Retail Debtor's Bid for "Super" Rent Holiday and Rent Abatement Denied

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The U.S. Bankruptcy Court for the Southern District of Texas has ruled that debtor Chuck E. Cheese could not obtain an additional extension of the statutorily prescribed rent-suspension period that debtors may enjoy for the first 60 days of the case pursuant toBankruptcy Code Section 365(d)(3), and that neither the force majeure clauses under the debtor's leases nor the doctrine of frustration of purpose allowed the debtor to delay or abate its rent obligations. The authors explain the decision, and how it fits in with caselaw in other districts, together with the December 27, 2020 amendments to Section 365(d)(3).

With little to no revenue at many locations, retail debtors have found it difficult during the COVID-19 pandemic to comply with Bankruptcy Code Section 365(d)(3)'s requirement that a debtor timely perform post-petition lease obligations while it decides whether to assume or reject a lease. However, given the pandemic's lasting impact, and related governmental orders that have affected operations, revenues, and the ability to pay rent, retail debtors have considered legal strategies for obtaining, over the objections of landlords, extensions of the initial 60-day rent suspension already afforded by Section 365(d)(3). While a few retail debtors have been successful, one was not in *In re CEC Entertainment*.[1]

BACKGROUND

Chuck E. Cheese restaurants, operated by CEC Entertainment Inc. ("CEC"), are primarily a pizza and arcade-focused birthday party venue for young children. Public health measures implemented by state and local authorities in response to COVID-19 shuttered arcades, and otherwise limited or prohibited large indoor gatherings to dine and socialize. While many Chuck E. Cheese

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[1] 2020 Bankr. LEXIS 3493 (Bankr. S.D. Tex. Dec. 14, 2020).

locations could have continued operating solely as restaurants under the governmental regulations, the ability to play games is so inextricably tied to the Chuck E. Cheese experience that its senior management decided to close many locations, reasoning that the business model would be damaged by allowing children to dine with games that could not be played visible in the background. This ultimately led to CEC's apparent "free-fall" Chapter 11 bankruptcy filing in June 2020.

Days after its bankruptcy filing, CEC obtained the initial 60-day "rent holiday" (i.e., a suspension and extension of any obligation to pay rent for the first 60 days of the case) afforded by Section 363(d)(3) of the Bankruptcy Code.[2] Otherwise, Section 365(d)(3) required the debtor to timely perform all obligations arising from and after the bankruptcy filing under its unexpired commercial leases, pending assumption or rejection.[3]

However, before the initial 60-day period expired, CEC filed a motion seeking to further delay or abate its rent payments until coronavirus related governmental restrictions were lifted. The motion initially sought to excuse CEC's obligation to pay rent at 141 locations across 12 states and was opposed by several of the debtor's landlords. Many of the landlord objections were resolved, but several others (for properties located in California, North Carolina, and Washington), persisted and were resolved by the court in the subject decision.

RENT DEFERRALS UNDER SECTION 365(d)(3)

Before COVID-19, debtors rarely invoked Section 365(d)(3) and bankruptcy courts rarely granted a 60-day extension when they did.[4]

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[2] Section 365(d)(3) was amended on December 27, 2020 (two weeks after the *CEC Entertainment* decision) to provide for, among other things, precisely what CEC requested, i.e., an additional extension of the initial 60-day rent holiday. However, the additional extension (up to an additional 60 days) is only available to small business debtors administered under Subchapter V of the Bankruptcy Code, and not larger debtors like CEC.

[3] 11 U.S.C. § 365(d)(3).

[4] *See, e.g.*, *In re T-Rex Partners, LLC*, 2008 Bankr. LEXIS 5162, at *10–12 (Bankr. D. Nev. 2008) (denying request for 60-day extension for lack of cause based on (i) mere presence of a second ground lease or lessor's legal disability to conduct business or (ii) debtor's immediate need to obtain insurance coverage after insurance lapses); *In re Pac-West Telecomm, Inc.*, 377 B.R. 119, 126 (Bankr. D. Del. 2007) (bankruptcy filing does not constitute "cause" under Section 365(d)(3); rather, "specific cause" or "applicable legal precedent" is required to obtain relief under the provision); *In re S & F Concession, Inc.*, 55 B.R. 689, 691 (Bankr. E.D. Pa. 1985) (acknowledging that debtor was previously denied a 60-day extension).

Since COVID-19, however, retail debtors have routinely sought and rather easily obtained the 60-day extension afforded by Section 365(d)(3), particularly during the earlier stages of the pandemic.[5] An additional strategy pushed by some debtors has been to "reserve the right" to seek additional rent holiday extensions, beyond the initial 60-days provided by Section 365(d)(3).[6] Indeed, the debtor in *Pier1 Imports* went even further when it affirmatively asked the bankruptcy court to defer rent payments beyond the first 60 days of its bankruptcy case. Over several landlords' objections, the court granted that request to defer rent payments by an additional 30 days.

BANKRUPTCY CODE FORBIDS "SUPER" RENT HOLIDAY

Section 365(d)(3) mandates timely performance of all post-petition lease obligations arising under a commercial lease until such lease is assumed or rejected.[7] That same provision also allows a debtor to obtain a 60-day rent

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[5] *See, e.g.*, *In re JC Penney Co., Inc. et al*, No. 20-20182 (DRJ) (Bankr. S.D. Tex. May 28, 2020) (Dkt. No. 338); *In re CraftWorks Parent, LLC*, No. 20-10475 (BLS) (Bankr. D. Del. May 20, 2020) (Dkt. No. 174); *In re Chinos Holdings, Inc.*, No. 20-32181 (KLP) (Bankr. E.D. Va. May 4, 2020); *In re True Religion Apparel, Inc.*, No. 20-10941 (CSS) (Bankr. D. Del. Apr. 13, 2020); *In re Pier 1 Imports, Inc.*, No. 20-30805 (KRH) (Bankr. E.D. Va. March 31, 2020) (Dkt. No. 438).

In more recent retail cases, however, debtors have refrained from requesting even the initial 60-day rent holiday afforded by Section 365(d)(3)(A). *See, e.g.*, *In re L'Occitane, Inc.*, No. 21-10632 (MBK) (Bankr. D.N.J. 2021); *In re Christopher & Banks Corp.*, No. 21-10269 (ABA) (Bankr. D.N.J. 2021); *In re Loves Furniture Inc.*, No. 21-40083 (TJT) (Bankr. E.D. Mich. 2021); *In re American Achievement Corp.*, No. 21-30058 (HDH) (Bankr. N.D. Tex. 2021); *In re Tea Olive I, LLC d/b/a Stock+Field*, No. 20-30037 (WJF) (Bankr. D. Minn. 2020). These debtors have concluded either that they (a) possess sufficient liquidity to pay the rent timely, and that the expense associated with litigating the issue is not warranted if the rent has to eventually be paid in full (whether it is on day 61 or the effective date of a plan), or (b) will identify and reject unwanted leases significantly earlier in the process. While it remains unclear, this may ultimately mean that the rent holiday fight is largely over for non-small business debtors. The issue will remain very much alive for small business debtors proceeding under Subchapter V Chapter 11 for several reasons, including the ability to pay out up to 120 days of accrued rent over the three to five-year life of the plan.

[6] *See, e.g.*, *In re Brooks Brothers Grp., Inc. et al.*, No. 20-117855 (CSS) (Bankr. D. Del. July 16, 2020) (Dkt. No. 162); *In re CEC Entertainment, Inc.*, No. 20-33163 (MI) (Bankr. S.D. Tex. June 30, 2020) (Dkt. No. 162); *JC Penney*, No. 20-20182 (DRJ) (Bankr. S.D. Tex. May 28, 2020) (Dkt. No. 338); *Chinos Holdings*, No. 20-32181 (KLP) (Bankr. E.D. Va. May 4, 2020); *True Religion*, No. 20-10941 (CSS) (Bankr. D. Del. Apr. 13, 2020); *Pier 1 Imports*, No. 20-30805 (KRH) (Bankr. E.D. Va. March 31, 2020) (Dkt. Nos. 438 and 562).

[7] If a lease is assumed, the debtor is obligated to continue performing all obligations under the lease and must cure all defaults under the lease. However, if a lease is rejected, the debtor is

holiday "for cause." Despite the statement in Section 365(d)(3) that "the time for performance shall not be extended beyond such 60-day period,"[8] CEC nevertheless urged the bankruptcy court to exercise its equitable powers under Section 105(a) of the Bankruptcy Code to continue the suspension, beyond the initial 60 days, of its performance and payment obligations under its leases.

Section 105(a) of the Bankruptcy Code authorizes a court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code.[9] CEC argued that this provision authorizes the bankruptcy court to extend the rent holiday beyond Section 365(d)(3)'s initial 60-day limitation. Just as it did in its initial rent-holiday motion, CEC asserted that it should not be required to pay rent for properties from which it receives "no—or a significantly limited—benefit," commencing on the 61st day of the case, because of the pandemic and related governmental orders.

The court flatly rejected CEC's argument. It reasoned that Section 365(d)(3) "expressly prohibits delays beyond sixty days" from the petition date and "does not provide the Court with authority to alter lease obligations beyond that sixty-day window."[10] Notably, however, the court did not order the debtor to begin making rent payments on the 61st day of the case (i.e., upon conclusion of the rent holiday), nor did it address what happens when the debtor fails to comply with 365(d)(3)'s direction, stating that its "equitable powers will be tested at the remedy stage."[11] This contrasts with *In re Pier 1 Imports, Inc.*,[12] where the bankruptcy court determined, even though Section 365(d)(3) does not provide a remedy for the debtor's failure to timely pay rent, other provisions of the Bankruptcy Code give the landlord an administrative expense claim for such failure, and such claim need not be paid until the effective date of the plan under Section 1129(a)(9)(A).[13] Thus, in neither case did the bankruptcy court

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relieved from further obligations under the lease and the landlord is entitled to rejection damages.

[8] *See* 11 U.S.C. § 365(d)(3) ("but the time for performance shall not be extended beyond such [initial] 60-day period").

[9] 11 U.S.C. § 105(a).

[10] *In re CEC Entertainment* (Bankr. S.D. Tex. 2020). The Consolidated Appropriations Act, 2021, Pub. L. No. 116–260 (2020), validates the *CEC Entertainment* court's holding that it lacked the authority to alter lease obligations beyond a case's first 60 days by adding a new sub-paragraph (B) to Section 365(d)(3) which grants a second 60-day rent holiday, but only for qualified small business debtors proceeding under Subchapter V.

[11] *Id.*

[12] 615 B.R. 196 (Bankr. E.D. Va. 2020).

[13] *See* 11 U.S.C. § 1129(a)(2)(A).

remedy non-payment of rent accruing during the first 60 days of the case by ordering immediate payment upon conclusion of the rent holiday.

STATE LAW REMEDIES FOR RENT DELAY OR RENT ABATEMENT

CEC also argued it should be excused from making rent payments as a matter of state law because: (i) the COVID-19 pandemic and related governmental regulations triggered the *force majeure* clauses in CEC's leases; and (ii) governmental regulations which limited the debtor's operations entirely "frustrated the purposes" of the debtor's leases.

Generally, *force majeure* clauses excuse performance of contractual obligations upon the occurrence of a covered event which is beyond the control of either party to the contract.[14] Courts hold that these contractual provisions allocate risk when performance is impacted due to the occurrence of events that the parties agree could not have been anticipated or controlled by them at the time of contracting, and consequently, when such an event occurs, an otherwise binding obligation is suspended or discharged. Importantly, the suspension or discharge of the obligation does not occur if the parties carved the obligation out of the *force majeure* clause.

While many non-bankruptcy COVID-19 *force majeure* cases remain in their pre-trial phases, some have been decided, with many rejecting the tenant's efforts to avoid paying rent.[15] *CEC Entertainment* represents the first major decision, after trial, in a Chapter 11 proceeding to reject a commercial debtor's/tenant's effort to rely upon theories of *force majeure* and frustration of purpose to avoid paying rent.

CEC's Leases Do Not Permit Rent Relief Even if the Force Majeure Clauses are Triggered

The *force majeure* clauses in CEC's leases for the subject North Carolina and Washington locations excused performance for "act[s] of God," "governmental restriction, regulation or control," or "any other condition beyond the reasonable control of such party." Importantly, however, the clauses specified that such excused performance "shall not apply to the inability to pay any sum of money due hereunder or the failure to perform any other obligation due to

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[14] *CEC Entertainment*, *supra*.

[15] *See, e.g.*, *East 16th Street Owner LLC v. Union 16 Parking LLC* (N.Y. Sup. Ct. 2020) (ordering tenant to pay rent because *force majeure* clause in lease did not permit tenant to withhold rent); *35 East 75th Street Corp. v. Christian Louboutin L.L.C.* (N.Y. Sup. Ct. 2020) (ruling in favor of plaintiff landlord and ordering defendant tenant to pay rent despite the impact of COVID-19).

the lack of money or inability to raise capital or borrow for any purpose."[16] Based upon this language in the leases, the bankruptcy court ruled that "[r]ent is a 'sum of money due.' " Consequently, the *force majeure* clauses did not permit the debtor to delay or reduce its rent obligations.

The subject California leases either contained a "*force majeure* carve-out" for rent similar to those in the Washington and North Carolina leases or an "anti-*force majeure*" clause (e.g., a clause providing that the occurrence of a *force majeure* event does not excuse contractual performance). Therefore, the conclusion was the same—the leases did not permit the debtor rent relief even if the *force majeure* clause was triggered. Consequently, the bankruptcy court found that neither of the California leases permitted CEC to abate or reduce rent due to *force majeure*.

As an aside, *CEC Entertainment* is distinguishable from *In re Hitz Restaurant Group*.[17] Rightly or wrongly, the bankruptcy court there concluded that a government order issued in response to the pandemic partially excused the tenant debtor's obligation to pay post-petition rent, even though the *force majeure* clause specified that "lack of money" was not grounds for *force majeure*. In *Hitz*, the court reasoned that "lack of money" was not the basis for the debtor's inability to pay rent; rather, the debtor's inability to pay rent was caused by the government's order to shut down all in-person dining.[18]

Rent Abatement Impermissible Under Frustration of Purpose Doctrine

Even though it sought to assume the leases under its plan, CEC also argued that its rent payments should be excused under the doctrine of frustration of purpose. CEC said the doctrine applied because the pandemic and related government regulations entirely frustrated the purpose—which it asserted is to operate family entertainment centers—of its leases.

The frustration of purpose doctrine excuses a party's performance under a contract when circumstances beyond the contracting parties' control frustrate the purposes of the contract. It generally applies in situations where the value

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[16] One of the Washington leases contained a slightly different carve-out, providing that the *force majeure* clause did not apply to "[t]enant's obligation to pay, when due and payable, the rents, charges or other sums reserved hereunder: and in addition, lack of funds and inability to procure financing shall not be deemed to be an event beyond the reasonable control of [t]enant." *CEC Entertainment*, *supra*. The court held that the substance of the lease was nearly identical to the other subject leases for purposes of its *force majeure* analysis.

[17] 616 B.R. 374 (Bankr. N.D. Ill. 2020).

[18] *See also In re Cinemex USA Real Estate Holdings, Inc., et al.*, No. 20-14695 (LMI) (Bankr. S.D. Fla. 2021) (Dkt. No. 1009).

of performance under the contract is "totally destroyed," or nearly so. Though the doctrine of frustration of purpose is similar to the doctrine of *force majeure* in that it seeks to address uncontrollable events that impact contract performance, the frustration of purpose doctrine is distinguishable in that frustration must relate to the "purpose of the contract," whereas *force majeure* relates to a party's "inability to perform" under the contract. However, under the law of each of the subject states in *CEC Entertainment*, the frustration of purpose doctrine does not apply if parties contractually agree to allocate risk between themselves for specific events (*e.g.*, agreeing that rent must be paid despite occurrence of a *force majeure* event).

Turning to CEC's arguments, the court ruled that under each of the subject states' laws, CEC could not avail itself of the frustration doctrine because the parties had agreed to allocate the very risk complained of (i.e., payment of rent upon occurrence of a *force majeure* event). In addition, the court reasoned that even if the frustration doctrine was available to CEC, the purpose of the leases could not have been frustrated because CEC sought to assume the leases as part of its plan of reorganization—proof positive that the leases were not rendered valueless.

CONCLUSION

Although it is unclear how much tangible benefit it provides, the decision in *CEC Entertainment* is a victory for landlords. *CEC Entertainment* is the first published decision in which a bankruptcy court determined that a court may not utilize its equitable powers under Section 105(a) to sidestep the express language of Section 365(d)(3) and defer a tenant debtor's obligations under a lease beyond the initial 60 days of the case. *CEC Entertainment* recognized that while the Bankruptcy Code provides various tools to assist a debtor's reorganization, it simultaneously protects landlords from an involuntary extension of credit to their tenants through supplemental rent deferrals.[19]

But, while it recognized the 60-day limit on the rent holiday afforded by Section 365(d)(3), the *CEC Entertainment* court did not order rent to be paid

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[19] This involuntary extension of credit is limited to debtors not proceeding under Subchapter V Chapter 11. Subparagraphs (B) and (C) of Section 365(d)(3), which became effective two weeks after the *CEC Entertainment* decision, expressly permit Subchapter V small business debtors to obtain an additional 60-day rent holiday (for up to a total of 120 days) and give landlords an administrative claim if such an extension is granted. Worse for landlords, the administrative claim need not be paid on the effective date of a non-consensual Subchapter V plan, and instead may be paid out of the three-to-five year-life of the Subchapter V plan. *See* 11 U.S.C. §§ 1191(c)(2) and (e).

once that period expires, nor did it discuss what remedies may be available to landlords for nonpayment of rent. In that regard, we do not think that *CEC Entertainment* changed the landscape, as it was previously not uncommon for courts to exercise their discretion as to ordering when rent must be paid (*e.g.*, immediately versus upon plan confirmation).

However, we do expect future cases to address landlord remedies for unpaid post-petition rent. In fact, the exclusion of unpaid rent claims against traditional Chapter 11 debtors from new Section 365(d)(3)(C), which expressly converts an immediate-pay claim into a future-pay claim, may provide a statutory basis for landlords to argue, and courts to hold, that except in Subchapter V cases, rent that accrued during the holiday must be paid immediately upon conclusion of the holiday.

CEC Entertainment also represents the first major Chapter 11 decision aligning with those COVID-19 era cases addressing whether pandemic-caused economic distress can overcome an absolute rent payment obligation in a tenant's lease. These cases generally stand for the proposition that where, as in *CEC Entertainment*, the lease has effectively a *force-majeure* carve-out—a provision that says the occurrence of a *force majeure* event does not excuse the rent payment obligation—the nature of the *force majeure* is irrelevant, and the parties' contract will be enforced.

Finally, *CEC Entertainment* may test the perception by some that bankruptcy courts are more flexible than non-bankruptcy courts (whether or not during COVID-19) to deploy equitable remedies rather than the terms of the parties' contract. If followed by other bankruptcy and non-bankruptcy courts, we expect this will be welcome news to landlords (as well as counterparties to other forms of contracts) threatened with arguments that the plain meaning of the applicable contract can be avoided based upon the pandemic and sundry equitable theories.