

# U.S. Bankruptcy Laws and Air Carriers

**Arthur E. Rosenberg, Esq.**

**John Pritchard, Esq.**

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**Holland & Knight**

# Outline of presentation:

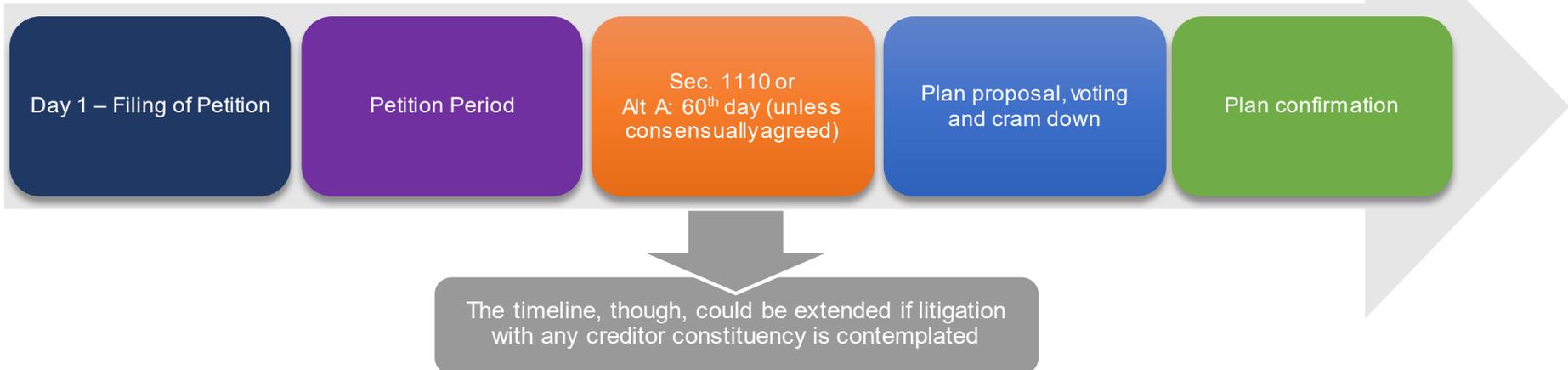
- U.S. Bankruptcy Code & Chapter 11
  - Debtor must a “person” with property/assets or a place of business in the U.S
  - Amount of property may be *de minimis* and may include a retainer
- Effect of a filing:
  - Automatic Stay
  - Comparison with Alternative A and s.1110
  - Creditor Rights under the Bankruptcy Code
  - Corporate governance
- Goals and timeline for proceedings
  - Plan of Reorganization
  - Sales of Assets
  - “Cramdown” Plans
- U.S. Bankruptcy Code & Chapter 15

# Timeline of a Chapter 11 Proceeding

- Automatic Stay
- DIP Financing/Use of Cash Collateral
- Retention of Professionals
- Use of Bank Accounts; Payment of Pre-Petition Debts
- Lease/Contract Rejection Procedures
- Motions to Assume/Reject Contracts
- Motions for adequate protection
- Bar Date
- Motion to Convert/Dismiss
- Filing of Plan
- Approval of Disclosure Statement
- Reject / affirm leases
- Perform obligations

Day 90 – Day 180

Day 180- Day 240 as needed



# US Bankruptcy Code & Chapter 11 Protection

- Commencing a case
  - Voluntary
  - Involuntary
- Qualification for foreign companies
  - Must be a “person” that resides, has a domicile, a place of business or property in the U.S. at time of filing to be debtor under U.S. law
  - Value of U.S.-based assets need not be significant (as little as a “peppercorn”)
  - US Bankruptcy Courts assert jurisdiction over insolvency proceedings of entities formed under foreign law
  - An interested party can challenge jurisdiction, but courts generally uphold the jurisdiction of U.S. bankruptcy courts, based on extremely low standard;
  - Questions arise as to the usefulness of a U.S. bankruptcy case against non-US creditors and counterparties .
- Where should the case be filed in the US?

# Effect of filing – Automatic Stay and other Tools

- **Generally prevents creditors** from pursuing actions against the debtor or exercising remedies to recover against a debtor's property, wherever located in the world
  - As a practical matter, the effect of the stay may be limited if a creditor is not subject to personal jurisdiction in the US, and thus is not subject to the Court's contempt power, and ignores the bankruptcy filing
- **Provides the "breathing room"** necessary for the debtor or trustee to assess and assemble all of the property of the estate without creditors seeking remedies to protect their own self-interests.
- **Allows** for the preservation of the debtor's assets and the maximization of their value and for an equitable distribution of those assets to creditors.

## Tools of the Code Include:

- Reject burdensome leases and executory contracts
- Results in a "rejection damages" claim that must be dealt with in a plan of reorganization
- "Claw back" assets that have been "preferentially transferred" or "fraudulently transferred"
- Avoid unperfected liens and other interests
- Sell assets free and clear of all liens, claims and encumbrances
- Object to and have disputed claims adjudicated by the court

## Timeframe:

- Example timeframes from prior airline insolvencies

# Effect of filing – Automatic stay, etc.

There are certain statutory exceptions to the automatic stay:

- Non-debtor counterparties not stayed from exercising contractual rights to liquidate terminate, accelerate, offset, net in connection with forward contracts/securities contracts
- Section 365 provides the debtor with similar protections, preventing lease or contract counterparties from terminating these agreements and giving the debtor the right to assume, reject or assign most such contracts
- s.1110 for U.S. air carriers
  - Stay lifted unless defaults cured in 60 days
- Cape Town Convention and Alternative A
  - Look to applicable waiver period of Contracting State
- Motions for Relief (eg. for adequate protection, to apply cash security deposits)

## Things a creditor should not do during a stay:

- Demand letters for outstanding amounts
- Application of cash security deposits or maintenance reserves
- Termination of Leases
- Repossession of off-lease aircraft or equipment
- Rejection of leases

## Things a creditor can do during a stay:

- Discussions with other creditors
- Drawing down amounts under Letters of Credit

## Impact of violations of the stay

- Fines, penalties and injunctive relief for contempt of court for violating the stay

# Creditors' Rights under the Bankruptcy Code

Section 361	Methods for providing adequate protection eg: contract rent, compliance with maintenance provisions and ADs
Section 362	Potential to lift stay for cause shown; adequate protection payments in the event that stay results in diminution in value of collateral
Section 363(e)	Condition use of collateral upon payment of adequate protection
Section 364	Post-petition loans may be pari passu with or even prime existing secured lenders but subject to grant of adequate protection to cover diminution in value of collateral
Section 365(d)	From or after 60 days for a lease of personal property: Obligation to perform all of the obligations under the leases unless the court orders otherwise while the stay remains in place No requirement to cure all defaults (different to s1110) Subject to any different court order
Section 507(b)	Diminution in Value Superpriority Claim – where an adequate compensation claim is found to be inadequate to compensate for diminution in value of asset between petition date and date asset is returned to creditor

# DIP Financing in Chapter 11 Bankruptcy Cases

- A Chapter 11 debtor can borrow money only if the terms of the loan are approved under Section 364 of the Bankruptcy Code in a structure known as “Debtor in Possession” (“DIP”) Financing
- DIP Financing can get priority over all pre-petition debt and administrative expenses
- DIP loans are usually secured by property that is not already subject to a lien, or the DIP lender may be granted a junior lien on property subject to an existing lien
- Under extraordinary circumstances, DIP Loans can prime existing lenders, including when the debtor is unable to get financing and the “primed” lien is granted adequate protection
- It is not unusual for a pre-petition secured lender to also provide DIP financing, and both loans may be “rolled up” into a larger priority loan, in which the pre-petition debt is no longer subject to challenge as to perfection, priority, amount, etc.

# Creditors' Claims Under Chapter 11

- Creditors with pre-petition or post-petition claims need to file Proofs of Claim in order to be paid out of the debtor's "bankruptcy estate"
  - How much will depend on the Plan, the amount of assets vs. liabilities and the outcome of the case
  - The court will set a "Bar Date" in each case by which claims must be filed
  - Proofs of Claim are fairly short and simple to prepare and file
- Once filed, the debtor (or trustee or a creditors' committee) has the responsibility to examine and analyze, and may object to the claim; once an objection is filed, the creditor has the burden to prove the amount and validity of its claim
- Claims based on pre-petition debt and damages may be known as "general unsecured claims"
  - Some unsecured pre-petition claims get priority under the Bankruptcy Code, which may include certain employee claims, tax claims, claims for goods sold and shipped immediately prior to bankruptcy, deposits, etc.

# Creditors' Claims Under Chapter 11 (cont'd)

- Claims based on the debtor's post-petition purchase of goods or use of services are known as "post-petition" and/or administrative claims, and will generally have priority over general unsecured claims, provided that the goods or services were used by the debtor post-petition and/or are considered the "actual, necessary costs and expenses of preserving the [bankruptcy] estate"
- Advantages to getting claims that are post-petition administrative claims, or somehow otherwise have priority
- Setoffs and security deposits are also advantageous

# Comparison of Alternative A to S.1110

CTC Alternative A	S.1110
Give possession upon earlier of relevant waiting period as set by declaration, or date creditor is otherwise entitled to possession; Standard declaration is 60 days.	After 60 days, subject to other agreement by the parties, Debtor becomes obligated to perform all obligations under the leases (unless the court orders otherwise) and must cure all defaults.
Airframes, Engines, together with related 'data, manuals and records'	Airframes, Engines, Propellers, Appliances and Spare Parts, together with those records which the related contract requires the airline to return, but not necessarily in accordance with the terms of the applicable lease
Must preserve aircraft object and maintain in accordance with contract.	Need court order for 'adequate protection'.
Debtor entitled to retain the aircraft objects IF all defaults are cured before the waiting period ends and debtor agrees to perform in accordance with the contract	Debtor's rights are substantially the same; Cape Town Convention will not apply to a domestic .U.S. bankruptcy case in which Section 110 applies, but may apply in case in which Section 1110 is inapplicable (e.g., a foreign airline)
Administrative agencies are to make the 'deregistration and export' remedies available to the creditor within 5 working days after notice; primarily relevant to exercise of an IDERA	No comparable support
Administrative agencies are to cooperate and support the creditor in its exercise of the 'deregistration and export' remedies	No comparable support

# Alternatives To A Plan Of Reorganization

- The U.S. Bankruptcy Code also permits a debtor to sell assets and assign Leases and other “Executory” Contracts in the bankruptcy case
- Section 363 permits a debtor to sell some or all of its assets “free and clear” of any liens, encumbrances or other interests in the assets, with any such liens, etc. attaching to the proceeds of the sale
- Such sales, which can involve a small portion or virtually all of the debtor’s assets, are frequently conducted through a “stalking horse” auction process, under which interested parties are permitted to bid against a potential “stalking horse” purchaser, which enters into an initial agreement with the debtor to “set the bar” for any sale

## Alternatives To A Plan Of Reorganization (cont'd)

- A 363 sale of assets frequently involves the assignment of Leases and other Executory Contracts under Section 365, subject to Bankruptcy Court Approval;
  - in order to assign leases and agreements, the debtor must first cure all defaults and assume the lease or agreement in question, and the assignee must reasonably demonstrate “adequate assurance of future performance” of the lease or agreement to the court and counterparty
  - Lessors should be ready to participate in one or more such transactions in a U.S. Chapter 11 bankruptcy case

# Effects of filing – Corporate Governance in Chapter 11

- The filing of a chapter 11 petition generally has no impact on the day to day management of the company.
- Management and Board of Directors remain in place and continue to operate the company in the ordinary course, subject to their existing fiduciary obligations as imposed by non-bankruptcy law.
- Management may also continue to operate the debtor during the post plan-confirmation process, unless removed by Board or a Chapter 11 trustee is appointed.
- Directors remain in place once reorganized, unless company liquidated or appropriately replaced by shareholders.
- Debtor that operates during chapter 11 case without a trustee is referred to as a “debtor-in-possession.”

- In certain situations, creditors or the United States Trustee may request appointment of a chapter 11 trustee “for cause.”
- “Cause” includes fraud, dishonesty, incompetence or gross mismanagement of the debtor’s affairs;
- Appointment of trustee must be in the best interests of the creditors and equity holders.

A chapter 11 trustee replaces management and holds sole control over the operation of the company and chapter 11 process.

*Appointment of a trustee terminates the debtor’s exclusive period to file a plan, making it possible for any party in interest to propose a plan.*

**Appointment of a chapter 11 trustee is the exception, not the norm.**

# Ultimate Goal of a Chapter 11 Case

- The overall goal of chapter 11 from the debtor's perspective is to re-set the debt (right) side of the balance sheet to equal the orderly liquidation value of the company's assets.
  - Secured creditors are entitled to a payment stream with a present value capped at the value of their collateral.
  - Unsecured creditors are entitled to a payment stream with a present value capped at what they would receive in a liquidation.
  - The net result is that the total of the debt side of the balance sheet is capped at the orderly liquidation value of the company.
  - But, equity is at a high degree of risk in a chapter 11 case:
  - The “absolute priority” rule mandates that equity retain nothing absent (i) full payment of unsecured creditors, (ii) plan acceptance by all classes of unsecured creditors, or (iii) a “new value” contribution.
- To achieve plan confirmation, there are several gating items in addition to the minimum financial treatment outlined above.
  - At least one “impaired class” must vote to accept the plan by 2/3 in amount and a majority in number.
  - The plan proponent must demonstrate “feasibility”, e.g., that confirmation of plan is not likely to be followed by the need for further financial restructuring.

# “Cramdowns” in Chapter 11 Bankruptcy Cases

- While a Plan may be confirmed when it is approved by a majority of classes of creditors, a Plan can also be confirmed and become “effective” under a “cramdown scenario” under Section 1129 of the US Bankruptcy Code
  - Creditors are organized into “classes” depending on their rights against the debtor and/or its property
- Under a cramdown, creditors in certain classes can be required to accept certain treatment even if their class does not approve the Plan
- At least one “impaired” class must approve the Plan by a majority vote
- All administrative claims must be paid in full under the Plan

# “Cramdowns” in Chapter 11 Bankruptcy Cases (cont’d)

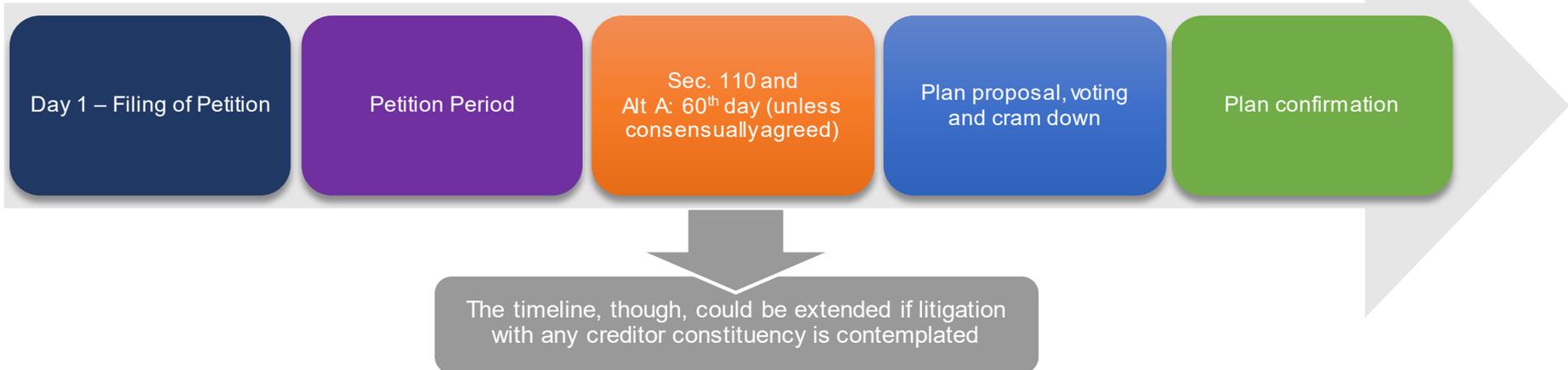
- Secured creditors can be “crammed down” if they receive their collateral or cash or other property with a value equal to the value of their collateral
- Unsecured creditors can be crammed down if no one subordinated to them receives any value under the plan, under the “absolute priority rule”
  - Notwithstanding the absolute priority rule, a subordinated class (e.g., equity) may receive value in a Plan (e.g., shares) if they contribute value to the reorganized debtor under the “new value exception” to the rule

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# Actions available to creditors prior to Chapter 11 / Chapter 15 filings

- Rent deferrals / Promissory Notes
- Preference Risk
- Cancellation
- Letters of Credit / Security Deposits / Secured Accounts
- Demand Notices
- Practical housekeeping tips (originals, LCs, notice details, maintenance, records)

# Special Issues for Engine Lessors in a U.S. Bankruptcy Case

- Lessors and Secured Lenders for Engines of a Debtor in a US Bankruptcy are treated in the same manner as Aircraft and Airframes
  - Any Lease would be Subject to Section 365
  - Section 1110 applies to any “aircraft, aircraft engine, propeller, appliance, or spare part (as defined in “section 40102 of title 49 [of the U.S. Code] that is subject to a” security interest or lease to “a debtor that, at the time such transaction is entered into, holds an air carrier operating certificate issued pursuant to chapter 447 of title 49 for aircraft capable of carrying 10 or more individuals or 6,000 pounds or more of cargo”
  - Although Leased or Financed Engines may be a lower priority to the debtor when compared with an airframe or entire aircraft, they must be dealt with by an airline debtor
  - Engines that are off wing or on the wings of multiple aircraft may be more difficult for the leasing/financing repossess, potentially resulting in additional costs that may result in administrative or pre-petition claims for the financing party;
  - It is generally easier to locate and take possession of an aircraft than multiple engines on disparate airframes, which may spread out around the world, although engines are smaller and may be moved more easily

# US Bankruptcy - Chapter 15 Protection

- Purpose is recognition and aid of a foreign bankruptcy proceeding by a U.S. bankruptcy court
- Cooperation between U.S. and foreign courts
- Protection of foreign debtor's assets in the U.S
- Differences with Chapter 11 proceedings:
  - No automatic stay until foreign proceeding is "recognized" - at least 21 days after filing
  - The U.S. court **may** grant provisional protection in the interim
  - Upon recognition, Ch 15 case becomes similar to Ch 11 case for debtor's assets/business in U.S. territorial jurisdiction
  - Section 1110 does not apply to a foreign airline, but CTC may apply instead
  - Right to assume/reject leases/contracts depends on foreign law
  - Obligation to pay for post-bankruptcy equipment use depends on foreign law
  - U.S. court **may** require adequate protection for lender's/lessor's interest in equipment located in the U.S
  - US fraudulent transfer and preference claims not applicable in a chapter 15; foreign debtor may assert setoff and turnover
- Once a Chapter 11 case is pending in the U.S., the debtor may file an ancillary proceeding in one or more foreign countries, provided that the UNCITRAL Model law has been adopted in those countries

# US Bankruptcy - Chapter 15 Protection

- Alternative A in a Secondary Insolvency Proceeding

- Fixed Waiting Period: The language of Alternative A, Article XI(2) is clear and unqualified: “the insolvency administrator or debtor, as applicable, shall give possession of the aircraft object to the creditor no later than ...(a) the end of the waiting period
- Cooperation: ‘...cooperate to the maximum extent possible with foreign courts and foreign insolvency administrators in carrying out the provisions of Article XI [Alternative A]’. Prot. Art XII(2), an Opt-In provision adopted by the US.
- Enforcement: ‘The courts of Contracting States shall apply Article XI [Alternative A] in conformity with the declaration made by the Contracting State which is the primary insolvency jurisdiction.’ Prot. Art. XXX(4), a mandatory provision applicable in the US and all Contracting States.
- The US Court is Obligated by the Convention and Protocol to apply the relevant countries Alternative A Waiting Period in accordance with such country’s declaration

- Oceanair example:

- Waiting Period: Brazilian declaration had selected Alternative A with a 30 calendar day waiting period. After commencement of the Chapter 15 case the Brazilian Court extended the Waiting Period
- Brazil’s Article 54(2) Declaration: all remedies available to the creditor under any provision of this Convention and the Protocol may be exercised only with the authorization of the Judiciary
- Comity: The US Court applied the Convention and Protocol *as has been interpreted and applied in Brazil*