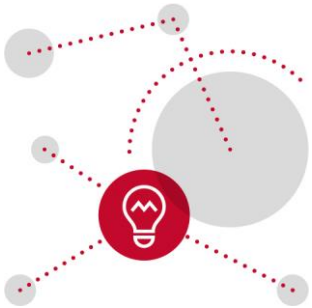
BonelliErede

Energy and Infrastructure Focus Team

27th March 2020

The Covid-19 emergency: protection and remedies for concessionaires and operators under concession agreements and public-private partnerships

Energy and Infrastructure Focus Team



Focus Team Leader
Mario Roli
mario.roli@belex.com
tel. +39-02-77113306

Authors

Giorgio Frasca
giorgio.frasca@belex.com
Tel +39-06-84551279

Giovanna Zagaria
giovanna.zagaria@belex.com
Tel +39-06-84551275

Beatrice Corda
beatrice.corda@belex.com
Tel +39-06-84551413

1. Introduction

The Covid-19 emergency is significantly affecting the performance of business in Italy, also due to **restrictive measures adopted by the Italian government and other competent authorities**[1]. These measures have also affected – directly or indirectly, depending on the market sector – **concession agreements** and, more generally, **public-private partnership agreements** ("**PPPs**").

This legal note aims to provide a preliminary, general overview of the possible remedies and protection concessionaires and operators have in response to the negative impact of this emergency on concession agreements (both work and service concessions) and PPPs.

The two main aspects to consider are:

a) the possibility for a concessionaire **to avoid liability** if it fails to fulfil contractual obligations under a concession agreement and fails to ensure minimum service levels; and
b) the power to request an **extraordinary revision of the economic and financial plan**.

2. Exemption from liability if contractual obligations are not fulfilled under concession agreements and minimum service levels are not ensured

General principles on contractual liability should be examined before considering the measures taken/provisions adopted to combat Covid-19 – this because, in the absence of ad hoc provisions, those general principles apply also to concession agreements and PPPs.

2.1 General legal principles

a) Frustration of performance and factum principis

[1] Please see, among others: a) Law Decree No. 6/2020; b) Inter-ministerial Decree Nos. 112, 116, 117, 118, 120 and 122 of 2020, adopted by the Ministry of Infrastructure and

The main provision is Art. 1218 of the Italian Civil Code ("ICC"), whereby an obligor that fails to regularly fulfil its obligations **is liable for damage due to the non-fulfilment or to the delay in performance, except if performance becomes impossible for a reason not attributable to the obligor**.

This principle is also enshrined in Art. 1256 of the ICC, whereby an obligation is extinguished when its performance becomes definitively impossible; if the impossibility or performance is temporary (i.e., due to a reason expected to be temporary), the obligor is exempt from liability until the impediment to performance ceases to exist.

The above provisions apply if the event that caused the frustration of performance is unpredictable and supervening and is not attributable to, under the control of, or remediable by, the obligor.

One of the events usually considered to frustrate performance is factum principis, namely the adoption of a law or administrative measure addressing general interests that objectively frustrates performance, independently of the obligor's cooperation. This principle exempts the obligor from liability, provided that the latter has used all available means to make a customary and reasonable effort to remove the impediment to performance put in place by a public authority, or has sought an alternative solution.

b) Good faith and fair dealing

According to caselaw, the principles of good faith and fair dealing, enshrined in Arts. 1175 and 1375 of the ICC, **require parties to act in accordance with good faith, loyalty and fairness also when performing an agreement**. These principles must be respected by way of cooperation or tolerance, as the case may be (even if the agreement lacks dedicated provisions in that regard) if the cooperation/tolerance is necessary to protect contractually agreed interests that are, or might be, affected by developments in a given factual situation that arises during performance of the agreement.

2.2 Ad hoc provisions to combat the Covid-19 emergency and force majeure contractual provisions

In addition to the general principles above, the following provisions – which refer specifically to the Covid-19 emergency – are to be considered:

a) Art. 91 of Law Decree No. 18 of 17 March 2020 ("Cura Italia Decree")[2]

Transport and the Ministry of Health; c) National Civil Aviation Board Statement Nos. 18 and 20 of 2020; d) the statements of Atac S.p.A. (the local public transport service operator in Rome) of 13 March 2020; and e) the statement of ATM S.p.A. (the local public transport service operator in Milan) of 12 March 2020.

[2] The article is called "Provisions on delays in performance or contractual breaches arising from the implementation of containment measures and on advance payments to public works contractors".

This article states that an obligor's compliance with the Covid-19 containment measures under Law Decree No. 6/2020 will always be evaluated for the purpose of determining **the obligor's exemption from liability under Arts. 1218 and 1223 of the ICC, including with reference to the application of any forfeitures or penalties relating to delays in performance or contractual breaches**.

The article states that compliance with the containment measures will be "evaluated": this leads to the conclusion that the exemption does not automatically apply. However, given that this evaluation must always be conducted – and given the exceptional situation governed by these measures and the macro-economic impact they could have – it is reasonable to infer that this clause aims to draw particular attention to the abovementioned circumstances on both the parties to the agreement in question and any judge that might hear a dispute between those parties. It opens up the possibility of a broader or more flexible interpretation or application of the legal principles that lead to exempting an obligor from liability or reducing its liability when performance is affected by Covid-19, namely an unforeseen event.

> The article does not refer to the health emergency itself but rather to the restrictive measures adopted by the Italian government; therefore, the actual effect of these measures should be evaluated on an agreement-by-agreement basis, and any contractual breaches should be precisely linked to one of the governmental measures in order to exempt the obligor from liability.

b) Provisions adopted by sector-specific regulatory authorities

ARERA (the Italian Regulatory Authority for Energy, Networks and the Environment) adopted Resolution No. 59/2020/R/COM, under which the Covid-19 pandemic might be considered a "force majeure event" and, thus, might exempt operators from the obligation to pay indemnities due to non-compliance with mandatory quality standards. Specifically, these quality standards (set out by ARERA) apply to **integrated water services**, **district heating** (teleriscaldamento) and **cooling** (teleraffrescamento) **services**, **electricity**, and **natural gas**.

This provision, too, does not envisage an automatic exemption, but it does appear to place special emphasis on evaluating the emergency. In any case, evaluations should be carried out on a case-by-case basis in light of available factual elements.

c) "Force Majeure" contractual provisions

Force majeure – i.e., an extraordinary and unpredictable event or circumstance that is beyond the control of the obligor and that prevents performance – is a general principle commonly mentioned under concession and PPP agreements.

In this respect, parties usually agree to include ad hoc provisions in their agreements, wherein they list the extraordinary and unpredictable events and circumstances that allow contractual performance to be **suspended** (or **reduced**, as the case may be); a situation that becomes permanent and cannot be remedied triggers the right **to terminate the agreement**.

2.3 Observations

Once it is clear (beyond doubt) that the current health emergency is an **extraordinary** and **unpredictable** event, it shall be verified in practice whether force majeure (or similar) provisions are included in the agreement in question. Only then can suspension/hiatus of performance be requested without incurring contractual liability.

In the **absence of contractual remedies**, it must be evaluated whether the emergency's consequences (or the government's containment measures) are such that they preclude or limit the performance of the concessionaire/operator's obligations, and if so, to what extent, and whether the concessionaire/operator is able to **overcome** or **limit** the impediment to performance or find an alternative solution.

For example, it seems reasonable to infer that, in light of the above criteria, a concessionaire/operator is **exempt from liability** (not to mention any penalties) if a restrictive government measure is directly, absolutely and objectively insurmountable and thus prevents continuation of the activities in question.

More in general, **it can be legitimately expected that, when evaluating any breaches that are directly or indirectly due to the Covid-19 emergency, courts and/or parties will place particular emphasis on the nature of the emergency** also for agreements in which an impediment does not seem absolute or insurmountable or is not strictly related to a restrictive government measure. Naturally, a case-by-case evaluation must still be carried out to take into account the relevant regulations and contractual provisions.

Nonetheless, **the need to ensure a minimum level of service under adequate health and safety conditions must also be taken into account** – at least when it comes to services and activities of public interest, and especially for essential services and those related to essential needs (formerly known as local public services). Thus, in such events, concessionaires/operators must proceed with caution when deciding to suspend/limit services or works, as liability exemptions will be more closely evaluated.

> Lastly, when evaluating possible suspensions/limitations of services or works, concessionaires/operators must also consider the impact a suspension/limitation will have on the recovery/remuneration mechanism of the investment or service. In this respect, and in accordance with the general principles mentioned above relating to the frustration of performance, the party that is exempted from performing its obligation (if it is definitively impossible) or whose obligation is

suspended/reduced (if the impossibility to perform is temporary or partial) cannot request the other party to fulfil its obligation, or the other party's obligation will be suspended/reduced accordingly. Again, this is without prejudice to a case-by-case assessment based on the relevant contractual and regulatory framework.

3. Extraordinary revision of the economic and financial plan

3.1 Definition of economic and financial balance

The main principle of concession agreements and PPPs is the maintenance of the **economic and financial balance of the contractual relationship**, which is to be understood in terms of both **financial sustainability** (sostenibilità finanziaria) (i.e., the ability of the project to generate enough cash flow to reimburse any financing) and **economic viability** (convenienza economica) (i.e., the ability of the project to generate an appropriate level of profitability in relation to the invested capital). This is without prejudice to the correct risk allocation between the public and private sectors and the operational risk to be borne by concessionaires/operators.

Concession agreements usually include specific tools to monitor and verify this contractual balance, e.g., through economic and financial parameters under the economic and financial plan that are periodically assessed during the execution of the contractual relationship.

3.2 Revision of economic and financial plans

Premesso Without prejudice to the above, some law provisions (see Arts. 165 and 182 of Legislative Decree No. 50/2016) envisage the possibility of revising the economic and financial plan to restore balance if extraordinary circumstances occur that are not attributable to a concessionaire/operator and affect the economic/financial balance of the contractual relationship. In any case, concessionaires/operators must still bear the risks that were allocated to them .

Additionally, if the parties fail to reach an agreement, the above provisions expressly stipulate that they may **terminate the agreement** and, in principle, the concessionaire is entitled to receive a **termination indemnity** corresponding to:

a) the value of the works carried out plus ancillary charges, net of depreciation, or, if works have not yet passed the testing phase, the costs actually incurred by the concessionaire; and

b) the penalties and other costs incurred or to be incurred as a consequence of the termination, with the exclusion of charges arising from the early termination of hedging agreements.

Concession agreements and PPPs very often govern the above aspects, with particular reference to the following:

a) **Rebalancing events**: These are considered **extraordinary** and **unforeseeable** circumstances/events that: (i) do not depend on the parties and/or are out of their control; and (ii) (materially) affect the agreement's economic and financial balance. Concession agreements and economic-financial plans usually set out objective criteria to test the materiality of the imbalance.

b) The **procedure for the extraordinary revision of the economic and financial plan** and the rebalancing measures that can be implemented: The typical rebalancing measures are **rescheduling/postponement** of investments, **tariff increases**, and **extension of the term of concession agreements** or **access to public grants**; in any case, these measures are subject to the limitations envisaged under EU and Italian legislation and regulations.

c) Remedies if the parties **fail to reach an agreement on rebalancing measures**. Some concession agreements envisage **specific criteria** to calculate the termination indemnity and indicate the entity that should pay the termination indemnity, together with terms and conditions for the payment of this indemnity and possible step-in rights.

According to some caselaw, legal and contractual provisions that envisage the right **to terminate an agreement constitute a mere possibility** for the concessionaire to terminate the contractual relationship, without prejudice to its right to initiate legal proceedings relating to the grantor's non-performance of its obligation to follow up on a revision request.

3.2 Considerations

In relation to the above, the current health emergency can be reasonably considered an extraordinary and unpredictable event under the definition of 'rebalancing event' that is usually set out under concession agreements and PPPs. Thus, if this emergency has led to a material financial and economic imbalance in a given contractual relationship, it is reasonable to infer that an extraordinary revision of the economic and financial plan may be carried out to restore balance.

> The crucial aspect of this analysis is to verify the actual impact of the health emergency (and of the government's measures) on the contractual relationship in question. Furthermore, account must be taken of: (a) the parameters/criteria set out by the business plan or agreement to assess the financial and economic balance of the relationship; and (b) the duration of the emergency. In this respect, it is expected that the longer the situation and the government's measures last, the more the economic and financial balance of concession agreements and PPPs will be undermined – and, thus, the more it will be possible to start an extraordinary revision procedure.

4. Final remarks

Due to the varied nature of concession agreements, PPPs and the market sectors involved, **all assessments of the aspects mentioned above must be carried out on a case-by-case basis** and must take into account the relevant concession provisions, applicable regulations, the impact of the emergency and of the governmental measures on the contractual relationship concerned, and the duration of the emergency.

Energy and Infrastructure Focus Team

The focus team is a constellation of skills in different practice areas with a focus on energy and infrastructure.

Mario Roli
Corporate

Niccolò Baccetti
Corporate

Riccardo Bicciato
Banking & Finance

Elena Busson
Corporate

Roberto Cera
Corporate

Paolo Daino
Corporate & Litigation

Gabriele Malgeri
Banking & Finance

Giuseppe Manzo
Corporate

Fulvio Marvulli
Corporate

Massimo Merola
Antitrust

Barbara Napolitano
Corporate

Luca Perfetti
Administrative

Alberto Saravalle
Corporate

Andrea Silvestri
Tax

Catia Tomasetti
Banking & Finance

Roberto Flammia
Banking & Finance

Alessandro Rosi
Administrative

Livia Cocca
Corporate

Giorgio Frasca
Banking & Finance

Giovanna Zagaria
Banking & Finance

Giulio Mazzotti
Tax