

WHAT ARE THE CONSEQUENCES ON CONTRACTUAL OBLIGATIONS CAUSED BY BREACHES DUE TO COVID-19? by Claudia Bortolani | Founder Legal Grounds Avvocati

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After more than a month from the burst of the Coronavirus in Italy and the increasing restrictive measures that the Italian Government has taken to contain the epidemic, all people who had pending contracts are facing the question of possible or actual breaches of contractual obligations.

First of all, a difference must be made between:

- cases where the **debtor cannot longer fulfill his obligations**, from those in which
- **performance is still possible but made more burdensome**.

THE CONCEPT OF “FORCE MAJEURE”

The first case would be what in the international agreements is called an “**event of force majeure**”, the second case is probably similar to the international concept of **hardship**.

First of all, **in the Italian legal system there is no definition of force majeure**, but reference is made to art. 1256 of the Italian Civil Code which titles “Liability of the debtor” and provides that “*the debtor who does not duly fulfill the agreed upon obligation is called to reimburse the other party for all damages suffered, unless he proves that the non-fulfillment or the delay was determined by the impossibility to perform the obligation determined by a cause not attributable to him*”.

The impossibility - according to case law - must be “**objective**” and “**absolute**”. Payment of a sum of money has never been considered as impossible. This appears to be in line with some U.S. Court decisions that, for example, did not excuse the debtor from payment of a sum of money not even after the crash of the financial system in the 30’s.

In Italy, for example, a Court did not recognize as a force majeure event a case in which the occupation of factory by the workers, and thus the total freezing of the sales, prevented the debtor from paying a bill. Also, the obligation to supply and deliver **goods determined in their kind but not unique in their nature** is not eligible to become impossible, unless the event stroke all of the producers of those goods and thus made it impossible to find the goods on the market or again the goods could no longer be produced by order of the authorities, and thus disappeared from the market. With respect to **commodities**, for example, a Court held the debtor responsible for failure to supply a quantity of sugar that had become extremely expensive due to war events, but it was still possible to find it.

In case of **obligations to do something**, performance is considered impossible when it would not be possible for any individual in the same position to perform the obligation.

In all cases, the debtor will have to show that the impossibility to perform was due to a **cause not attributable to him**. This means that he will be held responsible in all cases in which the impossibility to perform is due to an event that he had the duty to avoid.

In summary, the debtor must have acted in a **diligent manner** and prove that he did all he could to perform. **Thus, a simple hardship would not free the debtor from liability for the applicability of this provision.**

According to art. 1256 *“An obligation terminates when for causes not attributable to the debtor, performance becomes impossible”*.

THE CONCEPT OF HARDSHIP

As to **hardship**, art. 1467 of the Italian Civil Code provides that in all agreements that provide for an execution during the course of time or at a certain time, if performance of one party has become **excessively onerous** due to **extraordinary and unforeseeable events**, such party may request that the **agreement is terminated**. Termination cannot be requested if the excessive burden was in the **normal risk range** of the contract. The other party, requested of the termination, may avoid such termination by offering a renegotiation of the terms of the agreement at **equitable conditions**.

Case law has held that **hardship must be represented by objective criteria** caused by **extraordinary and unforeseeable events** at the time of signing of the agreement. **Extraordinary** are all those events that by their nature, their frequency of occurrence, size, intensity, statistics, while **unforeseeable** is determined in relation to possible knowledge of the parties at the time of execution of the agreement.

For example, Courts held that a severe monetary depreciation may represent hardship, if it can be qualified as a risk that was unforeseeable as not in the normal risk range of that specific agreement.

EXAM OF A POSSIBLE CASE

The facts

Mario Rossi, an Italian producer of design furniture entered into a contract for the sale of his products with a US distributor who in turn had entered into several contracts with his clients. In this case, the first assumption is that the Italian producer ordered the wood from a France seller whose production was halted due to urgent provisions issued by the French Government. The second, is that all agreements are governed by Italian law.

What will happen in this case?

The U.S. distributor will be responsible vis-à-vis his clients and will try to be held harmless from the Italian producer who, in turn, will seek damages from the French wood seller who will justify his breach by a force majeure event.

Who will be ultimately responsible and who will have to bear the risk of suffering damages?

First of all, an Italian Judge will review the agreement of the litigating parties and verify if clauses of force majeure and hardship are present and what they provide. Even in our country, where agreements tend to be less voluminous than in others as the Civil Code regulates in details the

contract manner, the international practice, based on the common law models, has determined that such clauses are very often, if not always, present.

Such clauses may not contemplate expressly epidemic or pandemic events, however they often state “including but not limited to” meaning that the list of events of force majeure is not limited in number.

If in our case (epidemic or pandemic) is not contemplated by force majeure or hardship clauses, the creditor will just have to show his right to obtain performance of the obligation by the Italian producer. It will be the Italian producer to be exempt from liability for force majeure that will have to prove i) that performance is impossible (in this case he cannot buy the timber anywhere else, which may be hard to prove) and (ii) the cause that rendered performance impossible (the health emergency). Probably, it would be easier in this case to prove hardship due to the extraordinary and unforeseeable event and demand the Judge termination of the contract, unless the other party offers an equitable renegotiation of its terms.

Also, a relevant impact on the evaluation of responsibility of the Italian producer will have his conduct, did he immediately inform the US distributor? Did he try to locate a different seller? Did he adopt any measure to reduce the damages? Did he use the diligence requested in this case?

As such, the evaluation of the liabilities of the debtors is something that has to be done on case-by-case basis.

THE NEW PROVISIONS FOLLOWING THE EMERGENCY

The Law Decree dated 17 March, in its art. 91 (still subject to review until it is converted into a Law of Italy) provides that *“compliance with the restrictions introduced to slow down the expansion of the epidemic, must be kept into account for the determination of the liability of the debtor also in relation to the application of penalties for delayed performance or failure to perform”*.

At the moment, however, this provision represents not more than a recommendation to the parties to keep into account the current emergency situation.

THE “CERTIFICATES OF FORCE MAJEURE” ISSUED BY THE CHAMBERS OF COMMERCE

Lastly, it is important to know that it has been introduced the possibility for the Italian Chambers of Commerce to issue to the companies that make a request, **“certificates”** on the state of emergency following the COVID-19 epidemic and the restrictions imposed by the Law to contain the epidemic.

These certificates are to be issued in English with reference to contracts with foreign counterparties, so that the non-fulfilling party may present them to the latter to justify the impossibility to perform the contractual obligations assumed by a certain deadline for unpredictable reasons and independent of the will and ability of the company.

While this will serve to prove the event of “force majeure”, the other aspects the impact of the event on the exact performance of the agreement and the diligence used will also have to be evaluated to determine the liability of the non-fulfilling party.

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