specific pandemic outbreak satisfies the general requirements under the contractual definition of force majeure—*e.g.*, whether it is unforeseeable and prevents performance of the contract.
- Even where the force majeure events listed in the contractual clause do not expressly include pandemic outbreak, it does not necessarily mean that a pandemic outbreak does not qualify as a force majeure event. Indeed, a force majeure clause may cover other circumstances triggered by the pandemic outbreak—*e.g.*, the clause may include “government order” or “government interference”. Therefore, actions taken by the government in response to the pandemic outbreak may constitute a force majeure event.

Some contracts may not enumerate the circumstances constituting force majeure, but instead rely on a general definition, or there may be an enumerated list that is said to be non-exhaustive. Such general force majeure clause will need to be analysed by reference to the principles of construction and governing law (for example, the governing law may apply the implied term doctrine to incorporate the term into the contract; or in case of ambiguity the governing law may apply a *contra proferentem* rule).

5. Does the contract contain other clauses that could be relevant (e.g., material adverse change, change of law, hardship) in these circumstances?

A *material adverse change clause* (MAC) is a common condition in an M&A context whereby a buyer may have the right to not perform in certain circumstances. Pandemic may per se not trigger this right, but the consequent effects on a company's commercial and financial status may constitute a material adverse change.

A *change of law clause* is often seen in long-term supply contracts. It may trigger renegotiation or termination rights. Whether a government order in response to a pandemic constitutes a "change of law" depends on the specific terms of the contract.

An *hardship clause* is similar to a force majeure clause, except the threshold for applying hardship is often lower. Legal consequences of triggering the clause depend on the specifically agreed terms.

6. What does the contract or the applicable law provide with regard to the essential elements of the claim, such as foreseeability, causation, notification requirements, and mitigation duties?

7. What are the default rules under the applicable law? Is force majeure regulated by statute?

Under Italian law force majeure is not specifically regulated. It is commonly construed as a fact that excuses performance under Article 1218 of the Italian Civil Code, thus excluding that the defaulting party should pay damages in case of non-performance. Under Article 1223 of the Italian Civil Code damages include both the loss suffered and loss of profits as long as they are the direct and immediate consequence of the breach.

8. Do the circumstances related to the pandemic render the performance impossible or merely burdensome? Is the default related to the pandemic temporary or permanent?

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Under Article 1256 of the Italian Civil Code, an obligation will be deemed as extinguished if the performance becomes impossible for unforeseen circumstances that cannot be reasonably imputed to the defaulting party.

By contrast, under Article 1467 of the Italian Civil Code, if the performance of one of the parties becomes excessively onerous—but not impossible—due to the occurrence of an extraordinary and unforeseeable event, that party may request the termination of the contract. In such a case the other party may avoid the termination by offering to amend the relevant terms of the contract.

9. Is there any law provision that has recently been enacted to provide guidance on defaults related to the coronavirus pandemic?

In Italy, Article 91 of recent Law Decree No. 18 of 17 March 2020, clarifies that: *“compliance with the containment measures ... shall be taken into consideration to exclude the liability of the debtor as per Article 1218 and 1223 of the Italian Civil Code, also with regard to the loss of rights and contractual penalties that may be foreseen in case of delayed or defaulted obligations”*.

10. Does the contract include a forum selection clause? Does it provide for arbitration and/or other ADR mechanisms? Please consider that domestic courts and international arbitral tribunals might have a different approach as to the construction of international contracts.

11. Is there any possible issue of contractual performance and/or enforcement of court judgments / arbitral awards taking place in a foreign jurisdiction? Is a State or a State entity involved?

In any case, when considering the impact of the pandemic on a contractual relationship, one should consider also commercial, reputational, and other factors. Based on our most recent experience, when considering whether to trigger a force majeure, a MAC, or other similar contractual clauses, one should analyse, without limitation: (i) How will it affect the long-term business relationship between the parties to the

contract? (ii) How will it affect other stakeholders (e.g., shareholders, employees, clients, suppliers, and lenders)? Will the decision cause those other stakeholders to take any action? (iii) If multiple similar commercial contracts are involved, whether declaring force majeure under one contract could affect claims under other contracts? (iv) Will the decision have any impact on the reputation of the company?

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