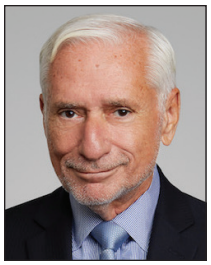
AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
The Essential Resource for Today's Busy Insolvency Professional

Feature

By Michael H. Traison, Michelle McMahon and Michael Kwiatkowski

Force Majeure Provisions Likely to Give Tenants Leverage with Landlords in COVID-19 Defaults



Michael H. Traison
Cullen and Dykman LLP
Chicago

Michelle McMahon
Cullen and Dykman LLP
New York

Michael Kwiatkowski
Cullen and Dykman LLP
Garden City, N.Y.

Editor's Note: *For another perspective on this topic, please read the cover feature of the August 2020 issue (abi.org/abi-journal).*

As a result of government-ordered shutdowns related to the COVID-19 pandemic, commercial tenants have been increasingly engaging landlords in negotiations — in and out of bankruptcy — to seek rent concessions and other relief to address accruing lease obligations on shuttered locations. In a recent decision, a bankruptcy court has determined that the *force majeure* provision of a lease partially excused the tenant's payment of rent where the leased premises were subject to a pandemic-related shutdown order. If other courts follow suit, the argument could provide tenants with additional arguments supporting their requests for rent relief.

What Are *Force Majeure* Provisions?

The phrase "*force majeure*" describes an event beyond the control of the parties that prevents performance under a contract and may excuse a party's non-performance. As explained by the Second Circuit, the purpose of a *force majeure* clause "is in general to relieve a party from its contractual duties when its performance has been prevented by a force beyond its control or when the purpose of the contract has been frustrated."[1] Courts have generally required that "a *force majeure* clause must include the specific event that is claimed to have prevented performance."[2] For example, a *force majeure* clause might provide the following: "The parties' performance under this Agreement is subject to acts of God, war, government regulation, terrorism, disaster, strikes (except those involving [a party's] employees or agents), civil disorder, curtailment of transportation facilities, or any other emergency beyond the parties' control, making it inadvisable, illegal, or impossible to perform their obligations under this Agreement."[3]

Although the *Restatement (Second) of Contracts* does not expressly refer to "*force majeure*," it provides for the discharge of contractual obligations by "supervening impracticability," which is largely the same. Specifically, it provides that

> [w]here, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the nonoccurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.[4]

1 *Phillips Puerto Rico Core Inc. v. Tradax Petroleum Ltd.*, 782 F.2d 314, 319 (2d Cir. 1985).

2 *Phibro Energy Inc. v. Empresa De Polimeros De Sines Sarl*, 720 F. Supp. 312, 318 (S.D.N.Y. 1989).

3 30 *Williston on Contracts* §77:31 (4th ed.) (citing *OWBR LLC v. Clear Channel Commc'ns Inc.*, 266 F. Supp. 2d 1214 (D. Haw. 2003)). Courts have also enforced fairly broad *force majeure* provisions that effectively left open the definition of "*force majeure*." *See, e.g., U.S. Hampton Roads Sanitation Dept.*, No. 09-cv-481, 2012 WL 1109030, *4-6 (E.D. Va. April 2, 2012) (permitting party to invoke *force majeure* provision, which stated that "'*Force Majeure*,' for purposes of this Consent Decree, is defined as any event arising from causes beyond the control of HRSD ... that delays or prevents the performance of any obligation under this Consent Decree despite HRSD's ... best efforts to fulfill the obligation.") (ellipsis in the original).

4 *Restatement (Second) of Contracts* § 261 (1981). Comment b to the provision explains that "[i]n order for a supervening event to discharge a duty under this Section, the non-occurrence of that event must have been a 'basic assumption' on which both parties made the contract," with "[t]he continuation of existing market conditions and of the financial situation of the parties are ordinarily not such assumption, so that mere market shifts or financial inability do not usually effect discharge under the rule stated in this Section." In addition, *Restatement (Second) of Contracts* § 264 (1981) provides an excuse from a party's contractual obligations where the party is prevented from fulfilling its obligation "by governmental regulation or order" as defined therein. Lastly, *Restatement (Second) of Contracts* § 265 (1981) provides that a party's discharge from its obligations under a contract by "supervening frustration" as defined therein.

Notably, if the "[i]mpracticability of performance or frustration of purpose" is "only temporary," it "suspends the obligor's duty to perform while the impracticability or frustration exists but does not discharge his duty or prevent it from arising unless his performance after the cessation of the impracticability or frustration would be materially more burdensome than had there been no impracticability or frustration."[5] Accordingly, a temporary impediment will not provide permanent relief from contractual obligations.

Prior Applications Based on National Events

Before the 2020 pandemic, courts addressed *force majeure* provisions with inconsistent results. For example, after the 2008 financial crisis, a bankruptcy court found that a *force majeure* provision excused a party's performance due to the financial crisis. In *In re Old Carco LLC*,[6] the bankruptcy court interpreted the following *force majeure* provision:

> [Old Carco] shall not be considered ... in default in the performance of its obligations under this agreement as a result of any cause beyond its reasonable control, including but not limited to severe and unusual weather, acts of God, or explosion, riot, acts of civil disobedience or sabotage, change to economic conditions and productivity and technological changes, power failures or shortages, restraint by court order or order of public authority, action or omission by any government agency, labor strikes or other labor disturbances.[7]

Focusing on the "change to economic conditions" clause in the provision, the bankruptcy court found that the 2008 Financial Crisis clearly "constitutes [a] change to economic conditions" within the meaning of the *force majeure* provision.[8] In excusing the debtor's performance under the underlying agreement, the bankruptcy court found "that the ability of Old Carco to remain a viable automobile manufacturer once the [2008] Financial Crisis struck was not within its reasonable control."[9]

By contrast, the court in *OWBR LLC v. Clear Channel Commc'ns Inc.*[10] declined to excuse a party's performance due to the Sept. 11, 2001, terrorist attacks. The parties had executed an agreement under which the plaintiff would host a music industry event/conference produced by the defendants in February 2002.[11] The event was cancelled by the defendants after the Sept. 11, 2001, terrorist attacks.[12] The *force majeure* provision provided, in pertinent part:

> The parties' performance under this Agreement is subject to acts of God, war, government regulation, terrorism, disaster, strikes (except those involving the Hotel's employees or agents), civil disorder, curtailment of transportation facilities, or any other emergency beyond the parties' control, making it inadvisable, illegal, or impossible to perform their obligations under this Agreement.[13]

Arguing that their performance was excused by the provision, the defendants claimed that the Sept. 11, 2001, terrorist attacks "severely disrupted travel, decimated the tourism industry, and created a pervasive sense of fear that gripped the country," such that holding the music event "was 'inadvisable' as referenced in the *Force Majeure* clause."[14] The court rejected this argument, finding that the defendants had "not presented sufficient evidence that terrorism presented travelers in February 2002 with circumstances so 'extreme and unreasonable' as to excuse performance under the Agreement."[15]

Pandemic-Related Shutdown Orders Can Constitute *Force Majeure*

As was reported by ABI Editor-at-Large **Bill Rochelle**,[16] a recent decision by the U.S. Bankruptcy Court for the Northern District of Illinois interpreting the *force majeure* provision of a restaurant lease could have significant implications for landlords. The court held that a *force majeure* provision of a lease partially excused the debtor tenant's payment of rent under the lease where the leased premises was under a government-ordered shutdown.[17] The bankruptcy court addressed a motion by a landlord seeking to compel Hitz, its debtor/tenant, to pay rent owed under a lease of nonresidential real property pursuant to § 365(d)(3) of the Bankruptcy Code. Hitz, a restaurant operator, argued that it should be excused from performance because, among other reasons, the language of a *force majeure* provision in the lease excused its performance when such performance was prevented, hindered or delayed by the government-ordered shutdown related to the pandemic. The lease provided, in pertinent part, that the

> 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 gov-

Michael Traison is a partner with Cullen and Dykman LLP in Chicago. Michelle McMahon is a partner in the firm's New York office. Michael Kwiatkowski is Of Counsel in the firm's Garden City, N.Y., office.

5 *Restatement (Second) of Contracts* § 269 (1981).
6 452 B.R. 100 (Bankr. S.D.N.Y. 2011).
7 *Id.* at 107.
8 *Id.* at 120.
9 *Id.* at 125-26.
10 266 F. Supp. 2d 1214 (D. Haw. 2003).
11 *Id.* at 1215.
12 *Id.* at 1216.
13 *Id.* at 1220.
14 *Id.* at 1221.
15 *Id.* at 1225.
16 "*Force Majeure* Clause Cut an Illinois Debtor's Rent by 75%," *Rochelle's Daily Wire* (June 11, 2020), *available at* abi.org/newsroom/daily-wire/force-majeure-clause-cut-an-illinois-debtor%E2%80%99s-rent-by-75 (last visited on July 23, 2020).
17 *In re Hitz Rest. Grp.*, No. 20-05012 (Bankr. N.D. Ill. June 2, 2020), ECF No. 48 (Memorandum Opinion).

ernment.... Lack of money shall not be grounds for *Force Majeure*.[18]

Hitz asserted that the Illinois governor's emergency order closing restaurants in response to the pandemic implicated the lease's *force majeure* provision and excused Hitz's obligation to pay rent under the lease. The emergency order stated:

> Beginning March 16, 2020, at 9 p.m. through March 30, 2020, 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. Such businesses are permitted and encouraged to serve food and beverages so that they may be consumed off-premises, as currently permitted by law, through means such as in-house delivery, third-party delivery, drive-through, and curbside pick-up. In addition, customers may enter the premises to purchase food or beverages for carry-out. However, establishments offering food or beverages for carry-out, including food trucks, must ensure that they have an environment where patrons maintain adequate social distancing.[19]

The bankruptcy court held that the emergency order "unambiguously" triggered the lease's *force majeure* provision because it "unquestionably" constituted a governmental action and the issuance of an order as contemplated by the language of the *force majeure* clause. The bankruptcy court also held that Hitz's ability to perform was hindered by the emergency order because it prevented the debtor from operating normally and restricted its business to take-out, curbside pick-up and delivery, and therefore was "unquestionably" the proximate cause of the debtor's inability to pay full rent. The bankruptcy court ruled that, accordingly under Illinois law, the *force majeure* provision excused Hitz's performance, at least in part.[20]

The bankruptcy court disagreed with the landlord's argument for a narrow reading of the *force majeure* provision that would apply only if the emergency order shut down the banking system or post offices and Hitz was physically unable to write and send rental checks to the landlord. The court also rejected the landlord's argument that the emergency order was not the proximate cause of Hitz's inability to pay rent, but rather Hitz's lack of money was the proximate cause, and the *force majeure* provision specifically excluded lack of money as a basis for invoking the provision.

The bankruptcy court held that the more specific provisions relating to a "governmental action" or "orders of government" as triggers for the *force majeure* clause prevailed over the more general provision excluding "lack of money" as a trigger for the *force majeure* clause. The court reasoned that in interpreting an Illinois contract, when there is a conflict between a clause of general application and a clause of specific application, the more specific clause prevails. Finally, the court rejected the landlord's assertion that Hitz could have obtained a small business loan to pay the rent, and it found that nothing in the *force majeure* provision supported this argument and that the landlord did not provide any supporting case law.[21]

However, the bankruptcy court held that the governor's emergency order did not wholly excuse Hitz's performance. It found that the emergency order did not order complete closure of restaurants but, rather, prohibited regular dine-in service while encouraging take-out and curbside delivery. Therefore, some performance by Hitz was possible. The bankruptcy court determined that 25 percent of the rent representing the portion of the restaurant operations was permitted under the emergency order. In addition, the court noted that the emergency order was issued in the middle of March and therefore had no impact on half of that month's rent obligations.[22]

Conclusion

If more broadly adopted, the bankruptcy court's decision could have significant implications for all landlords with leases containing similar *force majeure* provisions, both in and out of bankruptcy. For example, Jenner & Block LLP is reported to have been in negotiations with its landlord asserting similar claims for rent-abatement based on a *force majeure* provision of the lease for its Chicago offices.[23] We will probably see more of these lease-related disputes resolved out of court, but the *force majeure* issue will also come to the courts increasingly over the coming months. abi

Reprinted with permission from the ABI Journal, Vol. XXXIX, No. 9, September 2020.

18 *Id.* at p. 2.
19 *Id.* at p. 3.
20 *Id.* at pp. 3-4.
21 *Id.* at pp. 4-6.
22 *Id.* at pp. 5-6.
23 Debra Cassens Weiss, "Fighting Landlord's Suit, Jenner & Block Says COVID-19 Pandemic Entitles It to Rent Abatement," *ABA Journal* (June 24, 2020).