WARD AND SMITH, P.A.
ATTORNEYS AT LAW

Leases, Bankruptcy, and Coronavirus: Force Majeure Edition

Written By **Lance P. Martin** (lpm@wardandsmith.com)
July 1, 2020

Many businesses in bankruptcy or heading that way – particularly retail establishments – face an uncertain future as states and cities impose closures and phased re-openings.

If you lease your office, storefront, or restaurant building, what does the current economic reality mean for your lease obligations? And if you file bankruptcy, how will the bankruptcy courts handle your lease?

We recently wrote about a decision from the Bankruptcy Court for the Eastern District of Virginia involving the home furnishing chain Pier 1 Imports. There, the court allowed Pier 1 to defer rent payments for a few months over the lessor's objections. We cautioned this was only one decision from one court.

We now have another pro-tenant decision involving a restaurant group in Chicago. Hitz Restaurant Group filed Chapter 11 in February 2020. They stopped paying rent in March 2020. When their lessor asked to court to require them to pay all past-due rent and make future payments timely, they argued the force majeure clause in their lease excused them from making payments.

A force majeure is an event or effect that can be neither anticipated nor controlled, like a flood or war. Force majeure clauses in contracts address circumstances when performance becomes impossible or impracticable due to unforeseen events beyond a party's control. Force majeure clauses rarely provide for termination of an agreement. They generally **suspend** a party's obligation to perform under the agreement during the force majeure event.

Like any other contract provision, the specific terms of the force majeure clause control, Hitz's lease included "governmental action" and "orders of government" as force majeure events. In Illinois, the Governor issued an Executive Order on March 16, 2020, that prohibited restaurants from allowing on-premises consumption. Restaurant operations were limited to take-out, curbside pick-up, and delivery.

The court held that the Executive Order "unambiguously triggered" the force majeure clause because it was a government order that hindered the debtor's ability to perform by prohibiting it from offering on-premises consumption of food and beverages. The Executive Order was unquestionably the proximate cause of the debtor's inability to pay rent, at least in part, because it restricted its business to take-out, curbside pick- up, and delivery. Consequently, the force majeure clause partially excused the debtor's obligation to pay rent for April, May, and June 2020.

But the court held the debtor was not off the hook entirely because the Executive Order allowed and encouraged carry-out, curbside pick-up, and delivery services. The court found that to the extent the debtor could have continued to perform those services, its obligation to pay rent was not excused by force majeure.

The Court reduced the rent payment in proportion to Hitz's reduced ability to generate revenue due to the Executive Order. The debtor estimated that the Executive Order rendered 75 percent of the restaurant – the dining room and bar –unusable. The remaining 25 percent – the kitchen – could have been used for carry-out, curbside pick-up, and delivery purposes. Based on these estimates, the Court preliminarily found the debtor owed at least 25 percent of the rental payments for April, May, and June 2020.

This appears to be the first bankruptcy court to apply a lease's force majeure clause in the context of the Covid-19 pandemic and government shutdown orders. Over the next year, we anticipate many more disputes between lessors and lessees, as lessees seek rent abatement in bankruptcy or the shadow of bankruptcy. Lessors and lessees would be wise to consult with counsel to compare their situation – and their force majeure clause – to this one.

--