

Italy and COVID-19 – Practical and Legal Guidance on Key Business Issues

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As has been widely reported, after the initial outbreak of the Coronavirus Disease 2019 (“CoViD-19”) in China at the end of December 2019, the virus has progressively reached Europe and other continents, with Italy currently being hit the hardest.

Pressed by the increasing public health threat posed by the outbreak, the Italian Government and local authorities have adopted a series of urgent measures, principally intended to contain the contagion.

The effects of the epidemic are expected to affect (and, to a large extent, are already affecting) the conduct of all activities, including the administration of justice, the exercise of individual freedoms, the performance of existing contracts, and the continuation of business operations.

This memorandum¹ is intended to provide an initial overview from the Italian legal perspective of the questions that are most likely to arise in the current challenging scenario.

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¹ A prior memorandum focused on capital markets issues was published on March 10, 2020: https://www.clearygottlieb.com/-/media/files/alert-memos-2020/coronavirus_considerazioni-e-impatti-sulla-disclosure-degli-emittenti-pdf.pdf.



I. The Italian Government measures

Since February 22, 2020, the Italian Government has adopted various urgent decrees which have introduced progressively tighter measures to contain the spread of CoViD-19.

The most recent measures apply severe restrictions to the entire national territory until April 3, 2020.²

These Government measures and, more generally, the current CoViD-19 epidemic, create a number of legal and practical questions for businesses operating in or with Italy. In the following paragraphs we will outline some of them and provide some initial thoughts on how to address them.

II. Impact of the outbreak on existing contracts

The consequences of the CoViD-19 outbreak may affect the ability or the willingness of one of the parties to a contract to perform its obligations thereunder.

Litigation is likely to arise in these circumstances and it is essential to understand whether applicable law or the relevant contractual provisions may, depending on one's position under the contract, afford protections if one is unable to fulfill its obligations, or on the other hand enable one to continue demanding full performance of the contract.

In order to be prepared to face the challenges that the current circumstances present, companies should consider reviewing (at least) their crucial supply and customer contracts to identify possible weaknesses or exit routes and devise an appropriate strategy.

Certain key aspects to be considered are outlined below.

A. Force majeure / factum principis and other relevant principles of Italian contract law.

There may be a number of grounds under Italian law that may be invoked to avoid or delay performance

and/or excuse non-performance as a result of the CoViD-19 outbreak, including: (i) impossibility and/or *force majeure / factum principis*, which releases the debtor from fulfilling its obligation (Article 1256, paragraph 1) or, when it is temporary, excuses the debtor for late performance (Article 1256, paragraph 2); (ii) termination of the agreement for supervening impossibility (Article 1463); (iii) right to obtain a revision of the obligations or to withdraw from the agreement for partial impossibility (Article 1464); and (iv) termination of the agreement for supervening hardship (Article 1467, paragraph 1). In this last case, the counterparty can avoid termination by offering to renegotiate the contract on fairer terms (Article 1467, paragraph 3).

Thus, it may be advisable for companies to review their key agreements (in terms of value, duration, strategic impact, etc.) to determine whether (i) the company (or its counterparty) may have an interest in seeking to renegotiate or set aside that agreement as a result of the CoViD-19 outbreak and (ii) if so, what legal grounds may be available to it (or its counterparty).

Thereafter, a company may consider (i) contacting its counterparty with a view to identifying a potential consensual solution (*e.g.*, negotiate a standstill or a postponement of the performance) or (ii) alternatively, take the necessary steps to anticipate possible actions that it or its opposing party may take, such as seeking a declaratory judgement that a *force majeure* or similar event has (or, depending on one's posture, has not) occurred.

B. "Material adverse change" clauses in acquisition agreements

Contracts governing the acquisition of businesses often condition the buyer's obligation to complete the relevant transaction on no "material adverse change" ("MAC") occurring between signing and satisfaction of all other conditions precedent to closing.

event entailing the aggregation of people in public or places (including cinemas, theatres, museums) as well as the closure of most shops and retail activities (other than, mainly, supermarkets, groceries and pharmacies).

² These include: the suspension of all education and sport activities, the limitation on movement of people (regardless of whether affected by the virus) unless justified by ostensible work, health or urgent needs, the cancellation of all public events and the prohibition of any

The language of these clauses may vary significantly, depending on a number of factors. These provisions may include events affecting, or reasonably expected to affect, the target company's ability to run its business, the seller's ability to meet its obligations under the relevant contract, or the specific conditions and prospects of the target company. On the other hand, these clauses may also set forth exceptions to the buyer's ability to enforce them, by excluding changes affecting "general market conditions" (unless disproportionately hitting the target).

Whether the buyer can terminate an acquisition agreement based on the occurrence of a MAC condition will of course depend on the specific language of these provisions as well as on the future evolution of the outbreak. To the extent that the epidemic continues to be mostly limited to certain jurisdictions, for instance, a carve-out for industry-wide conditions might be insufficient to compel the buyer to complete the deal if the target is located in those jurisdictions.

C. Financing documents

In European loan agreements, the occurrence of a MAC often entitles the lender not to fund the loan or, should the MAC occur after drawing of the loan, give rise to an event of default (entitling the lender to require the borrower to repay the loan in advance).

However, given the uncertainty in the interpretation of MAC clauses as a matter of law, the limited information the lenders have on the borrower's condition, and the risk of lenders' liability arising from a wrongful acceleration, it is generally expected that lenders will be reluctant to refuse to fund or accelerate a loan solely based on the deemed occurrence of a MAC resulting from the CoViD-19 outbreak.

In any event, the spread of CoViD-19 (and the various measures to contain it) are expected, among other things, to affect the revenue-generation capacity, cash position and overall financial condition of a borrower.

In turn, this may undermine the ability of borrowers to meet the financial maintenance covenants contained in loan agreements (such as "leverage" ratio, "interest cover" ratio, or "debt service cover" ratio, all of which depend on the financial performance measures, such as EBITDA or cash-flow, of the borrower).

The breach of a financial covenant also typically results in an event of default, entitling the lenders to require the repayment of the outstanding debt.

Any company whose business could be substantially affected by the current epidemic should consider reviewing its prospective ability to meet the financial covenants contained in its debt financings.

Loan documentation has evolved dramatically in recent years, especially in the area of financial definitions. Borrower-favorable definitions may enable a borrower to "add back" to EBITDA or other relevant financial measures the amount of extraordinary losses, restructuring costs and other unusual items, or the proceeds of business interruption insurance that may be received by the borrower. A careful review of these provisions would be advisable in order to determine if and to what extent the impact of the CoViD-19 outbreak could be disregarded for purposes of compliance with these covenants.

If this analysis identifies a likely future breach, a company should consider taking early action, such as managing its cash in order to ensure compliance, or engaging in discussions with its lenders in order to obtain covenant resets before the breach actually materializes.

III. Actual or prospective insolvency, restructuring tools

Possible liquidity and other related financial issues prompted by the virus outbreak may also cause a debtor's insolvency.³ Insolvent companies may not continue to carry on their business and are required

³ Under Italian bankruptcy law, a company is deemed "insolvent" when it becomes unable to regularly pay its debts as they fall due.

to file for bankruptcy or other forms of insolvency protection.

Under Italian law, it is debated whether prospective insolvency⁴ is sufficient for admission to (or to require the filing for) bankruptcy liquidation proceedings (*fallimento*). However, in principle it would be enough to show a situation of distress (*crisi*) to enable the debtor to seek a court-supervised restructuring of its indebtedness.⁵

Further, the CoVid-19 outbreak may lead to a loss of a company's statutory capital, as a result of accrued operating losses or impairments of intangible assets, which, under Italian law, would require a company promptly to either recapitalize or liquidate.

Boards of directors and statutory auditors will need to make difficult judgment calls to determine a company's actual and prospective solvency as well as the integrity of its statutory capital. Reasonably informed assessments as to the duration of the outbreak and of its consequences are likely to be key in making determinations that withstand future legal scrutiny.

IV. Moratorium

Given the magnitude of the potential impact that the outbreak is expected to have on a broad range of businesses, the Italian Government has adopted⁶ certain forms of statutory *moratorium*, and has announced its intention to adopt further such

⁴ "Prospective insolvency" is generally referred to as the likelihood (based on objective criteria) that the debtor becomes actually insolvent in a defined period of time in the future.

⁵ Notably, a court-ratified restructuring agreement or a court-supervised composition with creditors (*concordato preventivo*).

⁶ In particular, under the Orders issued by the Head of *Protezione Civile* on February 29 and March 9, 2020, borrowers have the right to defer (until the end of the state of emergency) payment of principal instalments of loans granted by "credit and banking institutions" in connection with (i) real estate properties or (ii) commercial and business (including agricultural) activities. By April 1, 2020, banks and financial intermediaries are required to inform borrowers of the right to request the deferment and the related terms and

measures, to allow certain classes of debtors to defer payments on their loans or other debts for a certain period of time.⁷

It is unclear at the time of writing whether any such further measures will be adopted and, if so, what they will provide specifically. However, even if adopted it may be disputed whether these measures would bind non-Italian lenders or lenders under debt instruments not governed by Italian law. In addition, borrowers under financing agreements governed by a foreign law should review these documents to evaluate whether these measures, though designed to protect borrowers, could unintentionally give rise to technical defaults under "moratorium" or similar events of default.

V. Smart working and Government-backed labor support measures

With a view to ensuring continuity in the operations of all businesses affected by the outbreak (and thereby containing the ensuing effects), the recent measures adopted by the Government have favored the recourse to "smart working" work modes. In particular, the application of remote working has been extended to any employment relationship regardless of the existence of any individual agreement with employees to that effect (as would normally be required).⁸

conditions (failure to do so would result in the automatic deferment until November 14, 2020 at no additional cost for the borrower).

⁷ Certain private initiatives have already been taken in this respect. For instance, recently, the Italian banking association (ABI) announced an agreement with certain trade associations pursuant to which small-medium undertakings affected by the virus outbreak may request a moratorium (of up to 270 days for short-term loans and up to 120 days for agricultural loans) on the payment of principal repayment installments due under loans granted to them until January 31, 2020.

⁸ Employers must notify to the Ministry of Labor smart working arrangements by using a simplified online procedure.

Further, employers have been encouraged to promote the use of vacation and accrued leave during the current state of emergency.

Finally, employers may have access to State-backed support measures devised to absorb the labor effects of this type of event, such as the Ordinary Wage Guaranteed Fund (*Cassa Integrazione Guadagni Ordinaria*).⁹ Under the generally applicable rules, employers could make use of these welfare benefits in case of reduction or suspension of working activities as a consequence of a “sudden event not attributable to the company nor to its employees”.¹⁰

Finally, the Government is expected to take additional measures in the coming days in order to loosen the requirements for recourse to the existing social support measures or introduce new *ad hoc* measures to support employers in a situation of distressed caused by the outbreak.

VI. Data protection

Given the sensitive nature of data regarding affected individuals, the virus outbreak gives rise to significant issues which should be considered from a data protection perspective.

In this respect, the Italian Data Protection Authority recently¹¹ clarified that:

- the prevention of the spread of CoViD-19 should be pursued by healthcare professionals and officials operating within the National Civil Protection Service who are authorized to carry out the processing of information on citizens’ health;¹²
- in order to avoid data privacy issues, employers must refrain from requesting that employees fill travel or health declaration forms, collecting information on virus symptoms or on employees’ contacts, as well as from providing mandatory temperature testing. However, employees must report to the employer any situation of risk in the workplace connected to CoViD-19. In this context, the employer may recommend its employees to report whether they have recently visited an area at risk;
- personal data processing is considered “necessary for reasons of public interest in the area of public health” pursuant to Article 9(2)(i) of the GDPR only if it is carried out by competent authorities and professionals;
- the employer must carry out the ordinary tasks aimed at providing a safe workplace under Article 2087 of the Italian Civil Code. Consequently, the employer must inform the relevant authorities of any changes in the biological risk to health in the workplace connected to CoViD-19 and pursue all the other necessary activities together with the company physician (*e.g.*, scheduling extraordinary examinations of the most exposed employees);
- employees who are in contact with the public (*e.g.*, public relations services) must communicate to the health services any suspicions of CoViD-19, also through the employer, and, in any case, comply with the prevention guidelines provided by healthcare professionals.

⁹ This consists of a temporary lay-off measure grounded on specific business needs for a limited period of time, during which employees are entitled not to work and meanwhile receive a portion of their salary (around 80%) from a fund managed by the national social security authority.

¹⁰ An order by the public authority to suspend the production activities due to circumstances not attributable to the company (such as those contained in the recent measures adopted by the Government to face the virus outbreak) should be regarded as a ground to apply for this welfare benefit.

¹¹ In particular, on February 2, 2020, the Italian Data Protection Authority provided an opinion on the then draft Government decree aimed at addressing the emergency related to CoViD-19. On March 2, 2020, it also issued a document to stop employers’ autonomous initiatives in collecting employees’ personal data.

¹² Which represents special categories of personal data under Articles 9 and 10 of Regulation (EU) 2016/679, the “GDPR”).

VII. Judicial proceedings

Pursuant to the recent Government measures, all civil and criminal hearings scheduled between March 9 and 22 have been adjourned and will be re-scheduled to a date after March 22, 2020.

In addition, all procedural deadlines for civil and criminal proceedings are suspended until March 22 and are automatically postponed after such date, as confirmed by the Explanatory Report of the Premiership Office dated March 11, 2020.

If a procedural deadline expires after March 22 (and therefore does not fall within the “stay” provisions of the Governments), but a party is still prevented from respecting it (e.g., because it becomes impossible to retrieve documents to be filed in court or access other information due, for instance, to mandatory smart working limitations), it may be advisable to contact the opposing party to agree on a joint postponement or to apply *ex ante* for an extension by the Court.

In any event, the above-mentioned provisions do not apply to urgent matters. As regards civil proceedings, hearings continue to be held in the following cases: (i) family and personal rights and status (such as adoption, minors, maintenance obligations); (ii)

interim measures to protect fundamental human rights; and (iii) all cases where a delay could cause a serious harm to the parties, as determined by the court by a specific decision.

The recent Government measures also allow courts to: (a) postpone future hearings to a date after May 31, with the exception of the proceedings mentioned above; and (b) replace in-person hearings with written submissions and out-of-court decisions by the judge.

VIII. What next?

The situation in Italy (and Europe generally) is developing fast and the Italian authorities are endeavoring to prevent further deterioration of the current public health conditions.

Further extraordinary measures may therefore be taken in the coming days, including to address at least some of the issues discussed in this memorandum. Certain initiatives are also expected at European level, including because the virus outbreak seems to be unfolding beyond the Italian borders in substantially the same form currently experienced in Italy.

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