Ethics, Bankruptcy and Greed: The Unintended Consequences for Landlords of the 2005 Bankruptcy Amendments

Harlan D. Platt
Northeastern University
Professor of Finance and Insurance

Christopher R. Mirick
Cadwalader, Wickersham & Taft LLP
Partner

Marjorie B. Platt
Northeastern University
Professor of Accounting

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Introduction

This article is about the breach of ethics by commercial landlords which occurred when they lobbied Congress in connection with the 2005 revisions to the United States Bankruptcy Code to obtain a favorable position in bankruptcy cases of retailers and other stakeholders. Prior to the 2005 revisions to the Bankruptcy Code, these two parties - landlords and their tenants - had similar, but different, advantages in the bankruptcy cases of the commercial tenant. The 2005 revisions fundamentally altered the balance of power between these parties, ultimately to the detriment of the landlords and their stakeholders. When a commercial party’s consideration for its stakeholders is distorted by an opportunity for short-term gain, it creates a self-centric view of the world. This myopia, in turn, creates a blurred vision of others -- their needs and roles -- and consequently may cause parties to make decisions that ultimately prove to be disastrous not just to those immediately affected by the decision, but to themselves as well. Under accepted theories of corporate ethics, conduct of this nature would be considered unethical.

More specifically, this paper concerns certain provisions of the 2005 revisions to the Bankruptcy Code referred to as The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). The research question examined in this paper considers the effect of BAPCPA on the outcome of the bankruptcy process with respect to commercial property landlords and their retail tenants. We contend that in BAPCPA the landlords were able to obtain certain changes to the Bankruptcy Code that, given the economy at the time, had the potential to transfer value from other creditors to the landlords. We submit, and the evidence supports, that the failure to consider how these
changes would affect other parties represents a failure by commercial landlords of their ethical responsibility toward their significant stakeholders.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)

Prior to 1984, the United States Bankruptcy Code alternately favored commercial landlords or their tenants at various points in time. The implementation of the revisions to the Code in 1984 changed practice such that both parties were then on an even (or at least more even) playing field. See Miller and Waisman (2005) for a good historical review. The 1984 change to section 365(d)(3), colloquially called the Shopping Center Amendments, see Huben and Muchin (2005), required that tenants must continue to pay rent to the landlord during the bankruptcy process; further, tenants were given 60 days in which to make decisions on whether to accept or reject executory contract(s), including the time remaining on their unexpired lease(s). The 60 day limit was burdensome to retailers with many stores and leases nation-wide; courts often granted multi-year extensions “for cause” up to the confirmation of the reorganization plan at the end of the bankruptcy process. Thus, the consequence of this amendment was that retailers who filed for bankruptcy protection continued to operate, pay rent, pay their employees, and serve their customers while working out their problems in the court system. At the same time, landlords continued to receive rent for space occupied by the bankrupt tenant which benefited not only the landlord but the other tenants in the shopping mall who had the advantage of continued customer foot traffic and the resulting opportunistic sale of goods.

In 2005, Congress changed the Bankruptcy Code with BAPCPA. One asserted aim of BAPCPA was to change the behavior of consumers whose excesses had led to an
unacceptably high rate of personal bankruptcies. How BAPCPA addressed issues affecting these consumers – and whether these steps were necessary, appropriate, or even effective – are ignored in this article, as are non-landlord related changes affecting corporate bankruptcies. Rather, the focus of this article is on commercial landlords and the legislative changes they inserted into the Bankruptcy Code following a successful Congressional lobbying campaign.

For decades prior to BAPCPA, bankruptcy had been a sanctuary where distressed companies sought refuge from their obligations and were given time either to find new financing or to wait for their asset values to improve, or both (as improved asset values could be a large part of finding new financing). Part of this “breathing spell” in bankruptcy was the creation of a costless option for the debtor to decide whether to “assume” or “reject” its executory contracts\(^1\) and unexpired leases—a decision that did not have to be made until the debtor emerged from bankruptcy, months and sometimes years later. Contracts and leases that turned out to be above-market could be rejected—that is, the debtor slipped their bonds, and the counter-party was left with a reduced prepetition claim to be paid in tiny “bankruptcy dollars.” Contracts and leases that turned out to be below-market could be assumed – becoming part of the reorganized debtor’s basket of rights and assets – or, if not useful to the debtor, could be assigned to someone else—essentially sold to a new party with limited, if any, input from the counter-party to the agreement over who now stood in the debtor’s shoes.

To the extent a debtor could prolong its stay in bankruptcy, the debtor could expand its costless option. Although the pre-BAPCPA Bankruptcy Code required

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\(^1\) In bankruptcy law, executory contracts are contracts in which both parties to the contract have yet to complete some part of the bargain, see Countryman (1972-1973).
unexpired leases of nonresidential real property to be assumed or rejected within 60 days of the commencement of the bankruptcy, courts could – and routinely did – extend the time to assume or reject these leases until the confirmation of a plan of reorganization, or even beyond in some cases. (See Levin and Ranney-Marinelli (2005) for an in-depth discussion.) As mentioned above, it was not uncommon for retail debtors to have as much as three or four years to make their assume/reject decision. By contrast, with BAPCPA a strict statutory limit of 210 days (120 days as of right, and an additional 90 days “for cause”) was imposed on tenants to accept or reject an unexpired lease of nonresidential real property; any further extensions require the prior written consent of the landlord in each instance. A 210 day time period is not an onerous limit when the retailer has only a few leased properties. However, today, large, national retailers have hundreds of store locations. The growth in the number of retail outlets comes from the retail strategy of building ever larger big-box stores, the national proliferation of malls, and the need to produce continuous growth to satisfy Wall Street and the broader investment community.

Companies like Circuit City with 722 stores or Linens 'n Things with 571 stores could not possibly evaluate the economic worthiness of even 210 stores within 210 days (a rate of one per day), let alone hundreds more within the abbreviated statutory period allowed by BAPCPA. In short order following their bankruptcy filings, both Circuit City and Linens 'n Things liquidated. When a company liquidates, its assets are sold and proceeds are distributed to creditors. More importantly, its stores are usually closed and the firm goes out of business. While not the only reason for their liquidations, there is little question but that BAPCPA’s shortening of the time to assume or reject leases of
nonresidential real property was a strong contributing factor to these and many other retail liquidations since 2005.²

Under the pre-BAPCPA Bankruptcy Code, with more time to evaluate its stores and more time to craft a reorganization plan around the profitable locations while shedding the unprofitable or unneeded sites, a retail company similar to Circuit City or Linens ‘n Things might have emerged from chapter 11 court protection. The company would have continued to operate, paying all of its obligations to landlords on assumed leases, to retained employees who continue to work, and to other creditors whose contracts were assumed or who entered into new contracts post-filing. Further, other stores in the mall or affected area would continue to benefit from the stream of customers, drawn, in part, by the full complement of retails stores operating in the mall.³

Current theories of business ethics argue that managers have responsibilities to groups or communities beyond their immediate shareholders’ needs for maximizing profits. The following sections outline the major business ethics theories that are applicable to bankruptcy cases involving retailers and their landlords, the stakeholders relevant to retail bankruptcy cases, and the impact of the change in the Bankruptcy Code to the outcomes of retail bankruptcy cases.

**Corporate Social Responsibility/Integrated Social Contract Theory**

Milton Friedman argued that “few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible”

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² Duffy (2009) notes that other important factors leading to the spate of retail liquidations were a general shortage of capital, the effect of Wal-Mart, falling real estate values, and the growing popularity of buying products online.
³ The Wall Street Journal (2011) notes how shopping centers have declined during the financial crisis with a 9.1% vacancy rate at malls, which is the highest since the recession of 1990.
This straightforward view that corporate managers should concern themselves only with maximizing shareholders’ wealth has been succeeded by the development of several broader conceptions of where a company’s ethical boundaries lie. Two principal theories of business ethics are Integrated Social Contracts Theory (ISCT) (Donaldson and Dunfee, 1994) and Corporate Social Responsibility (CSR) (see Carroll, 1999 for a review). Each considers the corporation’s ethical responsibilities to include all stakeholders with whom the company interacts.\(^4\)

ISCT, while being fully cognizant of the pressures facing companies to maximize their earnings per-share and stock value, also extends the corporate ethical umbrella to encompass those outside the firm’s immediate beneficial or financial sphere (Donaldson and Dunfee, 1994). Donaldson and Dunfee (1994, p. 268) discuss the need for priority rules when “conflict occurs between two legitimate norms emanating from two separate communities.” Further, they argue that “attention should be given to norms that do not adversely have an impact on the freedom of other economic communities to create and support their own norms,” p. 269. An example of this extended community envisioned by ISCT would be the responsibility of landlords to consider the outcome of their decisions on their tenants, their tenant’s customers, and the community at large.

CSR, though different from ISCT, has a similar broad conception of how an ethical corporation fits into the modern world (Committee for Economic Development, 1971; Davis, 1973; Carroll, 1999; Kakabadse, et al., 2005). Of particular relevance is how CSR includes a company's relations with its local communities, suppliers, and consumers. In this view of corporate ethics, the well-being of tenants who are consumers

\(^4\) Not all observers agree with these new models. A recent report argues that companies should focus only on their bottom line (New York Times, 2011).
of the services provided by landlords should be considered by an ethical landlord. The Committee for Economic Development, for example, articulates three concentric circles: the inner circle (responsibilities for the efficient performance of business transactions), the intermediate circle (responsibilities to execute the firm’s business functions with sensitivity to changing social values; e.g., with respect to hiring and maintaining relations to employees, to fair treatment and protection of customers, etc.), and the outer circle (responsibilities to the broader social environment). Further, Davis (1973, p. 313) articulates the notion that the firm is obligated “... to evaluate ... the effects of its decisions on the external social system in a manner that will accomplish social benefits along with the traditional economic gains ...”

In summary, major theories of ethics applied to the business setting support the argument that companies have a responsibility to constituents beyond their immediate stockholders. Further, actions taken by companies in pursuit of maximizing profits for their stockholders should do no harm to other stakeholders and other interested parties; that is, companies should pursue pareto optimal policies⁵.

**Stakeholders**

The focus on this paper is on the relationship between the commercial landlord and its bankrupt tenant. Although the bankrupt tenant has multiple creditors involved in its bankruptcy proceeding, including suppliers, service providers, employees and banks and other lenders, the landlord has been given inordinate influence over the bankruptcy outcome by the statutory requirement that unexpired leases of nonresidential real property be accepted or rejected within at most 210 days. The theories of business ethics

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⁵ Pareto optimality is an economic concept that argues for making no change unless the change makes someone better off without making anyone else worse off.
described above argue that landlords have a responsibility to their tenants as significant
stakeholders of the landlords to do no harm to the tenants’ ability to emerge from
bankruptcy as new, solvent, viable going concerns.

Bankruptcy Outcomes

It is important to distinguish between the two typical outcomes of a company
filing a bankruptcy petition: liquidation and reorganization. Liquidation results in the firm
going out of business; in contrast, reorganization creates a new business enterprise out of
the assets of the original firm.

There should be no direct connection between BAPCPA and the rate at which
retail establishments find themselves needing to file for chapter 11 protection in the
courts, because that event is driven by the company’s debt decisions, top line sales, and
its cost of goods sold. Rather, we contend that BAPCPA affects the outcome of the
bankruptcy process. Historically, a significant fraction of large retail enterprises that
failed -- such as Kmart Corporation which filed in 2002 or Winn-Dixie Stores Inc. which
filed in 2005 -- reorganized and emerged from bankruptcy as new companies. In
contrast, since 2005 few large retailers have emerged from bankruptcy; all have ended up
in liquidation. We suspect that BAPCPA is the reason for this change.

It should be noted, however, that the development of large box enterprises like
Wal-Mart, Home Depot, Inc., and Target Corp. in the past two decades has led many
smaller retailers to fail. Figure 1 below illustrates the substantial growth in both total

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6 It is possible that the rate at which companies file for chapter 11 protection may be affected by whether
the Bankruptcy Code provisions are more or less attractive. However, the ability or not of a company to
reorganize under chapter 11 should not affect whether the company runs into financial trouble in the first
place. That is, the provisions of the Bankruptcy Code should not affect whether companies fail, but may
affect whether companies file for chapter 11.

7 Kmart later merged with Sears to create Sears Holding Corporation; Winn-Dixie continues to operate, as
of this date, as an independent company.
retail sales (growing from $261 billion in 1965 to $4.0 trillion in 2008) and the unabated growth in the share of retail sales of the 10 largest retailers (10.2% of sales in 1965 rising to 22.9% in 2008).

Wal-Mart became the number one retailer in 1992, see EssayTrader.net (2011). Ironically, 1992 precedes by only several years the beginning of a dramatic decline in the number of public retail companies as is seen in Figure 2. It is not unreasonable to assume that the decline in publicly listed retailers is also associated with the increase in big-box retailers.

The bankruptcy courts have historically been “courts of equity” as opposed to merely “courts of law,” with the power to make decisions that are equitable—that is, fair to all parties involved. Part of the political motivation behind BAPCPA was a popular (or at least oft-repeated) view that bankruptcy judges had too much discretion, such that debtor-friendly judges were being too deferential to debtors. BAPCPA greatly constrained judicial discretion in the consumer arena, introducing mandatory means tests and similar provisions. The BAPCPA amendments that tied the judges’ hands regarding the time to assume or reject leases of non-residential real property fit neatly into this construct. Fundamentally, commercial landlords saw an opportunity to capture the option value of their leases by forcing bankrupt tenants to assess their choices quickly, with the result that at least some tenants would vacate the premises. That is, the changes that restrict the courts’ ability to extend these time periods have curtailed an important feature of the bankruptcy system – courts can no longer “do equity” when the overall situation would support some time beyond the first 210 days for the debtor to decide what to do with the leases. By seeking to capture value for themselves by preventing courts
from acting in an equitable manner, commercial landlords acted in an unethical manner. As mentioned above, this lack of concern for related parties is a clear-cut example of a failure to be cognizant of a larger social responsibility.

**Methodology: Effect of BAPCPA on Bankruptcy Outcomes**

Empirical evidence on landlord’s behavioral motivations is difficult if not impossible to obtain. Consequently, the hypotheses proposed in this paper are tested by comparing the pre-and post- BAPCPA rates at which retail establishments liquidate. The basic hypothesis to be tested is that BAPCPA significantly affected the outcomes of chapter 11 filings. Using the Compustat database the names of 191 retail firms were obtained. To understand what transpired in the corporate histories of these 191 firms we sought the assistance of the largest international consultancy focused on retail establishments. With their assistance data on the outcome of bankruptcy process was obtained for 70 of the retail firms that filed for bankruptcy; 34 firms filed after the passage of BAPCPA which had an effective date in October 2005, and 36 firms filed in the six years preceding BAPCPA. Data could not be obtained on the remaining 121 companies because a) they were still in bankruptcy proceedings or b) they had merged while bankrupt with an existing company and so it was impossible to know whether on its own the firm might have reorganized or liquidated, or c) the outcome of the case could not be determined.

The 70 companies were bifurcated into those that reorganized in the traditional manner and those that liquidated. Companies beyond these 70 that completed the bankruptcy process with a sale to a third party under section 363 of the Bankruptcy Code, similar to the disposition of General Motors and Chrysler, were excluded from the sample.
as nontraditional reorganizations, because their outcome is somewhat between a normal liquidation and reorganization.

Of the 34 post-BAPCPA companies, 76.5% liquidated. The corresponding percentage liquidating for the 36 pre-BAPCPA companies was 57.9%. These statistics were compared using a z-test for differences between proportions. The z-statistic was 1.72, with a one-tailed p-value of .043. This result shows that there has been a significant increase in the proportion of retail firms which ultimately liquidated after filing for bankruptcy.

The unethical decision by landlords to change the law to maximize their (anticipated) returns by capturing their tenants’ lease options at the expense of their debtor tenants and other creditors of the debtor tenants has come back to haunt commercial landlords. Faced with the deadline for dealing with their leases, the retailer tenants have vacated properties in huge numbers; rather than providing a boon to the landlords, however, this wave of empty properties has occurred during the most severe economic downturn since the 1930s in the United States and abroad, making it difficult for landlords to re-lease the stores. As a consequence of the 2007-2009 economic decline, the commercial real estate industry has suffered great harm. BAPCPA had not been stress-tested prior to its passage in April 2005; when it ran head-on into the economic tsunami, the commercial real estate industry discovered frailties in the law that it had helped to pass earlier. The commercial real estate industry is reeling as a result: General Growth Properties Inc., the second largest operator of malls, is bankrupt\(^8\) and most other companies in the industry are facing severe financial distress. The commercial real estate industry clearly is having buyer’s remorse over the some of the BAPCPA changes—\(\textit{for}

\(^8\) General Growth reorganized and emerged from bankruptcy in the fourth quarter of 2010.
example, H.R. 1942 “The Business Reorganization and Job Protection Act of 2009” was introduced on April 2, 2009 to repeal portions of BAPCPA and revert back to the pre-BAPCPA time limits for assuming and rejecting leases. Although this legislation died in committee, it does indicate the interest in some sectors at the time in addressing the problems facing commercial real estate landlords dealing with their retail tenants’ bankruptcies.

**Effect of Economic Condition on Leases Options**

Commercial real estate landlords were unhappy about bankrupt tenants that would file for chapter 11 protection with unexpired leases and then sit in bankruptcy court (pre-BAPCPA) until the economy improved, at which point they would reject above-market leases they no longer needed, assume leases they wanted, and assign below-market but excess leases to other merchants. In effect, under the pre-BAPCA Bankruptcy Code leaseholders were able to extend the time horizon on the option afforded to them by the Bankruptcy Code, which greatly increased the option value. Landlords considered the dollars distributed to third party creditors as a result of the bankruptcy process as rightfully their own. After all, they owned the property, and the tenant had violated their lease by filing for bankruptcy and continuing to possess the property while not settling any pre-bankruptcy lease payment deficiencies.

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9 This bill never made it out of the House Subcommittee on Commercial and Administrative Law, and was cleared from the books in January, 2011.
10 Among the key variables in the Black-Scholes option pricing model is the length of time during which the option is in effect.
11 Prior to 1978, when the current Bankruptcy Code was enacted, provisions in a lease that caused the lease to terminate if the tenant filed for bankruptcy were enforceable. The Bankruptcy Code invalidates these “ipso facto” clauses – but they are still standard in most commercial leases.
12 Although the tenant is required to pay in full any pre-bankruptcy defaults in connection with assuming a lease, this payment does not have to be made until the end of the Chapter 11 case as the reorganized debtor is emerging from Chapter 11. And if the debtor decides to shed the lease instead, any recovery will be as a
A good way to think about below-market leases held by bankrupt firms is to view the lease as an option. This option gives the current (bankrupt) tenant the right, but not the obligation, to assign the lease to another tenant (or to assume the lease for its own use). A lease is a below-market lease if property values have risen above their value when the original lease was signed. Below-market leases are common during expansionary economic times especially when the rate of inflation is high. In effect, a below-market lease is an option that is “in the money,” meaning that if the holder assigns the lease to a third party at current market rates, the leaseholder will realize a gain of approximately the difference between the old and new lease values.13

In the expansionary economic period preceding BAPCPA most leaseholders held below-market leases with a face value below current market rates due either to increased demand pressure on lease rates or to the holding period of the lease. In either case, in a strong economy, leaseholders had an incentive to hold the lease during bankruptcy and continue to operate, hoping their economic condition improved or hoping to assign the lease to another retailer who would pay them something to take over the valuable below-market lease.

The courts In re Ames Department Stores Inc.14 authorized the sale of what became known as “designation rights,” permitting debtors to sell to other parties the right to designate the party to whom a lease would be assigned. As the sale of an estate asset, the trade in designation rights uses the same section of the Bankruptcy Code (section 363) under which both General Motors and Chrysler exited bankruptcy so quickly in the general unsecured claim, paid in “bankruptcy dollars” – i.e., the proverbial ten cents on the dollar (or whatever is available to unsecured creditors).

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13 This gain is capitalized and the leaseholder receives a single payment.
summer of 2009, selling their operations and “good” to new companies while leaving the
“bad” assets behind to be liquidated and distributed against the companies’ debts. The
argument for allowing the sale of the designation rights is essentially that section 363(b)
of the Bankruptcy Code allows a debtor to sell or lease its property; unexpired leases are
an asset of the debtor; the ability to decide who can “purchase” (take an assignment of)
this asset is also, therefore, an asset. A designation right allows someone else, who has
purchased this right, to cause a company (tenant) to assume an unexpired lease and to
assign it to a third party. Designation rights create value for the bankrupt company
because they add an additional asset to the list for sale – not only can the debtor assign
(sell) the lease, but now the debtor can sell the right to decide to whom to assign (sell) the
lease . In the Ames Department store case, Ames had approval from the U.S. Bankruptcy
Court to sell 18 unexpired leases to The Stop & Shop Supermarket Company, and several
other leases to Home Depot. The sale of these leases created sufficient capital to allow
Ames to fully repay all of its creditors, including landlords of rejected leases.

A strong economic environment breeds new tenants waiting to occupy space held
by the bankrupt company. In the landlords’ view, a bankrupt tenant should vacate the
premises and allow the landlord to find a new tenant who would pay a market rent.
Forget about loyalty, fairness, or the law. This is the slippery slope of moral values that
got the landlord community into trouble. The Bankruptcy Code not only allows

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15 The new tenant may not be given operating restrictions but must instead be treated as if the lease was
new. For example, the landlord must allow the tenant to change the signage. The bankruptcy court may also
halt provisions in leases that allow the landlord to regain possession of the property or to raise the rent, see
Eaton, 2004. However, the debtor may not assign a lease to a type of firm that the original lease enumerates
as unacceptable.

16 Section 502(b)(6) of the Bankruptcy Code caps the damage claim that can be asserted by the landlord as
a result of the rejection of a lease in bankruptcy, at the greater of one year’s rent, or 15% of the remaining
term of the lease, not to exceed three years. It is this capped claim that is entitled to be paid in the
bankruptcy, not the “full” damages suffered by the landlord.
companies to ignore the “don’t go bankrupt” provision of leases but it sanctions tenants’
disregard of the “may not assign the lease” provision\textsuperscript{17} as well. That is, tenant behavior
that operates to transfer value from landlords is condoned by the courts and by the
application of the Bankruptcy Code.

Let’s consider the behavior of landlords. Historically the Bankruptcy Code
allowed bankrupt tenants an extended but finite time period in which to hold onto leases.
That is, Congress intended tenants to have a long term option on the property that they
had leased prior to filing for bankruptcy. Presumably the Bankruptcy Code was designed
to assist these weak bankrupt firms, which employed thousands of people and provided
needed goods throughout the country, and provide them an opportunity to redeem
themselves. The societal good afforded by such redemption (or reorganization) was
presumably traded off against the possible damage to landlords of darkened store fronts
and malls “tainted” with bankrupt, vacated tenants who still owned the lease, but were
saving money by going dark.

Here is where moral values come into the equation. The cost/benefit of the pre-
BAPCPA Bankruptcy Code was already decidedly in the favor of landlords. While the
tenant was under the protection of the bankruptcy court the landlord continued to receive
lease payments and other contractual payments agreed to by the two parties. Should the
tenant stop making payments, the court would require the debtor to vacate the premises.
What damage the landlord suffered came in the event that the retail establishment went
dark by the debtor vacating the premises \textit{while} holding onto the lease or by holding a

\textsuperscript{17} A lease is assigned when one tenant turns the lease over to another tenant for some consideration.
“going out of business” sale.\textsuperscript{18} In other words, landlords suffered some damages but for the most part they were either nonmonetary or else were mostly perceptual. Further, these damages were borne only for a short time period. For the most part, landlords suffered very little under the pre-BAPCPA Bankruptcy Code.

But the landlords got greedy and hungered after the dollars they saw bankrupt tenants receiving from assigning the below-market leases to new tenants, which the landlords perceived as unfair to themselves. That greed precipitated lobbying actions by, for example, the International Council of Shopping Centers to change the Bankruptcy Code, piggybacking on the political impetus to reduce (perceived) consumer abuse of the bankruptcy system. That lobbying culminated in the passage of those portions of BAPCPA referred to above.

**Summary**

Were bankrupt retail tenants unfairly stealing from landlords? The facts are these:

1. Retail tenants had signed a long term lease giving them full and unimpeded access to retail space.
2. Retail tenants continued to pay lease obligations to landlords while in bankruptcy.
3. Some retail tenants regained their financial health and remained open during the bankruptcy process, operating for at least the duration of their current lease if not longer.
4. Other retailers assigned the lease to another (third party) merchant who paid the retail tenants something for it; the new retailer then continued to pay the landlord per the original lease and possibly even more if the lease contained a percentage-of-sales provision.
5. And some retailers rejected their leases, giving the landlords possession of the premises and a claim for unpaid rent and other damages (subject to certain caps in the Bankruptcy Code).

\textsuperscript{18} Landlords are typically concerned that consumers might not frequent malls if the tenants either go dark or hold going-out-of-business sales.
In other words, landlords were not being hurt in the sense of being forced to receive less than they originally bargained for – they got paid what they were owed under the lease, or they got the premises back and a claim for damages. The Bankruptcy Code thus did not enable tenants to take anything from landlords.

From the landlord’s perspective, it is possible to conceive of this legislation as legalized thievery by arguing that the existing lease prohibits assignment to another tenant (ignoring the Bankruptcy Code’s exception) and that the higher value of the property belonged to the landlord because the tenant had violated the lease by filing bankruptcy (despite the Bankruptcy Code’s rules to the contrary). This is a narrow view which is not supported by either legislation or customary practice.

The strength of the national economy prior to 2005 argued that landlords could capture the option value of leases held by bankrupt tenants by forcing these tenants to abandon (reject, in bankruptcy parlance) leases, thereby returning the premises and the option to the landlord. Today few retailers are expanding their businesses into new locations. Companies are unwilling to take on lease obligations and the associated investment in fixed assets that expansion to new locations requires. Following BAPCPA’s enactment, tenants have rejected leases and abandoned retail space, as contemplated – but the space has remained unfilled. The commercial landlords have the space back, and have no-one to whom they can lease it. The cash flow of malls and other retail locations has suffered as a consequence of the lowered occupancy resulting from this vacant space. Retail landlords themselves have been forced to seek protection from the bankruptcy courts.
Under the old bankruptcy system, tenants held the option value of leases. Had this remained unchanged, the slowing economy would have meant fewer below-market leases and there would have been less money gleaned from this asset by bankrupt tenants. However, the important point is that the large retail chains would not have been forced to make an early decision about accepting/rejecting leases and would have been able to remain in their locations for some period of time, operating their retail businesses, if their operations otherwise warranted remaining open.

Landlords wanted to take control over the option value of leases. The changes instituted by BAPCPA effectively granted landlords this wish just as the economy shrank and reduced the number of new tenants seeking retail space. The strict requirements imposed by BAPCPA transferred the option value of leases in bankruptcy to landlords. Landlords got their way. Their success in effectuating this shift is an example of “be careful what you wish for,” because you might actually get your wish granted. Landlords would today probably be happy if the changes were never instituted.

The pre-BAPCPA Bankruptcy Code allowed bankrupt companies to hold onto leases for an extended period of time. During that time, strong stores were retained and weak stores were identified and closed; corporate indebtedness was reduced; and a healthy viable new corporate entity often emerged from the bankruptcy process. The normal outcome to a retail bankruptcy under BAPCPA is just the opposite. Companies abandon their leases almost immediately and eventually sell off their inventories, fixed assets, and receivables to the highest bidder in a section 363 sale. Landlords are losing tenants at the worst possible time.19

19 Landlords on an individual basis can agree to extend a lease allowing a bankrupt tenant to remain in possession of the property. However, a store like Circuit City with 722 outlets could not possibly seek out
ISCT and CSR, which are both important theories of business ethics, recognize the importance of a company maintaining its ethical standards with various stakeholders. Each theory understands the need for a corporation to earn profits, but each also recognizes that when companies shirk these duties, as in the case of landlords vis-à-vis their tenants, harm ultimately comes to all parties connected with the business.

**Alternative Hypotheses**

What motivated landlords to seek this change in the Bankruptcy Code, restricting the ability of the bankruptcy courts to extend a debtor’s time to assume or reject a commercial lease? Was it principally greed driven by a lack of ethical concern for a class of stakeholders who are critical to the landlords’ long-term success as we have alleged, or were there other more socially acceptable reasons? There are three principle alternative hypotheses. Landlords may have wanted to

1. Refresh their properties by encouraging failed retailers to vacate their leases thereby allowing newer merchants into the space.
2. Assist bankrupt retailers by taking leases off of their hands.
3. Contribute to local economies because sales taxes (city and state) are based on revenues which may be reduced while a company is in bankruptcy.

Each of these is discussed serially below.

The first alternative hypothesis is that landlords lobbied for changes in the Bankruptcy Code in order to maintain the competitive edge of their malls. This argument is not solely self-serving, as it can be argued that consumers benefit from the addition of fresh new ventures into a shopping mall. That is, mall owners may have been more altruistic than we argue above, and their financial gain would have been a consequence of all these individual landlords and negotiate a lease extension from them before the 210 day limitation runs out.
that altruism (Mercer, 2009). This argument is hard to refute because mall refreshment and increased consumer choice are byproducts of the original argument that landlords lobbied for a change that pushed bankrupt retailers out of malls for avaricious reasons.

The second alternative hypothesis is also couched in altruism: landlords wanted to reduce the burden on failed retail business by accepting responsibility for mall property. Although it is possible that this motive was at the forefront of landlords’ thinking, we suspect that the primary motive was the capture of the option value of leases and that the “unwelcomed” assistance provided to bankrupt tenants was, at best, a subsidiary motive. After all, under the pre-BAPCPA Bankruptcy Code the tenant always had the right to welcome this assistance by selectively rejecting those leases it did not want to retain, early in its bankruptcy case.

The third alternative hypothesis is a derivative of the second one: that is, the objective was to help municipalities and states secure higher sales tax revenues by retaking the lease and then, as a subsidiary of the first alternative hypothesis above, by attracting fresh tenants. This hypothesis is a possibility but it should only be considered if either of the first two alternative hypotheses is accepted as this third hypothesis follows upon either of the first two hypotheses.

It is not possible to obtain definitive proof as to which hypothesis is correct. It may be that small contingents of landlords actually had one of the three alternative hypotheses in mind. But given the strong mall environment during the years immediately preceding the passage of BAPCPA, we suspect that the actual motivation on the part of landlords was pure and simple greed.

ISCT and CSR understand a corporation’s ethical responsibilities to other parties.
ISCT views the appropriate circle of responsibility to include all parties in the firm’s immediate beneficial or financial sphere. CSR considers the need for a company to be concerned about its local community, suppliers, and consumers. Both theories understand the need for landlords to be cognizant of the interests of tenants and not to just consider their own concerns.

Descriptive ethics depict an individual’s or a company’s real moral values. In the case of landlords, the only word that adequately describes their moral values is greed. The film writer Oliver Stone (1978) wrote that “greed is good.” Had Mr. Stone seen the plight of landlords following changes to BAPCPA he probably would have changed that famous line to “greed brings its own rewards.”
References


