Updates
December 18, 2020
Landlords Defeat Debtors Seeking COVID-19 Rent Abatements and Deferrals

Retail, restaurant, entertainment, and other industries have been devastated by COVID-19 and the resulting governmental orders either precluding or materially limiting operations. In that regard, retail bankruptcy filings have become common occurrences and bankruptcy courts a favored venue for businesses seeking a proverbial "breathing spell." Perhaps most significantly, some bankruptcy courts have granted tenants relief from their rent obligations under nonresidential real property leases. However, as demonstrated by the CEC Entertainment, Inc. (CEC) bankruptcy case, such rent relief is not a foregone conclusion upon commencing a bankruptcy proceeding.

CEC operates Chuck E. Cheese entertainment venues throughout the United States, which offer arcade games, entertainment, and dining. As a result of governmental restrictions pertaining to retail, dining, and entertainment establishments, CEC requested that the Bankruptcy Court enter an order abating CEC's post-petition rent obligations at over 140 venues temporarily closed or otherwise operating at limited capacity, including 75 in California, North Carolina, and Washington.[1] CEC advanced three grounds in support of its request. First, CEC contended that sections 105(a) and 365(d)(3) of the Bankruptcy Code authorize the Bankruptcy Court to exercise its equitable powers to alter CEC's post-bankruptcy rent obligations. Second, CEC alleged that COVID-19 and the corresponding governmental orders were force majeure events under its applicable leases, thereby permitting it to delay its contractual obligations. Finally, CEC argued that the frustration of purpose doctrine applied to relieve CEC of its rent obligations. The Bankruptcy Court rejected all three grounds.

First, section 365(d)(3) provides, in pertinent part, that a debtor "shall timely perform all the obligations ... arising from and after the [bankruptcy filing] under any unexpired lease of nonresidential real property." However, this section further provides that a bankruptcy court "may extend, for cause, the time for performance of any such obligation that arises within 60 days after the [bankruptcy filing] but the time for performance shall not be extended beyond such 60-day period." Based upon the foregoing and notwithstanding the equitable powers bestowed upon bankruptcy courts by section 105(a),[2] the Bankruptcy Court held that section 365(d)(3) expressly precludes it from altering CEC's lease obligations beyond the first 60 days of the bankruptcy case. The Bankruptcy Court unequivocally concluded that it "cannot override [section 365(d)(3)'s] statutory mandate."

Second, the Bankruptcy Court turned to the force majeure clauses in the applicable leases.[3] In doing so, the Bankruptcy Court found that, although COVID-19 and/or the governmental orders limiting or restricting entertainment centers and restaurants from operating either in whole or in part fit within the applicable force majeure clauses, the provisions of the leases in question expressly provided that the occurrence of a force majeure event will not relieve CEC of its monetary obligations under the leases. The Bankruptcy Court therefore held that the applicable force majeure clauses would not provide the rent relief that CEC requested.

Finally, the Bankruptcy Court considered the frustration of purpose doctrine and explained that "[t]he doctrine excuses a party's performance when circumstances beyond the parties' control frustrate the purpose of the deal." Indeed, [u]nlike the force majeure clauses at issue, frustration relates to the purpose of a contract, as opposed to a party's actual inability to perform." The Bankruptcy Court found that California, North Carolina, and Washington each permit contracting parties to delegate the risk of frustration. According to the Bankruptcy Court, the leases all delegated such risk to CEC by operation of the force majeure clauses, which did not provide for any rent relief upon the occurrence of a force majeure event. Thus, the Court held that the force majeure clauses superseded the frustration of purpose doctrine. The Court also held that the doctrine did not apply because the purpose of the leases was not entirely frustrated. Each lease permitted uses other than the operation of Chuck E. Cheese entertainment centers.

While bankruptcy courts are often debtor friendly and other courts provided significant rent relief to retailers and restaurant owners, the CEC case serves as a caution to prospective debtors of two important principles: (1) Bankruptcy courts may not always go out of their way to provide the extraordinary relief of rent abatements or deferments, and (2) the specific provisions of each lease can be a determining factor.

Endnotes

[1] CEC and its affiliates' bankruptcy cases are pending in the U.S. Bankruptcy Court for the Southern District of Texas, Houston Division, and they are being jointly administered under Case No. 20-33163.

[2] Section 105(a) of the Bankruptcy Code provides, in pertinent part, that a bankruptcy court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." Often treated as a "catch-all" for a bankruptcy court to act when an issue is not expressly addressed by the Bankruptcy Code, many courts conclude that section 105(a) does not provide a bankruptcy court with authority to act in contravention of express provisions of the Bankruptcy Code.

[3] The Bankruptcy Court explained that "[a] force majeure clause is a 'contractual clause that excuses performance of contractual obligations—either wholly or for the duration of the force majeure—upon the occurrence of a covered event which is beyond the control of either party to the contract.'"

Authors

Explore more in

Bankruptcy & Restructuring | Real Estate & Land Use | Mergers & Acquisitions | Retail & Consumer Products

Related insights

Update

Illinois Pay Transparency Requirements Arrive

Update

USPTO’s Significant Restructuring of Trademark Fees Takes Effect January 18, 2025