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COURT RULES FORCE MAJEURE CLAUSE REDUCES TENANT'S RENT BY 75% DUE TO COVID-19

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Ever since governors across the country implemented Stay at Home orders to slow the spread of COVID-19 by closing non-essential businesses, experts have debated whether a force majeure provision of a lease would excuse a tenant's obligation to pay rent. In one of the first judicial decisions to test this question, *In re Hitz Restaurant Group*,[1] the United States Bankruptcy Court for the Northern District of Illinois ruled that the answer is at least partially "yes."

In re: Hitz Restaurant Group

Hitz Restaurant Group ("Hitz") operated a restaurant in the City of Chicago pursuant to a lease. Hitz did not pay its rent for February 2020, and on February 24, 2020, the company filed a Chapter 11 bankruptcy petition. Hitz then did not pay any of its post-petition rent for March, April, May, or June.

Shortly after Hitz's bankruptcy filing, Illinois Governor JB Pritzker issued a series of executive orders that substantially limited business activity in the State of Illinois due to the COVID-19 pandemic. The first executive order that applied to restaurants went into effect on March 16, 2020. This Order mandated, "All businesses in the State of Illinois that offer food or beverages for on-premises consumption—including restaurants, bars, grocery stores, and food halls—must suspend service for and may not permit on-premises consumption."[2] However, this Order went on to say that restaurants were still permitted and encouraged to serve customers for the purposes of take-out and delivery. The subsequent Illinois Stay at Home Order contained substantively the same restrictions, but notably added, "No provision contained in this Executive Order shall be construed as relieving any individual of the obligation to pay rent, to make mortgage payments, or to comply with any other obligation that an individual may have under tenancy or mortgage."[3]

On April 14, 2020, Hitz's landlord filed a motion asking the Court to compel Hitz to pay its rent for February through June 2020.[4] The Court limited its ruling to the March through June rent payments, since the Bankruptcy Code requires that a debtor pay its post-petition rents until the lease is assumed or rejected in the bankruptcy,[5] and the February rent payment was a pre-petition obligation.

Hitz opposed the motion on the basis that the lease contained a force majeure clause that fully excused its obligation to pay rent for those months, since the Executive Orders were events contemplated in this clause. This provision read, in part:

> Landlord and Tenant shall each be *excused* from performing its obligations or undertakings provided in this Lease, in the event, but only so long as the performance of any of its obligations are prevented or delayed, retarded or hindered by . . . laws, governmental action or inaction, orders of government. . . . Lack of money shall not be grounds for Force Majeure.[6]

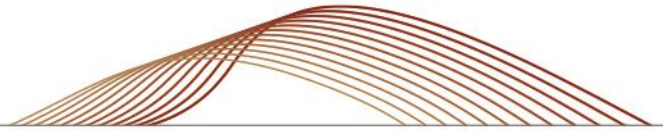
As a general matter, Illinois courts narrowly interpret force majeure clauses, and the specific wording of the provision is critical to a court's determination of whether to enforce the provision.[7] Additionally, under Illinois law, a force majeure clause will excuse performance only if the event was the proximate cause of a party's nonperformance.[8]

Here, the *Hitz* Court found that, beginning on March 16, 2020, the force majeure clause was "unambiguously triggered" by the Executive Orders because they were both "governmental action" and "orders of government" as contemplated by the clause. The Court also found that the restrictions under the Executive Orders were the proximate cause for Hitz's nonpayment of rent, "at least in part, because it prevented Debtor from operating normally and restricted its business to take-out, curbside pick-up, and delivery."[9]

However, the Court decided that, since the Executive Orders did not require the outright closure of the business, Hitz's obligation to pay rent should be abated "in proportion to its reduced ability to generate revenue due to the executive order."[10] The Court said that the parties did not provide many details to assist it in determining what amount of rent abatement was warranted, other than Hitz's estimates that the kitchen comprised 25% of the restaurant by size and the dining areas comprised the remaining 75% of the space. Since the Executive Orders permitted Hitz to continue using the kitchen portion of the space for take-out and delivery, the Court ruled that Hitz was required to pay 25% of the rent for the months of April through June.[11] The Court's discussion raises the possibility that, if other information had been or is made available to it (such as lost revenue, reduced profits, or employee headcount reduction), it might have used or may in the future use a different methodology for determining the rent abatement.

The Court was not persuaded by any of the landlord's arguments as to why the force majeure clause was inapplicable. First, the landlord argued that the Executive Orders did not shut down banks or post offices, so Hitz was not prevented from writing a rent check and mailing it to the landlord. The Court rejected this argument as "specious" and unresponsive to the contention that Hitz could not operate its restaurant as intended.

Second, the landlord argued that the express qualification in the force majeure clause stating, "Lack of money shall not be grounds for Force Majeure", precluded the application of the clause, as Hitz's failure to pay rent was arising from such a lack of money. The Court acknowledged that there is a "conflict" in the language of the clause (i.e., an event could be an "order of government" or a "governmental action," and also cause a "lack of money" at the same time), but stated that an "order of government" and a "governmental action" are more specific than the category of "lack of money" (which the Court said was a "general provision"), so the "lack of money" qualification does not take precedence. The Court was more persuaded by Hitz's argument that the Governor's closure of on-premises services was the proximate cause of its inability to pay rent. In coming to this conclusion, the Court either set aside the "lack of money" qualification and/or implied that an inability to generate revenue was not the same as a lack of money. Thus, the Court's rationale raises the question of when the "lack of money" qualification would apply.



Finally, the landlord argued that Hitz should be obligated to pay its rent because it could have obtained sufficient funds by applying for a Small Business Administration loan. The Court did not find any provision in the lease or other legal authority to support the suggestion that a tenant has an obligation to apply for a loan before a force majeure provision can be invoked, and therefore rejected this argument as well.

Key Takeaways

The *Hitz* decision is a significant development in the context of the treatment of leases during the COVID-19 era, as it is one of the first examinations by a court of a force majeure clause's applicability to governments' Stay at Home orders. The ruling stands for the proposition that if a force majeure clause contains language describing "governmental action," "orders of government," or the like as force majeure events, and the relevant State's executive orders prohibit in whole or in part the operation of a tenant's business, then the tenant may be entitled to a rent abatement during the period that such orders are in effect.

Notably, it appears that the landlord in the *Hitz* case did not argue that (i) the Court should uphold Hitz's full obligation to pay rent because the Illinois Stay at Home Order expressly stated that nothing within it was to be construed as relieving any tenant of the obligation to pay rent, or (ii) the lease stated that Hitz's obligation to pay rent was an "independent obligation" of the tenant, so the payment of rent was due regardless of the Executive Orders. We believe that these positions, alongside the landlord's argument that Hitz's failure to pay rent on the grounds of reduced revenue equated to a "lack of money" that the lease expressly said did not qualify as a force majeure event, would have been prudent for the landlord to take. Future litigation may answer the question of whether these arguments together would or would not overcome what appears to have been the fundamental objective of the *Hitz* Court: reaching what it believed was a fair result for both landlord and tenant.

While the *Hitz* decision is not binding on other courts, it may have a substantial impact on other cases—particularly because state courts often look to federal courts (including bankruptcy courts) for precedential or, at minimum, persuasive authority. Critically, the *Hitz* Court's analysis was primarily grounded in Illinois State law and contract interpretation, rather than in federal bankruptcy law.

Furthermore, the *Hitz* decision may signal a developing trend of tenants in the COVID-19 era receiving tenant-friendly judgments. Rulings from other bankruptcy courts in New Jersey, Texas, Virginia, Delaware, and Kansas have similarly resulted in debtors not having to pay timely their post-petition rents during the pandemic, although those decisions were based on different grounds than force majeure.[12]

Whether this outcome was truly equitable depends on one's perspective, but perhaps the lesson is that courts will expect landlords and tenants to each shoulder a portion of the burdens that the COVID-19 pandemic and ensuing governmental orders have put on businesses.

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Paul Hastings is uniquely positioned to provide negotiation, bankruptcy, and litigation assistance to landlords and tenants regarding force majeure provisions and Stay at Home Orders. Please contact the Paul Hastings attorneys listed here should you have any questions about this article or its applicability to your particular lease.

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[1] *In re Hitz Rest. Grp.*, Case No. 20-05012, 2020 WL 2924523 (Bankr. N.D. Ill. June 3, 2020).

[2] Ill. Exec. Order 2020-7.

[3] Ill. Exec. Order 2020-10.

[4] *See In re Hitz Rest. Grp.*, Case No. 20-05012, at Dkt. No. 21.

[5] *See 11 U.S.C. § 365(d)(3)*.

[6] *In re Hitz Rest. Grp.*, Case No. 20-05012, 2020 WL 2924523 at *2 (Bankr. N.D. Ill. June 3, 2020). Note that this provision's language states that the obligation is "excused" rather than "delayed" or "postponed," so it is possible that that word was key in determining that the result was a rent abatement.

[7] *See, e.g., Wisconsin Elec. Power Co. v. Union Pac. R. Co.*, 557 F.3d 504, 507 (7th Cir. 2009). Note also that under Illinois law, there is a general duty of good faith to try to resolve the force majeure event. *See Commonwealth Edison Co. v. Allied-Gen. Nuclear Servs.*, 731 F. Supp. 850, 859 (N.D. Ill. 1990).

[8] *Northern Ill. Gas Co. v. Energy Co-op, Inc.*, 461 N.E.2d 1049 (Ill. App. Ct. 1984).

[9] *In re Hitz Rest. Grp.*, Case No. 20-05012, 2020 WL 2924523 at *2 (Bankr. N.D. Ill. June 3, 2020).

[10] *Id.* at *3.

[11] Since Hitz's obligation to pay March 2020 rent occurred on March 1, which was before the Executive Orders were issued, the Court ordered Hitz to pay the full amount of March 2020 rent. The Court did not explain its decision not to apply the 75% rent reduction to the period from March 16 through March 31.

[12] These other rulings were based on equitable arguments in light of COVID-19 that were made under federal Bankruptcy Code provisions (Sections 105(a), 305(a), and 365(d)(3)) in the context of debtors requesting deferments of post-petition rent obligations and/or suspensions of the debtors' bankruptcy proceedings. *See, e.g.*, *In re J. C. Penney Co. Inc.*, Case No. 20-20182 (DRJ) [Docket No. 721] (Bankr. S.D. Tex. June 11, 2020) (extending time for performance of lease obligations under Section 365(d)(3) for sixty days pursuant to Section 105(a)); *In re Art Van Furniture, LLC*, Case No. 20-10553 (CSS) [Docket No. 373] (Bankr. D. Del. Apr. 27, 2020) (same); *In re Pier 1 Imports, Inc.*, Case No. 20-30805 (KRH) [Docket No. 493] (Bankr. E.D. Va. Apr. 6, 2020) (approving deferment of rent payment obligations on the basis of Section 105(a) until the debtors filed a notice of intent to reopen, after which the debtors should make "reasonable best efforts" to pay the deferred rent); *In re Modell's Sporting Goods, Inc.*, Case No. 20-14179 (VFP) [Docket No. 166] (Bankr. D. N.J. Mar. 27, 2020) (suspending the debtor's bankruptcy proceedings and also deferring all rent payments and other lease-related expenses of the debtor for sixty days on the basis of Sections 105(a) and 305(a) of the Bankruptcy Code, the latter of which permits suspension of all proceedings in a bankruptcy case); *In re Craftworks Parent LLC*, Case No. 20-10475 (BLS) [Docket No. 535] (Bankr. D. Del. May 21, 2020) (granting debtor's financing order containing proposal to pay only "critical expenses" pursuant to Section 105(a) for a six-week period, which did not include the payment of rent to landlords); *In re Bread & Butter Concepts, LLC*, Case No. 19-22400 (DLS) [Docket No. 219] (Bankr. D. Kan. May 15, 2019) (exercising equitable powers under Section 105(a) to permit the debtor-tenant to withhold post-petition rent payments).