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Insights

A Bankruptcy Court Weighs In: Do Force Majeure Clauses Excuse Commercial Tenants from Paying Rent?

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Almost immediately after governors issued stay-at-home orders and the President declared a National Emergency to combat COVID-19, attention turned to the *force majeure* clauses often found in commercial leases and insurance policies. Now, some three months' worth of quarantine later, courts are interpreting and applying those *force majeure* clauses in the context of the current economic crisis.**1** Most recently, Bankruptcy Judge Cassling of the Northern District of Illinois addressed the effect of a *force majeure* clause on a tenant's obligation to pay rent in *In re Hitz Restaurant Group*, 2020 WL 2924523 (Bankr. N.D. Ill. June 3, 2020).

Hitz Restaurant Group ("Hitz"), a restaurant operator and tenant, had a commercial lease ("Lease") for restaurant space with Kass Management Services, Inc. ("Kass"). On February 24, 2020, Hitz filed a voluntary chapter 11 petition for relief in bankruptcy, and shortly thereafter Kass filed a motion to require Hitz to continue paying postpetition rent as required by 11 U.S.C. §365(d)(3).**2** Kass also filed a motion to modify the automatic stay, and sought an order requiring Hitz to vacate the premises if Hitz failed to pay postpetition rent.**3**

Pursuant to 11 U.S.C. § 365(d)(3), a trustee or debtor in possession is required to "timely perform all the obligations of the debtor…arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected."**4** In considering the landlord's motions, the court first reviewed the lease to ascertain whether Hitz' obligation to pay rent arose "from and after the order for relief." The lease required Hitz to pay rent on the first day of each month.**5** Hitz' bankruptcy petition was filed February 24, 2020, which commenced the "relief" in the form of the automatic stay in bankruptcy. Hitz' obligation to pay rent in February therefore was not postpetition because its rent was due on February 1, 2020. On the other hand, Hitz' was obligated to pay rent on March 1, 2020, and all subsequent months until Hitz assumed or rejected the lease because those rents arose after the February 24, 2020 petition date.**6**

However, the lease had a *force majeure* clause, which Hitz argued excused its obligations to pay rent postpetition. The *force majeure* clause stated:

> 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.**7**

The "governmental action" in question was an executive order of Illinois Governor J.B. Pritzker, issued on March 16, 2020 ("Order") that banned bars and restaurants from offering on-site consumption of food and beverage.**8** The Order did not ban restaurants and bars from offering food services such as delivery, curbside pick-up, and take-out.

The crucial question for the court was whether the Order implicated the Lease's *force majeure* clause, and if so, whether it excused Hitz' postpetition rent obligations. Because the Order was issued on March 16, 2020, the court held that Hitz was not excused from paying rent due on March 1, 2020.**9**

The court reached a different conclusion for Hitz' rent for April and later months. Illinois law states that "a force majeure clause will only excuse contractual performance if the triggering event cited by the nonperforming party was in fact the proximate cause of that party's nonperformance."**10** The court concluded that the Order was clearly a form of "governmental action" within the meaning of the lease's *force majeure* clause, and that it proximately caused Hitz' inability to pay rent because it could not serve food and drink on-site.

The court's analysis did not stop there, however. The Order did not ban all restaurant services, and in fact permitted restaurants and bars to offer delivery and take-out. Accordingly, the court found that Hitz' obligation to pay postpetition rent only was partially excused, because the Order did not bar Hitz from operating entirely. The parties did not brief the matter, but Hitz did concede that it could have offered delivery and take-out services, and that the kitchen accounted for approximately 25% of restaurant's square footage. The court preliminarily concluded that Hitz owed at least 25% of its rent obligations from April through June.

Interestingly - or confusingly - enough, the landlord did not raise this "partial rent" argument, and instead raised other arguments. First, the landlord argued that the Order did not shut down the banking systems, and therefore Hitz' ability to write checks, such as for rent, was not hindered.**11** The court did not entertain this. The landlord also argued that the *force majeure* clause explicitly stated that "lack of money" is an insufficient reason to miss rent, but the court noted that Hitz was arguing that the Order is Hitz' reason for failure to pay rent, not the lack of money.**12**

The landlord's other argument was that Hitz could have applied for a "Small Business Administration Loan," which is novel for the current economic circumstances. Congress passed the CARES Act on March 27, 2020, which, among many things, provided $349 billion to the Small Business Administration to implement the Paycheck Protection Program, a program offering federally guaranteed loans and potentially forgivable to small businesses. While true that Hitz, the debtor-tenant, could have applied for such a loan, the court noted that neither Illinois law nor the Lease's *force majeure* clause require the affected party to affirmatively take steps, such as borrowing money, to counteract the adverse situation.**13**

On a final note, Hitz also argued that the landlord's failure to make repairs to the premises excused Hitz from paying rent. The court dismissed this argument, finding that such a claim belongs in state court, not bankruptcy court, and noting that lift-stay motions are summary proceedings that do not delve into "non-core issues of state law."**14**

In short, the court found that by paying no postpetition rent whatsoever, Hitz failed to adequately protect the landlord's interest. Accordingly, the court ordered Hitz to pay full rent for March, plus common area maintenance fees and real estate taxes, and 25% of those amounts for April, May, and June.**15**

Takeaway: *Hitz* underscores the importance of carefully considering the scope of *force majeure* clauses, such as by including reference to "governmental action" in such clauses.

Although *Hitz* arises in a bankruptcy context, this decision is illustrative of how *force majeure* clauses fare in Illinois. For more information on how *force majeure* clauses fare in Indiana, please see our earlier Alert, "***Force Majeure Considerations For Commercial Leases In Indiana***," which previously was posted by Krieg DeVault's Commercial Real Estate professionals.

Krieg DeVault remains committed to providing clients with the necessary insights into the ever-changing landscape of today's environment. If you would like to learn more about please contact any of our **Real Estate Professionals** or **Financial Services Professionals**.

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

[2] Id. at 1.

[3] Id.

[4] 11 U.S.C. §365(d)(3)

[5] Id.

[6] Id.

[7] Id. at 2.

[8] Id.

[9] Id.

[10] Id. (citing Northern Ill. Gas Co. v. Energy Co-op., Inc., 461 N.E.2d 1049, 1058 (1984)).

[11] Id. at 3.

[12] Id.

[13] Id.

[14] Id. at 4. (citing In re Vitreous Steel Prods. Co., 911 F.2d 1223, 1232 (7th Cir. 1990).

[15] Id. at 4.