ENERGY CRISIS: FOOD FOR THOUGHT ON CONTRACT LAW

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The current energy crisis is raising, as the pandemic did before it, important concerns regarding the management of contingencies in long-term contracts and is highlighting the inadequacy of existing regulatory relief in the face of global emergencies.

> "At present, after the experiences of recent months, it is crucial that contracts are drafted more cautiously, so as to set up appropriate mechanisms for the management of contingencies."

In recent months, the energy crisis has become a major news topic, which has only accelerated since the outbreak of war in Ukraine.

In fact, well before the start of the conflict, electricity and natural gas prices, in particular, had increased unexpectedly in comparison to market trends in recent years. Due to several factors, the increase in prices was accompanied by a major growth in energy demand. Therefore, energy companies, both wholesalers and suppliers of energy to end customers, found themselves simultaneously having to supply greater quantities of energy than budgeted while sourcing energy at a time when market conditions were far less favourable than at the time when agreements were made. This in turn severely impacted the profit margins on their sales.

When faced with an extraordinary and unforeseeable event which profoundly alters a contractual relationship, the legal system provides an instrument for termination if performance of a contract becomes excessively onerousness. This applies even if the contractual duties required of a party which suffered from an event is not legally or physically impossible. This is provided for in Article 1467 of the Italian Civil Code.

Following an extraordinary and unforeseeable event, the party that sees the cost of performance increase to a level that exceeds the proportional expectations of the contract may terminate said contract early unless any other party agrees that the cost of the performance can be reduced.

However, following the route of termination due to the excessive onerousness of performance raises two critical issues for parties seeking to take advantage of it: (i) it is a *caducatory remedy*, requiring the contractual relationship to be terminated, and (ii) it must be a judicial termination, the declaration of which will have to be made by a court decision. The time required for such a judicial decision to be reached risks nullifying any benefits of the remedy. This is particularly evident with the energy crisis, where extreme price volatility and major increases in losses for some energy companies require solutions be enforced rapidly.

Given the difficulty (and sometimes impossibility) of relying on termination due to excessive onerousness that have arisen in the current environment, many energy companies have attempted, not always successfully, to renegotiate their existing agreements, especially wholesalers with retailers, or the latter with large industrial customers.

Indeed, in the wake of the Covid-19 pandemic, the guideline that imposes an obligation on parties to renegotiate agreements has been strengthened in cases where the performance of one of the parties has become excessively onerous as a result of extraordinary and unforeseeable events. This guideline is based on the principles of good faith and equity. In a report dated 8 July 2020, the Italian Supreme Court of Cassation provided an overview on the management of contractual contingencies, highlighting the existence of an obligation to renegotiate long-term contracts where inequitable events have substantially altered the original balance negotiation. It is the court's view that in long-term contracts there is, in effect, an underlying renegotiation clause.

The obligation to renegotiate requires that any new negotiations are entered into and conducted properly. However, the party that was not disadvantaged as a result of the unforeseeable event(s) cannot be obliged to enter into a modified contract. For example, a supplier will not be able to impose its terms on their customer but can only demand that proper and non-malicious negotiations be entered into. That is to say there must be a serious intention to revise a contract's terms. Understanding whether a party is in breach of its renegotiation obligation is not always easy, and these negotiations often require legal support.

The court also addressed the issue of failing to reach a revised agreement and the possibility of court intervention to redefine contractual requirements if faced with a relationship that has become unfair.

The possibility of obtaining a court-ordered revision of a contract would be a particularly effective remedy for a supplier, who could also gain from emergency protection provided under Article 700 of the Italian Code of Civil Procedure. However, judges are not always in favour of such rulings as they can be seen as a revising basic contractual principle.

The energy crisis has, as the pandemic did, created difficulties for those who manage contingencies in lengthy contracts, and has also highlighted the inadequacy of existing regulatory measures to deal with global emergencies and an economic reality far more complex than that assumed in the Civil Code. Despite improved openness, the legal framework does not yet offer adequate protection to parties disadvantaged as a result of extraordinary events. In light of the experiences of recent months, it is crucial that contracts are drafted more cautiously so as to set up appropriate mechanisms for managing contingencies.

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