Litigation Alert
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Bankruptcy Court Holds COVID-19 Triggers Force Majeure Clause in Lease

For the past several months, businesses across the country have grappled with the question of whether the pandemic and local "stay at home" or "shelter in place" orders aimed at curbing the spread of COVID-19 trigger force majeure clauses in their leases and other contracts. In one of the first cases to consider this question, the U.S. Bankruptcy Court for the Northern District of Illinois held in *In re Hitz Restaurant Group* that a restaurant tenant was entitled to a rent reduction under its force majeure clause due to Illinois Gov. J.B. Pritzker's Executive Order 2020-07, which directed all restaurants in the state to suspend service for on-premises consumption.

Key Takeaways:

- *Hitz* is one of the first cases to hold that where a lease defines force majeure to include "governmental action" or "orders of government," a state's executive order prohibiting the operation of a tenant's business in whole or in part during the COVID-19 pandemic entitles the tenant to a rent reduction.
- That the executive order hindered the tenant's operation of its business within the leased premises was sufficient to trigger the force majeure clause. The court rejected the notion that the tenant remained able to pay rent because banking services and post offices remained accessible during the pandemic.
- The court reduced the tenant's rent payments "in proportion to its reduced ability to generate revenue due to the executive order." Because the tenant, a restaurant, was permitted to continue using its kitchen area for takeout and delivery service, and the kitchen area comprised approximately 25% of the premises, the court imposed a 75% rent reduction while the executive order remained in place.
- Unlike some other commercial leases, the restaurant lease in *Hitz* did not expressly carve out rent payments from the types of performance obligations that are excused by a force majeure event.

In re Hitz Restaurant Group, Case No. 20-05012, 2020 Bankr. LEXIS 1470 (Bankr. N.D. Ill. June 2, 2020)

Summary of the Case

Hitz Restaurant Group operated a restaurant in the city of Chicago pursuant to a lease agreement with Kass Management Services Inc. Hitz did not pay rent for February and, later that same month, filed a Chapter 11 bankruptcy petition in the U.S. Bankruptcy Court for the Northern District of Illinois.

On March 16, Gov. Pritzker issued Executive Order 2020-07, which sought to curb the spread of COVID-19 by ordering that all restaurants in the state "must suspend service for and may not permit on-premises consumption." The order "permitted and encouraged" restaurants to continue serving food available for delivery, carryout and curbside pickup.

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In April, Kass filed a motion with the bankruptcy court pursuant to 11 U.S.C. Sec. 365(d)(3), which requires debtors to pay post-petition rent on any unexpired nonresidential lease "until such lease is assumed or rejected," and sought to enforce Hitz's obligation to pay rent for March, April, May and June. Hitz argued that its obligation to pay rent was excused by the lease's force majeure clause, which provides as follows:

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 act of God, fire, earthquake, flood, explosion, actions of the elements, war, invasion, insurrection, riot, mob violence, sabotage, inability to procure or general shortage of labor, equipment, facilities, materials or supplies in the open market, failure of transportation, strikes, lockouts, action of labor unions, condemnation, requisition,* ***laws, governmental action or inaction, orders of government*** *or civil or military or naval authorities, or any other cause, whether similar or dissimilar to the foregoing, not within the reasonable control of the party or its agents, contractors or employees (each, individually and collectively, an event of "Force Majeure").* ***Lack of money shall not be grounds for Force Majeure.*** *[emphasis added]*

The lease did not otherwise state that Hitz was required to pay rent notwithstanding the occurrence of a force majeure event.

As an initial matter, the court held that the lease's force majeure clause did not excuse Hitz's March rent payment, which became fully due and payable on March 1, two weeks prior to Gov. Pritzker's executive order. It did hold, however, that the force majeure clause was "unambiguously" triggered by the executive order and applied to Hitz's rent payments for April, May and June. The court reasoned that the executive order "unquestionably constitutes both 'governmental action' and issuance of an 'order' as contemplated by the language of the force majeure clause" and "unquestionably 'hindered' [Hitz's] ability to perform by prohibiting [Hitz] from offering 'on premises' consumption of food and beverages."

Kass advanced three arguments as to why the lease's force majeure clause did not excuse the payment of rent, each of which the court rejected. First, Kass argued that the executive order did not shut down the banking system or post offices in the state and thus did not hinder Hitz's ability to write and deliver rent checks—that is, the order did not preclude Hitz from paying its rent as a practical matter. The court, however, characterized this argument as "specious," stating without further analysis that it "lack[ed] any foundation in the actual language of the force majeure clause in the lease."

Second, Kass argued that Hitz's failure to pay rent arose from a "lack of money," which the lease expressly carves out of its force majeure definition. The court, however, concluded that the executive order—not a purported lack of money—was the proximate cause of Hitz's inability to generate revenue and pay rent. Furthermore, the court explained, "[t]o the extent that there is a conflict between the lease's general provision that 'lack of money' does not trigger the force majeure clause, while the lease's more specific provision that a 'governmental action' or 'orders of government' does . . . the 'governmental action' or 'orders of government' provision must prevail."

Third, Kass argued that Hitz was not hindered in paying rent because, notwithstanding the executive order, it could have applied for a Small Business Administration loan. The court rejected this argument too, observing that the force majeure clause is triggered merely by government actions or orders and imposes no requirement on the adversely affected party to borrow money to counteract their effects.

Notwithstanding application of the force majeure provision, the court held that Hitz should not be fully excused from its rent obligations because the executive order permitted the restaurant to continue preparing food for delivery, carryout and curbside pickup. It held that Hitz was entitled to a rent reduction only "in proportion to its reduced ability to generate revenue due to the executive order." Although noting that the parties had not fully briefed this issue, the court pointed to Hitz's estimate that 75% of the restaurant's space, consisting of the dining room and bar, was rendered unusable by the executive order, while the remaining 25%, consisting of the kitchen area, could have been used for preparation of food for off-premises consumption. As a result, the court ordered Hitz to pay 25% of base rent, common area maintenance fees and real estate taxes for April, May and June.

Although the court did not order the payment of rent past June, it suggested that Hitz would be responsible

for reduced rent payments moving forward, stating that "[m]onthly rental payments due thereafter are likely to increase as the government's shut-down restrictions are gradually lifted." This issue will likely play out in another forum: Several weeks after its decision, on June 23, the court granted Kass relief from the automatic stay so that it could pursue "nonbankruptcy remedies" with respect to the leased premises.

Impact of the Court's Ruling

Hitz is noteworthy for its holding that local shutdown orders such as Executive Order 2020-07 "unambiguously" trigger force majeure clauses that include language regarding government orders or actions. That language is common to contractual force majeure definitions, and *Hitz* provides the first indication as to how courts may interpret similarly worded clauses in future pandemic-related cases.

Whether *Hitz* portends more tenant-friendly decisions in the force majeure context is, however, unclear; the outcome of future cases ultimately will depend on the specific language of the force majeure clauses at issue.

The imposition of a 75% rent reduction in *Hitz* may signal courts' willingness to embrace equitable solutions to certain pandemic-related rent disputes. Other recent trends support this conclusion: Even in the absence of a force majeure clause, some bankruptcy courts have excused commercial tenants from compliance with Bankruptcy Code Section 365(d)(3)'s unambiguous rent-paying requirement when the debtor's business has been sharply curtailed or terminated because of COVID-19, typically on the basis of frustration of purpose or impossibility or impracticability of performance.

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