Brownstein Hyatt Farber Schreck

News

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Contracts in the Age of Coronavirus: Are Businesses in Breach If Forced to Close by Government Order?

COVID-19 has upended our everyday lives and business operations around the country. Many states have taken drastic steps to curb the spread of the virus by ordering businesses to close and/or individuals to shelter in place. While necessary to protect the public health, these restrictions present serious legal concerns for businesses large and small. For example, if forced to close, or effectively close, by government order, can a business still be found liable for breach of contract?

Sometimes, parties include a so-called "force majeure" clause in their contract, which excuses performance under certain circumstances, such as natural disasters (see ***Do Force Majeure Clauses Cover a Coronavirus Pandemic?*** for more on this topic). Once the force majeure event occurs, as defined in the agreement, each party can walk away from the contract with no penalty. But what if you didn't either include a force majeure clause in your contract or identify a global pandemic or government-mandated closure in your force majeure clause? In these circumstances, will a court still enforce the contract despite at least one party being unable to conduct business?

If you didn't see this coming, don't worry—the law may provide an escape hatch. If your business was forced to close during these extraordinary times, there are an array of common law defenses that may shield you from contract liability and help protect your business. The two that appear to have the most teeth are the doctrines of impossibility and illegality.

Impossibility—When You Can't Fulfill the Contract

The doctrine of impossibility discharges one's contractual obligations when an unforeseen event makes it impossible to satisfy the terms of the agreement. Importantly, the event must have been truly unforeseeable. If the event was one that a party should have foreseen, but simply failed to consider, the defense is unavailable.

Consequently, determining whether the defense applies becomes a highly fact-intensive inquiry. Courts will consider several factors, including the subject matter of the contract and means of performance, the timing of contract formation, and the scope of specific provisions that shed light on what the parties considered while negotiating the deal. Generally, satisfying the contract must actually be impossible—not just more costly or impracticable—to excuse the party invoking the defense. But, again, that is a factual determination made on a case-by-case basis. If

performance would cause a party to suffer severe financial hardship, that may well rise to the level of impossibility, particularly in these times. Just because performance is technically possible doesn't necessarily mean that it won't be excused under the doctrine of impossibility if there are compelling fiscal circumstances present.

Few could have foreseen the spread of coronavirus, and fewer still could have foreseen the government's response to it. After all, the U.S. hasn't seen an epidemic of this magnitude in over a century, arguably since the 1918 flu pandemic during World War I. In response to such a serious threat to public health, several states—including **Nevada**—have issued emergency declarations to close all nonessential businesses for weeks (possibly months), effectively making it impossible for these businesses to fulfill their contracts during that time. With no way to operate, business owners are rightfully worried about how clients, customers and vendors may react to the news that they can no longer satisfy their contracts (at least for the time being).

Luckily, the defense of impossibility may provide some reprieve for those who are threatened with or sued for breach of contract as a result of these unsettling times. The defense's success will depend largely on when the contract was executed. For example, contracts executed in Nevada before March 20, 2020—the date Gov. Sisolak announced the closure of all nonessential businesses, including hotels and casinos—is much more likely to succeed under this theory than those signed after this date. Other factors, as noted, such as the nature and scope of the contract and the parties' financial circumstances, will also be considered.

Illegality—When Satisfying the Contract Means Breaking the Law

It's a fundamental precept of contract law that parties can't agree to something illegal and expect a court to enforce the agreement (think a contract killer being able to enforce an assassination contract, which obviously isn't sound public policy). The general rule is this: a contract cannot compel you to break the law. If it does, and you refuse to do so, a court won't enforce it. *Martinez v. Johnson*, 61 Nev. 125, 119 P.2d 880, 882 (Nev. 1941) ("The general rule is that an act done, or contract made, in disobedience of the law, creates no right of action which a court of justice will enforce."). Accordingly, the doctrine of illegality discharges your contractual obligations if satisfying the contract would require you to commit a crime.

To ensure compliance with the government mandates requiring nonessential businesses to close, many states, counties and cities have passed additional laws making violation of the blanket order a criminal act. For example, immediately following Gov. Sisolak's nonessential business-closure directive in Nevada, Clark County approved an ordinance making violations of the directive punishable as a criminal misdemeanor. As such, attempting to conduct business during these closure periods may not only be impossible, it may be downright *illegal*.

Unlike impossibility, this defense relies far less on the factual circumstances surrounding contract formation (although those facts are still relevant to a certain extent). Instead, this defense is a much more straightforward inquiry into whether the terms of the contract would violate an applicable statute. Generally, statutes are on the books to promote sound public policy, and going against that policy would be antithetical to one of the court's primary objectives.

What that means for businesses in the age of coronavirus is this: in jurisdictions such as Clark County, where violation of the local ordinance constitutes a crime, judges would be particularly receptive to the doctrine of illegality. Any contract terms that require businesses to remain open—both violating the ordinance and potentially furthering the spread of the deadly virus—would likely be void.

Of course, every business and contract is unique. We recommend consulting our attorneys to learn more about how the contract defenses above may apply to you.

***Click here* to read more Brownstein alerts on the legal issues the coronavirus threat raises for businesses.**

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