Chuck E. Cheese: The Mouse Who Didn't Get the (Rent Relief) Cheese

By Valerie Bantner Peo and Michael Myers

In a small victory for landlords of bankrupt tenants, the Bankruptcy Court for the Southern District of Texas has ruled that the Chuck E. Cheese parent company may not use its bankruptcy filing to avoid paying its rent.

The COVID-19 pandemic and related stay-at-home orders have prompted numerous retailers and restaurants to seek bankruptcy protection. Many of those companies successfully used the bankruptcy process to obtain relief from their rental obligations. In the early days of the pandemic, some companies sought to "mothball" the bankruptcy by suspending the proceedings and the obligation to pay certain expenses, such as commercial rent, until the initial stay at home orders expired.[1]

As the pandemic has dragged on, however, requests for rent relief have changed form. In *Pier 1*,[2] for instance, the Bankruptcy Court held that the debtor could defer paying rent until confirmation of the company's chapter 11 plan—a decision which ultimately resulted in payment of less than all of the accrued rent and other expenses of the bankruptcy estate. In *Hitz Restaurant Group*,[3] the Bankruptcy Court held that a force majeure clause excused the company's obligation to pay 75% of its rent, on the theory that the restaurants could only utilize 25% of the restaurant space.

More recently, CEC Entertainment, Inc. *et al.*—aka Chuck E. Cheese—sought to suspend its rental obligations based on the Bankruptcy Code, force majeure, and frustration of purpose arguments. Because CEC had settled with many of its landlords, the decision applied to the non-settling landlords that leased properties to CEC in California, Washington, and North Carolina. The Bankruptcy Court rejected each of the company's three arguments, as summarized below.

The Bankruptcy Court's Equitable Powers

The *CEC* Court swiftly rejected CEC's argument that the Bankruptcy Court should use its equitable powers under section 105 of the Bankruptcy Code to alter CEC's rent obligations. The Bankruptcy Court concluded the request contravened Bankruptcy Code section 365(d)(3), which requires that a company in bankruptcy (among other lease obligations) pay rent until the lease is assumed or rejected.

[1] In re Modell's Sporting Goods, Inc., et al., Case No. 20-14179 (Bankr. D. N.J.).
[2] In re Pier 1 Imports, Inc., 615 B.R. 196 (Bankr. E.D. Va. 2020).
[3] In re Hitz Restaurant Group, No. 20-B-05012, 2020 WL 2924523 (Bankr. N.D. Ill. June 3, 2020).

This stands in contrast with *Pier 1* in which the Bankruptcy Court concluded that section 365(d)(3) did not prevent the Court from using its equitable powers under section 105 to defer rent, because the Court could instead award the landlords an administrative expense claim, to be paid in full upon confirmation of a chapter 11 plan. The *CEC* Court expressly disagreed with *Pier 1*, although, as the Court noted, its disagreement was "perhaps on the margins." That is because the *CEC* Court found that the remedy for a violation of section 365(d)(3) was beyond the scope of its decision.

Force Majeure

The *CEC* Court also concluded, under applicable state law, that the force majeure clauses in the leases at issue did not excuse CEC from paying rent. Key to the Court's analysis is that most of the provisions at issue exclude "the inability to pay any sum of money due" or similar language as a force majeure event which would excuse performance.

This is in stark contrast to *Hitz*, in which the Bankruptcy Court applied the lease force majeure clause to excuse the payment of rent, despite language excluding a "lack of money" from the scope of the clause. While the force majeure clauses in the CEC leases were perhaps more sophisticated than the clause in the Hitz lease, it is difficult to distinguish them substantively. Interestingly, while the *CEC* Court cited to the *Hitz* decision, it did not expressly state that it disagreed with that court's interpretation of force majeure clauses or attempt to distinguish the provisions in CEC's leases from those in Hitz's lease.

Frustration of Purpose

Finally, CEC argued it should not be expected to pay rent because the purpose of the leases was frustrated. The *CEC* Court analyzed the frustration of purpose doctrine under each state's law and concluded, in each instance, that the doctrine did not apply because the parties had allocated the risk of a force majeure event to CEC as the tenant. Among other things, the *CEC* Court pointed out that the motion to abate rent only made sense if CEC intended to assume the leases, i.e., there was value in keeping the leases. As the Court put it, the "destruction is temporary, not total" and it could not find a case "in which such a temporary reduction in the value of the lease was adequate for the Court to determine that there had been a frustration of purpose."

Takeaways

As these disputes continue to play out during the COVID-19 era of bankruptcies, there are several lessons parties can take with them from the *CEC* decision:

- **The Scope of Government Restriction Matters**: Courts may be less receptive to force majeure arguments as businesses are allowed to reopen to some degree—even if a partial or limited reopening is not financially attractive to the tenant. The *Hitz* Court applied the force majeure clause to excuse 75% of the rent based on the fact that the restaurant was under a government order to keep those areas closed. In *CEC*, the company made a business decision to keep its dining areas closed.

- **The Distinction Between Rent Deferral and Rent Forgiveness Matters**: Courts seem to be more receptive to a rent deferral in which the landlord *could* get paid in full later, versus abating rent altogether. For instance, the *Pier 1* Court expressly stated that it was not deciding "whether the Debtors' performance under the applicable lease has been excused due to impossibility, impracticability, or frustration of purpose." In practical terms, though, commercial landlords still need to seek relief for non-payment of rent even if a Court refuses to abate rent, because landlords could be left holding the bag for deferred rent that will never come.

- **The Force Majeure Clause Matters**: As some states re-impose tighter restrictions to counter the recent surge in COVID-19 cases, commercial tenants will likely continue to assert force majeure as a defense to payment of rent. Thus, it is critical that leases include well thought out force majeure provisions.

Buchalter is committed to helping our clients assess their rights with respect to COVID-19 and stands ready to assist in navigating these uncharted waters.

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