

The International Scene

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Mind the Gap: The Uncertain Status of Aircraft Lenders to Foreign Airlines in Chapter 11



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Following the COVID-19 pandemic, many foreign airlines with international operations relied on chapter 11 proceedings to resolve their financial distress, including Avianca, Aeromexico and LATAM. For domestic chapter 11 filers, § 1110 of the Bankruptcy Code¹ provides enhanced rights for creditors and lessors of aircraft equipment.² Section 1110 provides creditors and lessors with certainty as to when they will be able to obtain possession of the qualifying aircraft equipment or the curing of past defaults.

The European Union, U.K. and more than 80 nations globally mirror these protections by adapting the strong “Alternative A” insolvency provision of the Aircraft Protocol of the Cape Town Convention (CTC).³ However, foreign air carriers that file for protection in the U.S. do not appear to be covered by either § 1110 or the CTC.

On July 22, 2024, the Southern District of New York issued a decision suggesting that Alternative A should be enforceable in the U.S. if the airline’s primary jurisdiction gives international effect to Alternative A.⁴ This article addresses the key differences among the regimes applicable under the CTC, chapter 11 and certain domestic proceedings around the world, highlighting how to navigate this uncertain landscape.

The Legal Landscape

The CTC provides a mechanism for the international creation and registration of security interests in aircraft. Within the U.S., air carriers certified by the FAA are subject to § 1110,⁵ which operates as an exception from the Bankruptcy Code’s automatic stay, under which counterparties may not enforce their rights absent relief from a bankruptcy court.

Section 1110 provides that a debtor must agree to perform obligations under the lease (or loan agreement) and cure all past defaults within 60 days of the petition date (unless otherwise agreed) if the debtor wants to avoid repossession. As a result, a debtor or trustee must decide quickly whether the leased asset or collateral is a net asset or net liability to the estate. After the end of the 60-day period, the debtor can still reject the leased asset or collateral, but this is unlikely in practice because the debtor’s agreement to perform under the lease (or loan) qualifies as a post-petition obligation and has administrative-expense priority that would have to be paid for the debtor to emerge from a chapter 11 case.

Outside of the U.S., § 1110 does not apply and the CTC is relevant. The CTC enables contracting states to elect two alternative routes for aircraft creditors in a bankruptcy scenario. Alternative A, which is modeled on § 1110, provides that a debtor must agree to perform obligations under the lease (or loan) and cure all past defaults within a designated waiting period, which is usually 60 days. Alternative B gives the bankruptcy court discretion on whether or not to permit enforcement of creditors’ rights.

The U.S. has not elected to apply Alternative A or Alternative B⁶ because § 1110 already includes the desired protections available under Alternative A. However, most other contracting states, including the EU and U.K., have elected to apply Alternative A with respect to creditors’ and lessors’ rights in bankruptcy.

The Court Decision in SAS

While § 1110 specifically protects aircraft creditors by requiring the debtor to agree to perform obligations under the lease (or loan) and cure past defaults, the scope of § 1110 does not include non-U.S. air carriers and is limited to FAA-certificated domestic air carriers only. Because the U.S. has not adopted Alternative A, the relevant choice-of-law rules and applicability of Alternative A in a chapter 11 case of a non-U.S. carrier have been untested in the U.S. courts for many years.

¹ 11 U.S.C. § 1110.

² Section 1110 applies only to chapter 11 cases of U.S. carriers because the scope of § 1110 is expressly limited to aircraft equipment that is subject to security interest granted by a debtor that holds an air carrier operating certificate issued by the U.S. Federal Aviation Administration (FAA) pursuant to chapter 447 of title 49. See 11 U.S.C. § 1110(a)(3)(A).

³ The Convention on International Interests in Mobile Equipment (the “Convention”) and its related Protocol on Matters Specific to Aircraft Equipment (the “Aircraft Protocol”), dated Nov. 16, 2001, available at unidroit.org/instruments/security-interests/cape-town-convention. The Convention, together with the Aircraft Protocol, are referred to as the “CTC.”

⁴ *In re SAS AB*, Case No. 22-10925 (Bankr. S.D.N.Y. July 22, 2024), available at www.nysb.uscourts.gov/sites/default/files/opinions/312818_2877_opinion.pdf (unless otherwise specified, all links in this article were last visited on Sept. 27, 2024).

⁵ See 11 U.S.C. § 1110(a)(3)(A). As previously mentioned, this section limits the scope of application to aircraft equipment that is subject to security interest granted by a debtor that holds an air carrier operating certificate issued by the FAA pursuant to chapter 447.

⁶ See “Declarations Lodged by the United States of America Under the Aircraft Protocol at the Time of the Deposit of Its Instrument of Ratification,” Int’l Inst. for the Unification of Private Law (UNIDROIT), available at unidroit.org/instruments/security-interests/aircraft-protocol/states-parties/d-united-states-of-america.

However, on July 22, 2024, the U.S. Bankruptcy Court for the Southern District of New York, in a decision delivered by Hon. **Michael E. Wiles**,⁷ suggested that Alternative A should be enforceable in a U.S. bankruptcy case if the debtor's primary insolvency forum gives international effect to Alternative A. Scandinavian Airlines (SAS) and its affiliated companies filed for chapter 11 in 2022.

The company is headquartered in Sweden, which is a party to the CTC, but Sweden has not made a declaration to give international effect to Alternative A. Instead, Sweden adopted Alternative A only for the purposes of its domestic law. When SAS filed for chapter 11 in the U.S., the company leased two aircraft from CAVIC Aviation Leasing (Ireland) Co., Designated Activity Company.

During the case, SAS and CAVIC Aviation Leasing agreed to allow SAS to continue operating the aircraft for an extended period, without agreeing about whether Alternative A applied. Before the expiration of the agreed extension period, SAS rejected the leases and returned the aircraft to CAVIC. CAVIC then filed claims asking the court to treat the accumulated rent as being subject to Alternative A, which would require full payment.

The court held that CAVIC was not entitled to full payment for several reasons, including the inapplicability of Alternative A. Specifically, the court stated that "Article XI of the Protocol (which includes Alternative A) 'applies only where a Contracting State that is the primary insolvency jurisdiction has made a declaration pursuant to' certain other provisions of the Convention." Since Sweden has never made such a declaration, the court rejected CAVIC's argument. By negative inference, the court's refusal to apply Alternative A where the country has not made the declaration implies that Alternative A would apply in a chapter 11 case of a non-U.S. airline if the airline's primary insolvency jurisdiction has made the declaration.

Alternative A vs. § 365

If a court applies Alternative A in a chapter 11 case of a non-U.S. carrier, then aircraft creditors should be able to obtain repossession of their aircraft or the curing of past defaults within the designated waiting period (again, usually 60 days). Moreover, an airline's estate would not likely reject a leased asset or collateral after the end of the 60-day period, because any claims resulting from such a rejection would likely qualify as an administrative expense claim.

However, if a court refuses to apply Alternative A, a lessor will be subject to § 365 of the Bankruptcy Code, which offers less protection to the lessor and more flexibility to the debtor. Within the 60-day period, the debtor need not make a commitment to perform, nor is it required to cure all past defaults. Section 365(d)(5) only mandates that the debtor pay contract rent after 60 days if it remains in possession of the aircraft without rejecting the lease. Cure of defaults can be postponed until the lease is assumed, and the debtor keeps alive the option to reject after day 60. Therefore, as previously discussed, the applicability of Alternative A in a bankruptcy case of a non-U.S. airline in U.S. bankruptcy courts is critical.

Declaration to Give International Effect to Alternative A

According to the information available on UNIDROIT's website, Sweden has made only two declarations relating to the CTC: "The Kingdom of Sweden declares that it will apply Article XII," and "The Kingdom of Sweden declares that it will apply Article XIII."⁸ There is no declaration to apply Article XI of the Aircraft Protocol or Alternative A that is contained in it. Therefore, Sweden's implementation of Alternative A was not sufficient to enable Alternative A to apply in the chapter 11 case of SAS, which had a primary insolvency jurisdiction in Sweden.

Unlike Sweden, many other states have made the required declaration to enforce international application of Alternative A. For example, the Republic of Kazakhstan declared that "it will apply Article XI, Alternative A in its entirety to all types of insolvency proceedings and that the waiting period for the purposes of Article XI(3) shall be sixty (60) calendar days." Such declaration is contained in the ratification law of the Republic of Kazakhstan relating to the CTC and has been officially lodged with UNIDROIT.⁹

Other countries in Central Asia (such as Uzbekistan,¹⁰ Tajikistan¹¹ and Kyrgyzstan¹²) have made similar declarations. Because these declarations specifically include Alternative A and Article XI of the Aircraft Protocol, and because they were officially lodged with UNIDROIT,¹³ these provisions give international effect to the Alternative A insolvency election.

Going forward, it will be critical to understand the status of the CTC adoption and insolvency selection made by the contracting states under the CTC. Moreover, the reasoning as articulated by Judge Wiles indicates that it also will be important to analyze the status of various declarations made by the contracting states as relating to the CTC and Aircraft Protocol.

Conclusion

Although SAS does not analyze or resolve this question directly, it suggests that Alternative A should be enforceable in the U.S. if the debtor's primary insolvency jurisdiction has made the necessary declaration under Article XI of the Aircraft Protocol. Insolvency professionals must consider, in detail, whether and how the relevant contracting state has implemented the CTC, and whether there is uncertainty with respect to declarations made by that state. Going forward, practitioners should give the entire SAS decision careful consideration when enforcing the CTC against a non-U.S. debtor where rent and other amounts payable under the lease (or loan) are material to the bankruptcy case. **abi**

8 See "Declarations by the Kingdom of Sweden Under the Aircraft Protocol at the Time of the Deposit of Its Instrument of Accession," UNIDROIT, available at unidroit.org/instruments/security-interests/aircraft-protocol/states-parties/d-sweden.

9 See "Subsequent Declarations Lodged by the Republic of Kazakhstan Under the Cape Town Convention," UNIDROIT (Nov. 16, 2012), available at unidroit.org/instruments/security-interests/cape-town-convention/states-parties/d-kazakhstan-ct.

10 See "Declarations Lodged by the Republic of Uzbekistan Under the Cape Town Convention at the Time of the Deposit of Its Instrument of Accession in Respect Thereof," UNIDROIT, available at unidroit.org/instruments/security-interests/cape-town-convention/states-parties/d-uzbekistan-ct.

11 See "Declarations Lodged by the Republic of Tajikistan Under the Aircraft Protocol at the Time of the Deposit of Its Instrument of Accession," UNIDROIT, available at unidroit.org/instruments/security-interests/aircraft-protocol/states-parties/d-tajikistan.

12 See "Declarations Lodged by the Kyrgyz Republic Under the Aircraft Protocol at the Time of the Deposit of Its Instrument of Ratification," UNIDROIT, available at unidroit.org/instruments/security-interests/aircraft-protocol/states-parties/d-kyrgyz.

13 UNIDROIT is the official repository of all declarations made by contracting states regarding the CTC and Aircraft Protocol.

7 *In re SAS AB*, Case No. 22-10925 (Bankr. S.D.N.Y. July 22, 2024).