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Court Concludes Force Majeure Clause in Lease Excused 75 Percent of Tenant's Rent Obligation Based on Tenant's Permitted Reduced Use During COVID-19 Shutdown

By Gregory D. Call, Tracy E. Reichmuth, and Ethan W. Simonowitz*

The authors of this article discuss a recent decision that suggests that courts may be increasingly receptive to arguments tying rent to tenant's actual and/or permitted operations under "shelter in place" orders.

The U.S. Bankruptcy Court for the Northern District of Illinois has issued one of the first decisions to apply a force majeure clause to a commercial tenant's rent obligations in the wake of a COVID-19 government-mandated shutdown. Pursuant to an Illinois executive order, restaurant operations were limited to curbside pickup. The court ultimately concluded that the force majeure clause in the parties' lease supported a 75 percent reduction in rent.

The decision in *In re Hitz Restaurant Group*[1] suggests that courts may be increasingly receptive to arguments tying rent to tenant's actual and/or permitted operations under "shelter in place" orders.

BACKGROUND

The tenant debtor, Hitz Restaurant Group ("Hitz"), leased space from landlord creditor Kass Management Services, Inc. ("Kass"). The force majeure provision in the lease provided:

> 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.

On February 24, 2020 (prior to the issuance of any COVID-19 "shelter in place" orders), Hitz filed for bankruptcy. It also did not pay rent for March or

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[1] No. BR 20 B 05012 (Bankr. N.D. Ill. June 3, 2020).

subsequent months. In March, Illinois Governor J. B. Pritzker issued Executive Order 2020-7 in response to the growing COVID-19 pandemic. Section One of that order required restaurants such as that operated by Hitz to "suspend . . . on-premises consumption" effective March 16, but permitted such businesses to use delivery, "drive-through, and curbside pick-up."

Hitz argued that this executive order, as well as subsequent orders extending the limitation on restaurant activity, triggered the force majeure clause in the lease such that Hitz did not owe rent from March onward. Kass moved the bankruptcy court to order Hitz to pay post-petition rent and "to timely perform all future rent obligations."[2]

FORCE MAJEURE "UNAMBIGUOUSLY APPLIES"

The court found that Governor Pritzker's order "unambiguously triggered" the force majeure clause in the lease and that the clause "unambiguously applies" to rent payments that became due thereafter (April, May, and June).[3]

The executive order triggered the force majeure clause because the order (1) "unquestionably" constitutes "governmental action" or "order of government" as enumerated in the provision; (2) "unquestionably 'hindered' "—pursuant to the clause—Hitz's ability to perform under the lease by proscribing on-site food consumption; and (3) was "unquestionably" the proximate cause (a requirement for the analysis of force majeure provisions under Illinois law) of Hitz's inability to pay rent because "it prevented [Hitz] from operating normally and restricted its business to take-out, curbside pick-up, and delivery."[4]

To determine whether—and to what extent—Hitz was obligated to pay rent for the duration of the executive order and its extensions, the court scrutinized the uses expressly permitted and encouraged by Governor Pritzker's directive. The court relied on Hitz's estimation that 75 percent of the restaurant's square footage, including the dining room and bar, was "rendered unusable" by the order.[5] Hitz conceded that the 25 percent of the premises occupied by the kitchen "could have been used" for activities permitted by Governor Pritzker's order: namely, carry-out, curbside pick-up, and delivery.[6] The court determined that Hitz's rent obligation was "reduced in proportion to its reduced ability to

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[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] *Id.*

[6] *Id.*

generate revenue due to the executive order" and ultimately concluded that Hitz owed 25 percent of the rent due for April, May, and June.[7]

Kass made three arguments to support its claim that the force majeure clause should not apply, each of which the court quickly rejected.

First, Kass argued that Governor Pritzker's executive order did not prohibit the continued functioning of banks or the post office, making payment of rent physically possible. The court summarily rejected this "specious" argument.[8]

Second, Kass argued that the force majeure provision, by its express terms, did not apply to Hitz's inability to perform based on "lack of money." The court rejected this characterization by emphasizing that Hitz argued that it was the government-mandated prohibition on its business—and not lack of money—that was the proximate cause of its inability to pay rent.

Third, Kass argued that Hitz could have applied for a Small Business Administration loan to cover its rent, which the court rejected given that there was no affirmative duty of Hitz to do so.

The court also considered the "lack of money" exclusion "general" language, and that the more specific inclusion of governmental orders controlled.[9] The court cited authority that force majeure clauses supersede the common law doctrine of impossibility. The parties and court did not address other legal theories raised by commercial tenants, such as frustration of purpose.

IMPLICATIONS FOR FUTURE CASES

As one of the first decisions to appraise the effects of force majeure provisions on rent obligations during the COVID-19 pandemic, the decision could serve as important persuasive authority for other disputes. The key takeaways include the following:

- *A proportionate rent reduction may be appropriate if limited uses are allowed.* The *In re Hitz Restaurant Group* court found that a tenant's "obligation to pay rent is reduced in proportion to its reduced ability to generate revenue due to the executive order."[10] The concept of tying rent amounts to allowable tenant use could prove to have increased purchase as courts confront the practical effects of shelter-in-place orders on restaurants, retail, and services.

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[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *Id.*

- *Tenant's invocation of force majeure may prevail.* The court rejected the landlord's attempt to re-frame Hitz's argument as an inability to pay rent due to a "lack of money," which would have been excluded as a viable excuse pursuant to the force majeure provision. In doing so, the court embraced Hitz's argument that the proximate cause of its inability to pay rent stemmed from the executive order and its effects on Hitz's business. This should give tenants confidence in making arguments based on force majeure provisions. That said, it will be interesting to see if other courts will follow the court's reasoning in minimizing the impact of the "lack of money" exception.
- *Unclear impact on force majeure clauses that exclude rent payment.* Unlike many force majeure provisions, the clause at issue in this case did not expressly exclude payment obligations from performance excused pursuant to a force majeure event. This made it easier for the tenant to argue that its rent obligation should be suspended because of its inability to operate fully as a result of governmental mandates. It remains to be seen how a court would interpret a clause that expressly carves out rent obligations.
- *Uncertain what affect—if any—landlord counterarguments regarding partial use may have.* The court acknowledged that the landlord's counterarguments were weak and that the landlord did not make an argument regarding the square footage that the tenant could have used while remaining within the terms of the order. The degree of use by a tenant will likely prove a serious point of contention in future disputes.