NOTE TO USERS

Strategic Implications of Bankruptcy for Airlines

by

Aster van de Velden

Institute of Air and Space Law
McGill University, Montreal
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Acknowledgments/Prologue

" *Sometimes a scream is better than a thesis.*"---Ralph Waldo Emerson

"First comes thought; then organization of that thought, into ideas and plans; then transformation of those plans into reality. The beginning, asyou will observe, is in your imagination." ----Napoleon Hill

It is a Dutch tradition and similarly, I believe I owe it to you, reader of this thesis, as an introduction, to describe shortly what can only be called a long voyage and personal struggle towards the 'lift off' and 'touch down' of this thesis.

During and after my year at the Air and Space law Institute of McGill University, as any other LL.M. student, I was looking for that " One Perfect Thesis Topic". My great mission and concern was that it had to be of some 'additional and meaningful value'. My devotion to applying the highest standard is complete.

However, had I known the challenges around the corner. Whereas every difficulty finally presents a stepping stone to a success, it first takes faith, courage and belief. My faith has been tested severely with all of the challenges I have had to deal with the last years. Surely, I cannot but thank God and also express my gratitude to many of his wonderful human angels encouraging me to continue.

Reader, please know that I am finishing this thesis with mixed emotions. First with a feeling of being blessed with the opportunity but then "perseverance" is a word with multi-dimensionality. Significantly, I have learned a lot. Not only in theory but also in practice.

The topic of this particular thesis is chosen purposefully. I was fortunate to have the beautiful experience and challenge of a New York internship; a lot of hard work but definitely a lifetime event! My NY law firm had its 10-year anniversary celebration so we had a dinner party in Windows of the World (WTC). How I enjoyed the privilege of being in New York.

But then September the 11th . . . the devastation, shock, horror and the questions . .

Obviously, as a graduate student in air and space law, I particularly felt the obligation as well as pressure to use my academic voice. While working in New York, I acquainted myself with Bankruptcy Law, which, very much to my own surprise, I found very interesting. To me, bankruptcy law appeared as an important social, legal and economic forum with many intriguing aspects. The multi-disciplinary and international context. . .

All too coincidentally, worldwide 'Airline Bailouts and Bankruptcies' triggered my writing senses and a thesis topic was born!

However, I soon came to note my journey had only started:

1. If you think of something new, it's been done.
2. If you think something is important, no one else will.
3. If you throw it away, someone else will publish it, obtain a grant, write a book, and get on the Oprah Winfrey show.
4. No theory will answer the important questions.
   Corollary: All theories are irrelevant.
5. When you think you have discovered the real problem, you have not.
   Corollary: When you are sure it is not important, it is.
6. Your study will only make sense as long as your research question is hazy.
7. The more you enjoy your research, the less data there is to support it.

--Murphy's law on research.

Research took place both at IASL in Montreal, in New York, Leiden and Amsterdam. With the help and support of many lawyers, fellow students and associates around me. With an opened mind & heart I very proudly present this thesis in gratitude for the infinite patience, love, belief, support and goodwill of all around me.

Aster van de Velden

Abstract

In the wake of September 11, 2001 events, most western airlines find themselves in financial difficulties. In their struggle to stay in the sky, many airlines look for pro-active tools and fitting strategies. The primary focus of this thesis is to discuss the unique characters of the airline business, particularly, within the context of US bankruptcy reorganization law (Chapter 11). After identifying primary competing interests in this perspective, the hypothesis explored is that Chapter 11 bankruptcy reorganization provides a forum that may uniquely address any of the specific needs of the different key players, if invoked strategically. The corporate strategy of "facilitated survival" as provided for within the context of US bankruptcy law is definitely worthwhile for the airline industry to take note of.

Résumé

A la suite des évènements du 11 septembre 2001, la plupart des compagnies aériennes occidentales se sont trouvées en proie à des difficultés financières. En luttant pour leur survie, plusieurs compagnies aériennes cherchent des instruments pro-actifs ainsi que des stratégies adéquates. Le sujet central de ce mémoire consiste à discuter le caractère unique de l'industrie aérienne, et en particulier dans le contexte de la législation américaine sur la réorganisation du redressement judiciaire (chapitre 11). Après avoir identifié les intérêts primaires compétitifs dans cette perspective, on explore l'hypothèse selon laquelle le chapitre 11 relatif à la réorganisation judiciaire fournit un forum susceptible de satisfaire de manière unique les besoins spécifiques des différents acteurs concernés, si il est invoqué de façon stratégique. La stratégie des entreprises de la « survie facilitée », telle que mentionnée au sein de la législation américaine sur le redressement judiciaire mérite à coup sûr d'être prise en considération par l'industrie aérienne.

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Introduction

1. *Strategic Implications of Bankruptcy for Airlines* [1]

"This is not just about restructuring our balance sheet –this is about restructuring our operational costs, including labour and fleet; restructuring commercially to better meet the needs of our customers and restructuring the corporation to better focus on the development of stand-alone businesses. The business model is broken and it must be fixed without burning any more furniture...we need to embrace a culture change and a new way of doing business..." [2]

This thesis primarily focuses on the unique legal status of the airline business, particularly within the US. [3]

In addition to the human tragedy caused by the terrorist attacks on New York, the World Trade Centre and Washington, the Pentagon, the events of September 11, 2001 bogged down the airlines worldwide: added burdens have been the cyclical economic downturn, the war in Afghanistan in 2002, and recently, the war in Iraq and the SARS-epidemics. Airlines are in need of help, having to face the deep impact of these conditions on operations and profits.

This thesis will propose that while government aid or insurance recoveries may suffice for some, affected airline businesses may and are currently looking for new strategies and fitting solutions beyond. [4]

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[1] Terminology: in this thesis both the words bankruptcy and insolvency should be understood and read as meaning exactly the same legal venue.

[2] Air Canada to restructure under CCAA in order to facilitate its operational, commercial, financial and corporate restructuring. Said by Milton of Air Canada.

[3] For any source or reference I may have forgotten to acknowledge, I herewith implement such source or reference without having meant to exclude such. This source or reference should consequently be taken into full account and be awarded full recognition as source of information and inspiration.

[4] Similarly, the arguments against airline reorganizations are plenty. Firstly, it is argued that historically most airline reorganizations eventually did result in liquidation. Secondly, the phenomenon of ' continued operations' will then often wasted assets that creditors would have received in immediate liquidations. Further, debtor carriers' below-cost fares, made possible by the Chapter 11 protection, will have forced the financially healthy carriers to lower their fares on competing routes; See article "note & comment: flying at risk: how should bankruptcy interact with aviation safety enforcement? 1996, at 855 under paragraph D and further, by K.A. Clark, , Bankruptcy Developments Journal, 12 Bank. Dev. J. 845,: "*...The only apparently successful bankruptcy reorganization of a major airline in recent years has been that of American West*

The main objective of this thesis will be to flag various legal issues with respect to bankruptcy reorganization of airlines.

This particular legal forum offers the airline a unique status with accordingly its benefits, but it definitely poses some specific thresholds as well. Whereas the airline industry incontestably consists of mostly multinational ventures, this thesis also places the subject of airline bankruptcy in its own unique global context. Because of the certainty of future airline bankruptcies, airline debtors, airline creditors, labour unions, aircraft lessors and the general public should be familiar with the malleable US bankruptcy law.

Its specific malleability is uniquely to the US because the bankruptcy court determines whether reorganization shall be the most effective tool in the particular circumstances of the case by evaluating the particular situation against the criterion of whether "*debtors should continue in control of their businesses under the umbrella of the reorganization court, however not beyond the point at which reorganization no longer remains a realistic undertaking.*" [5]

It should be noted that this thesis' hypothesis is primarily explored from the perspective of the airline's strategic survival, so that US bankruptcy reorganization will be discussed against the backdrop of the special needs of the airlines. However, due to its malleability, Chapter 11 may also be the appropriate

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Airlines. Both Pan American World Airways and Eastern Air Lines were liquidated in the early 1990s after extended periods of unprofitable operations in bankruptcy...' '...While Continental Airlines and TWA each have emerged from chapter 11, neither has yet been able to sustain profitable operations. The ultimate survival of each remains in question. Many financially-distressed smaller carriers have also disappeared while in bankruptcy. A typical example is Wright Air Lines, which continued to operate between Cleveland and Detroit while in chapter 11. The Wright court examined the firm's continuing cash losses, limited prospects for cost savings, inability to finance cash-generating expansion, and the ineffectiveness of its management. Concluding that the case was hopeless, the court ordered Wright's bankruptcy converted to chapter 7. Accordingly, bankruptcy's most valuable role in an airline failure may be to facilitate a timely and orderly liquidation and distribution of the carrier's assets..."' and from article "Will Fallen Global Carriers Rise again?" article by F. Barbetta and T. Marson, at http://www.phoneplusinternational.com/articles/2b1Cover.html (last checked October 24, 2003); Also, article Airline Bankruptcy Virus Must Be Stopped, Aviation Week and Space Technology, May 3, 1993, at 66.

[5] In re Wright Air Lines, Inc., 51 B.R. 96 (Bankr. N.D. Ohio 1985)

venue for other key player like equipment financiers and employees, when purposefully and creatively called upon. [6]

2. The Premises of Bankruptcy

The problem of enterprises in financial difficulties is a persistent ailment in our present economy. While significant costs remain attached to bankruptcy, presently bankruptcy or reorganization law is held to offer unique benefits to businesses. It may even have some strategic implications. In any case, it is no longer viewed as a mere passive response to unfavourable market conditions. In the US, bankruptcy no longer is used as 'a last resort option'. Once US corporations tried desperately to avoid bankruptcy for it was considered as a sure sign of failure in a success-driven society. Now, however, by a remarkable shift, bankruptcy is considered as an actual tool of survival, creating a 'breathing spell' from liabilities. As a point of departure, this thesis addresses the background, workings of the bankruptcy law forum.

3. Corporate Remedy and Strategy?

US Chapter 11 bankruptcy reorganization should be understood from the point of view that it may offer a number of unique benefits to the airlines, including the automatic stay (section 362) which prevents creditors subject to the US court's jurisdiction from taking action against the airline debtor; the ability of the airline debtor to obtain financing during the bankruptcy proceedings on relatively favourable terms; the ability to force vendors to continue performing as long as they are paid for services rendered during the reorganization; opportunity to reject

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[6] I refer to section 1110 (equipment lease) and section 1113 (collective bargaining agreements); Despite its restrictions, section 1113 continues to allow airline debtors some leverage so as to at least modify existing labor contracts. Such decision can no longer be made unilaterally, however. Namely, under present law; in order for management to reject a collective bargaining agreement, some procedural requirements and standards must first be met. The defaulting airline must now first bargain with the union prior to modifying or rejecting any agreement. As a first requirement, management may only propose to the labor union representatives those modifications in employee benefits that are absolutely necessary in order to permit reorganization, i.e. a labor contract can in essence, only be changed if the debtor can show the court that the action is necessary to save the company from going out of business. [6] Then, the labor unions may not refuse the proposal 'without good cause'. The courts generally use the so-called "nine point test" in determining whether a rejection should be supported.

or assume executory contracts or leases (implications of applicability of section 365). [7]

How and why 'the remedy' of Chapter 11 Bankruptcy may "work" shall be explored. The most important characteristics of Chapter 11 are discussed. This chapter places US bankruptcy reorganization law and forum in the airline industry's own specific contextual place. To this end, the unique aspects of the airline business shall be introduced. '*...The US bankruptcy courts have shown a great ability over the years to jump from one industry to the next, hour-to-hour, day-to-day, and very competently address the problems of an industry; the airline industry is a business that has added burdens and responsibilities with it....*' 8

The airline industry is a highly cyclical industry. Many airlines barely are surviving in the present global competitive environment. In this view, the historical vulnerability of airlines to changes or downturns of any kind shall be mirrored against the current state of the industry.

Avoiding liabilities, shifting risk and financial burdens; forum shopping, strategic sale of (part of) the company.... this thesis will discuss whether Chapter 11 indeed keeps its promise of providing "a breathing spell during turbulent times". Additionally, discussed shall be whether the bankruptcy reorganization forum indeed offers the –unparalleled- opportunity to restructure operations, balance sheets and raise new capital"?

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[7] For instance, only where a debtor complies with the requirements of 11 U.S.C.S. § 1110 is it entitled to retain an aircraft and move to assume the lease under 11 U.S.C.S. § 365 of the Bankruptcy Code. *..Six months after we last explored the overall state of the airline industry, things have only gone from bad to worse. Most carriers are holding junk credit ratings, one has filed for bankruptcy protection and another may be unable to avoid it. The losses are getting narrower, but they're still there. Analysts expect most carriers to report a loss for fiscal-year 2002 and 2003. ...if there is any good that has come from the industry carnage of the past two years, it is that executives finally acknowledge that theirs is a fundamentally flawed business model and that they cannot continue as is. Judging from some of the steps being taken now, they won't continue as is for much longer..*" From: article "One Year Later No End To The Turbulence For Airlines" by Lisa DiCarlo, 09.11.02, www.forbes.com, checked October, 24, 2003 latest.

[8] See article "American bankruptcy institute the healthcare industry bankruptcy workouts forum" in American Bankruptcy Institute Law Review, Spring, 2000

4. Resolution of Liabilities, Interplay and Competition: Bankruptcy Provisions of Specific Interest and Benefit to Airlines

Historically, the United States Bankruptcy Code virtually gives the airline industry its own specific status. With reference to the previous chapter, filing chapter 11 may be strategically attractive for an airline. Nevertheless it may also be controversial since a variety of competing interests accompany bankruptcy reorganization. Each of these specific interests naturally tries to shape the law in its own favour or at least to be elevated at the expense of another. The US legal framework therefore especially aims to balance some competing interests in several specific provisions of the Bankruptcy Code. Competing interests surrounding the airline debtor particularly involve the government or general public (i.e. environment, safety), the airline competitors, the travelling public, airline vendors, financers and airline employees (labour unions). In this view, several provisions deserve specific attention. Firstly, of direct direct concern to the airlines is section 1113. This provision regulates the status of collective bargaining agreements and offers the debtor airline the possibility to resolve one of the core liabilities: labour cost. Secondly, the interplay between bankruptcy reorganization and several other particular aviation related subjects shall be addressed (i.e. whether airport slots and operating licenses are assets in the airline debtor's estate).

5. Aircraft Equipment

Additionally, as the airline hardly ever owns its aircraft (equipment) outright, also applicability of section 1110 is of particular interest. Pursuant to this provision, under certain strict conditions, aircraft equipment lessors may repossess despite (the to the airline debtor attractive) applicability of the automatic stay.

At all times, the airlines are exposed to unique risks, which should be properly and timely identified, recognized and tackled especially in the context of bankruptcy reorganization being utilized as a (strategic) business tool.

6. Multi-Nationality of the Airlines: The Phenomenon of International Reorganization

Following the previous chapters, another characteristic of the airline industry, which is not yet addressed, is that the airlines operate in a globally highly competitive industry, having ties and connections to many different jurisdictions. The market place is evolving, becoming ever more 'global' or inter-connected, resulting in the creation of a 'new' phenomenon: the phenomenon of 'international or multinational or cross-border insolvency'. Legal chaos and uncertainty definitely exists in this context, which should be mitigated and controlled. Critical to understanding the strategy of filing Chapter 11, is that in the US, parties are able, where appropriate, to assert that the Bankruptcy Court applies its jurisdiction extra-territorially and issue appropriate orders to facilitate a reorganization effort even outside the US. Consequently, non-US creditors and shareholders may be subject to the jurisdiction of the US courts. [9] In what follows, various theories of extra-territorial application of law are explored.

7. Conclusion: Final Considerations

The airlines find themselves in dire straits. While struggling to keep *'a flight'*, this thesis explored the hypothesis that Chapter 11 bankruptcy reorganization is a forum that uniquely addresses the specific needs of key players within an industry that is consistently bogged down. In this view, the bankruptcy reorganization provisions may be availed of by the airlines with full purpose and intent.

It shall be concluded that the bankruptcy reorganization forum as provided in Chapter 11 is flexible, adaptable and may appropriately and strategically "work for" different key players in the airline industry, amongst which particularly the airlines, its equipment financers, employees or international subsidiaries, affiliates or counterparts. When the strategy is facilitated survival and a restructured solid presence in the economic big level international playing field, Chapter 11

[9] This will be addressed more fully in the Chapter on International Bankruptcy, however.

provides the airlines with an impressive operating procedure, which can be shaped to meet the many demands that are particular to the industry.

CHAPTER 1

The Premises of Bankruptcy

1. Introduction

The problem of enterprises in financial difficulties is a persistent ailment in our present economy. While significant costs remain attached to bankruptcy, presently bankruptcy or reorganization law is held to offer unique benefits to businesses. It may even have some strategic implications. In any case, it is no longer viewed as a mere passive response to unfavourable market conditions. In the US, bankruptcy no longer is used as 'a last resort option'. Once US corporations tried desperately to avoid bankruptcy for it was considered as a sure sign of failure in a success-driven society. Now, however, by a remarkable shift, bankruptcy is considered as an actual tool of survival, creating a 'breathing spell' from liabilities. As a point of departure, this first chapter will address the background of bankruptcy law.

'...Reorganizations can be compared to an operation on a living being....while '...every other type of litigation is the application of an "autopsy", more specifically the determining of the rights and wrongs of transactions in the past...'[10]

"...It is important that our valued passengers and other constituents understand that US Airways is not going out of business. Chapter 11 gives us time to renegotiate contracts with key aircraft lessors and financiers and return aircraft no longer needed. Every ticket will be honored and accepted...throughout the restructuring period and beyond.... We will now focus our energies on utilizing the Chapter 11 process to return US Airways to a profitable and highly competitive company. US Airways has long been an integral member of the cities and towns in which we live and work –as an employer, customer and a service provider. Our ability to complete our reorganization is too important to too many people and we intend to remain a viable competitor for many years to come..." [11]

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[10] Fall, 2001 17 Conn. J. Int'l L. 99, "global development: the transnational insolvency project of the American law institute" by Jay Lawrence Westbrook, at 101, citing Canadian Justice James Farley

[11] US Airways Reorganization, press release Friday, December 27th. 2002; see also James T. McKenna, *Crandall Blasts U.S. Policies that Bolster Failing Carriers*, see also "Airline Bankruptcy Virus Must Be Stopped", May 3, 1993, "*Bankruptcy laws as applied today keep failed carriers operating well beyond the*

8. The Evolution

The United States Bankruptcy Code virtually gives the airline industry a specific status since the bankruptcy code aims to resolve some of the most common concerns in the context of potential default of an airline. Among these are: section 1113 (labour costs) and section 1110 (aircraft equipment leases). These provisions shall be discussed in more detail in the next chapters.

As facilitated by the bankruptcy code, bankruptcy no longer is a mere passive response to unfavourable market conditions. Significantly, in the US, bankruptcy no longer is 'the last resort option'. Many remarks may randomly be selected from when US bankruptcy is the topic of discussion. [12]

Uniquely to the US, Chapter 11 especially facilitates specific industries such as the airlines by providing them with an operating procedure that may only be availed of by qualifying as a specific entity at law. The focus of this chapter shall firstly be to illustrate the Chapter 11 procedure from the airline's perspective. Also, some of the strategic implications of this operating procedure as provided under Chapter 11 shall be discussed.

9. The Main Concerns

As key objective and correlating concern for an airline operating during bankruptcy reorganization, is to re-evaluate, re-negotiate and restructure its

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end [sic] of their natural economic lives,' as said by Crandall Id. (quoting Robert L.Crandall, president of American Airlines).

[12] Delaware Lawyer, September 1997 issue '*Bankruptcy allows an otherwise strong company to survive short term cash shortages, outliving economic downturns; it determines the fate of the financially troubled firm and allocates who gets what when there are not enough assets to go around...*' citing an unidentified official of Texas Air Corporation 'Chapter 11 bankruptcy one of the top ten business trends' of the year.' Business Week Magazine, January 20, 1986 *'Bankruptcy court is becoming a court of first resort rather than last.'* M. Klein, bankruptcy attorney *'The agreement will be part of a package filed under Chapter 11 of the US bankruptcy code that will give the company "a fresh start and a solid balance sheet".* S. Warsaw, president and chief executive officer of Chiquita Brands International Inc. "*The airline industry goes through a painful, almost cathartic period and in the end airlines will emerge leaner and profitable. The Bankruptcy Forum facilitates the change of an airline's structure while allowing the industry to function. Where deregulation has failed, bankruptcy has adequately filled the gap; it has kept some airlines flying and sold off the effective parts of airlines that could not stay afloat. ....."'* from Delaware Lawyer, September 1997 issue' *' I am confident that we can restore profitability and re-establish United Airlines as the world's premier global carrier....after the bankruptcy filing.; Our best days are ahead of us..* CEO Glenn Tilton, United Airlines, December 9, 2002, Newsweek Web Exclusive

business and at the same time to retain most of its capital assets against both competitive and attractively updated conditions, which are necessary to conduct cash flow-generating operations.

In this perspective, it is firstly helpful, however, to generally understand the interrelation between airlines and bankruptcy, the (turbulent) state of the airline industry, the general background and workings of a chapter 11 reorganization procedure.[13]

10. Interrelation Between Bankruptcy and Airline Industry

A constellation of factors rather than any one specific factor, has given rise to the increase in the number of airline bankruptcies. [14] Firstly, in the US in general, revenue and profitability was constrained in the airline industry by high levels of competition caused by the deregulation of the industry by US government in the late 1970s. This intensification and increase in competition led to so-called 'roll-up transactions', which involved acquisitions or mergers, whereby the airlines attempted to get bigger in order to achieve the economic and business advantages of economies of scale. [15]

However, as another side of the coin, the initial logicality of these kinds of transactions was quickly replaced with random despair due to consequential 'code red balance sheets'. In this regard, airlines, being a highly capital intensive

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[13] Will Fallen Global Carriers Rise Again? article by F. Barbetta and T. Marson, at http://www.phoneplusinternational.com/articles/2b1Cover.html (last checked October 24, 2003)

[14] *".....Bankruptcy is viewed as an increasing sign price deflation has taken hold in an industry suffering from massive debt and over-capacity, and an inability to raise prices across the board...Probe Research Inc. suggests that the scene is characterized by the following conditions: Transport prices so low that most carriers cannot even cover operating expenses, much less achieve returns on capital; Networks operating at very low utilization rates; Widespread entry into the carrier sector led every new entrant, in an effort to gain market share to lower prices even further.....-Without a major spike in customer spending and/or sharp economic recovery, revenue may be difficult to grow, so the carrier sector faces three choices. Firstly, to sharply cut operating expenses. Secondly, to slash budgets or thirdly to declare bankruptcy....'* From: United Airlines Briefing, available at: http://www.ual.com/ual/asset/customer_brochure_120902.pdf

[15] Paul S. Dempsey, Paul S. Dempsey, Turbulence in the "Open Skies": The Deregulation of International Air Transport, 15 TRANSP. L.J. 305, 310, 1987; see also Paul Dempsey & Andrew Goetz, "Airline Deregulation and Laissez-Faire Mythology", Quorum, 1992; David Graham & Daniel Kaplan, "Competition and the Airlines: An Evaluation of Deregulation", CAB, December,

business, became highly vulnerable to any additional burden and adversity. For many airlines September 11th presented the trigger worldwide. If not for the recent wars in Afghanistan and Iraq, together with the SARS-epidemics that particularly added to the already devastating impact of September 11 to the airlines.

As observed in its year 2002 report the American Air Transport Association (ATA):[16]

"...Air traffic growth falters, aircraft are parked or retired, aircraft orders are reduced, break-even load factors (the point at which costs are met and profits can begin) have increased up to 77%; passenger revenues are down, air cargo volumes are trailing, and insurance costs have tripled since the first quarter of 2001..."

In conclusion, airlines are facing turbulent times causing a dramatic drop in the cash flows, operations and profits all of which are required to service the already alarming liabilities after the period of deregulation and economies of scale. [17]

1982, and also U.S. Airlines: The Road to Resuscitation; and also "State of the US Airline Industry, ATA, 2002; a report on recent trends for US Air Carriers"; at page 2 and following.

[16] The ATA expects the net loss for 2001-2003 to nearly equal the net profit for 1995-2000, with a net loss of $ 18 billion for 2001-2002, and a loss of $ 7 billion in 2002, only mitigated by the compensations under the Air Transportation Safety and System Stabilization Act; Carol B. Hallett, State of the U.S. Airline Industry: A Report on Recent Trends for United States Carriers (Mar. 11, 2002), at htttp://www.airlines.org/pubic/news/pda.asp?nid=5228; and John Heimlich, U.S. Airlines: The Road to Resuscitation, at 3 (Feb. 6, 2003), available at http://www.air-transport.org/public/industry/bin/Econ102.pdf.; See also the illustrative graphics in "State of the US Airline Industry, ATA, 2002; a report on recent trends for US Air Carriers"; at page 2 and following.

[17] As the ATA report also says: "*...that the combined impact of the 2001 economic downturn and the steep decline in air travel after September 11 have resulted in devastating losses for the airline industry...*": Also see generally Richard Lieb & Robert Feinstein, LBO Litigation, Financial Projections and the Chapter 11 Plan Process, 21 SETON HALL L. REV. 598, 599 (1991) (noting that bankruptcy filings increased dramatically in 1990's because businesses effected leveraged buy outs which dramatically amplified their debt); ee Richard Lieb & Robert Feinstein, LBO Litigation, Financial Projections and the Chapter 11 Plan Process, 21 SETON HALL L. REV. 598, 599 (1991) (noting that bankruptcy filings increased dramatically in 1990's because businesses effected leveraged buy outs which dramatically amplified their debt); also Thomas A. Smith, The Passion of Professor Fischel: Defending Milken's Financial Revolution Law and Social Inquiry, 22 L. & SOC. INQUIRY 1041, 1043-45 (1997) (noting that while hostile takeovers and leveraged buyouts restructure American businesses by producing more concentrated equity, they also produce more debt). Both hostile takeovers and leveraged buy-outs leave businesses in poor equity positions; Lieb & Feinstein, at 599 recognizing relationship between rise in leveraged buy-outs and increased bankruptcy filings.

11. The History of Airline Bankruptcy

The current state of the industry shall be mirrored against the historical vulnerability of airlines to changes or downturns of any kind.

The number of Chapter 11 bankruptcy proceedings rose steadily in the 1980's, from 6,700 Chapter 11 filings nation wide in 1980 to nearly 21,000 in 1990. [18] The major recession in 1990 exponentially increased the number of so-called 'mega-filings'. As T.L. Ambro describes: "*...Already at that time, airlines like Continental Airlines and TWA, could not survive absent reorganization..*". [19]

Whereas these airlines typically have faced the prospects and experience of bankruptcy reorganization under Chapter 11, cases are also very recent. [20] One may only refer to United Airlines, US Airways, American Airlines, Sabena Airlines and Hawaiian Airlines.

12. Understanding the Importance

Concurrent to the number and frequency of airline bankruptcies, bankruptcy is increasingly viewed and called upon as a business tool rather than an end to business. Additionally, taking into account the likelihood of future airline bankruptcies, it is, increasingly important and interesting for parties involved so as to become familiar with the different prospects under US bankruptcy chapter 11.

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[18] Sources: Bankruptcydata.com, *USA TODAY research*

[19] Airline Bankruptcy Virus Must Be Stopped, AVIATION WEEK AND SPACE TECHNOLOGY, May 3, 1993, at 66, see also article "Why Delaware?" by Thomas L. Ambro and Mark D. Collins, Richards, Layton & Finger (this article is an adaptation of an article printed in the September 1997 issue of Delaware Lawyer)

[20] Airline Bankruptcy Virus Must Be Stopped, AVIATION WEEK AND SPACE TECHNOLOGY, May 3, 1993, at 66; see also INFORMATIONAL BRIEF OF UNITED AIR LINES, INC."...By 1992, the industry had suffered more than 150bankruptcies, witnessed 50 mergers and, in the process, had "lost all the profit it had made since the Wright Brothers flight at Kitty Hawk, plus $1.5 billion more.." at page 19 and following

1. UAL Corp' s United Airlines; starting 9/12/2002 with assets $22,800,000,000
2. US Airways, Inc.; starting 11/8/2002 with assets of $ 8,025,000,000
3. Continental Airlines Holdings; starting 3/12/1990 till April 1993 with assets of $ 7,656,140,000
4. Eastern Airlines Inc: 9/3/1989 till December 1994 with assets of $4,037,000,000
5. Pan Am: 8/1/1991 till December 1991 as well as February 1998 till June 1998 with assets of $ 2,440,830,000
6. America West: June 1991-Aug. 1994
7. TransWorld /Airlines 10/1/2001 with assets of $2,137,180,000
8. America West Airlines 27/6/1991 with assets of $1,165,260,000

It should, however, be stressed, that within the US the public interest pressures related to airline bankruptcies remain enormous. This specifically pertains to legislative dispositions and judicial interpretations bearing upon the airline industry. The consequences, which may either be positive or negative for the airlines, are in any case not to be ruled out. Typically, this may be explained from the fact that when an airline struggles, concerns of safety remain, also thousands of employees may potentially be affected, which in turn may affect the cities in which they live and work. Consequently, within the US, pressure is placed on congressional, judicial and other governmental representatives to keep the airline operating (allegedly against all cost sometimes).

9. Resorts International 12/11/1989 with assets of $1,034,580,000

CHAPTER 2 – The Remedy

The Corporate Remedy of Airline Bankruptcy Reorganization

1. Introduction

US Chapter 11 bankruptcy reorganization should be understood from the point of view that it may offer a number of unique benefits to the airlines, including the automatic stay (section 362) which prevents creditors subject to the US court's jurisdiction from taking action against the airline debtor; the ability of the airline debtor to obtain financing during the bankruptcy proceedings on relatively favourable terms; the ability to force vendors to continue performing as long as they are paid for services rendered during the reorganization; opportunity to reject or assume executory contracts or leases (implications of applicability of section 365). [21]

This chapter explores how and why 'the remedy' of Chapter 11 Bankruptcy may "work". The most important characteristics of Chapter 11 are discussed in this regard. US bankruptcy reorganization law and forum shall be explored from the airline industry's own specific multi-contextual perspective. To this end, the unique aspects of the airline business shall be introduced. '*...The US bankruptcy courts have shown a great ability over the years to jump from one industry to the next, hour-to-hour, day-to-day, and very competently address the problems of an industry; the airline industry is a business that has added burdens and responsibilities with it....*' [22]

For the airlines operate in a highly cyclical economy and a highly competitive global environment, in which they barely are surviving.

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[21] For instance, only where a debtor complies with the requirements of 11 U.S.C.S. § 1110 is it entitled to retain an aircraft and move to assume the lease under 11 U.S.C.S. § 365 of the Bankruptcy Code.

[22] American Bankruptcy Institute Law Review, *AMERICAN BANKRUPTCY INSTITUTE THE HEALTHCARE INDUSTRY BANKRUPTCY WORKOUTS FORUM*, Spring, 2000

In this view, the strategy of the airline is to be able to avoid liabilities, to suspend, avoid, eliminate or shift risks and financial burdens or to offer "a breathing spell during turbulent times". This thesis discusses to what extent Chapter 11 may indeed provide the operational structure for such strategy to be successfully employed. Chapter 11 The ultimate question therefore shall be whether and if so, to what extent the bankruptcy reorganization forum indeed offers the airline an – unparalleled- opportunity to legitimately restructure for its survival at a time that essentially indicates its exit?

1.1 The Theory of the Overflowing Bucket

Since the Bankruptcy Code requires that all not matured claims be accelerated, and that all contingent, disputed, and unliquidated claims be either renegotiated or liquidated, the filing of a chapter 11 petition may aid a company in obtaining a structured, balanced, realistic new outlook just before 'the bucket of liabilities overflows', which obviously shall be of much detriment to all involved.[23]

2. The different characteristics of Chapter 11

2.1 Good Faith Requirement

Generally, section 109 of the Bankruptcy Code establishes which entities are eligible to be a "debtor" under the Bankruptcy Code. [24] The conditions for an entity to file a petition for bankruptcy reorganization under Chapter 11 are not

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[23] The first company to achieve notoriety in 'taking advantage of' the Chapter 11 procedure', in this context, was Johns-Manville Corporation. This corporation filed a petition for reorganization under Chapter 11 on August 20, 1982. At the time of filing, the corporation's net worth exceeded $1 billion. The reason for filing for bankruptcy was however, that 16,500 lawsuits already had been filed against the company, alleging liability because of asbestos-related injuries. The company estimated that up to 52,000 lawsuits were expected to be filed, creating a potential liability of up to $2 billion. In addition, the company would be liable for unforeseen liabilities since the victims of asbestos exposure were not expected to develop any symptoms for a prolonged period of time. D. Bechara, in The Freeman, a publication of the Foundation for Economic Education, Inc., September 1986, Vol. 36, No. 9, also available at www.libertyhaven.com, last checked November 3, 2003. "*...Consequently, Amatex Corporation filed for bankruptcy protection in November, 1982, in light of the fact that it was defending itself against 10,000 lawsuits. Similarly, in August, 1985, A. H. Robins filed for bankruptcy since at the time of filing there were 5,000 lawsuits pending, and the company estimated up to 300,000 claims to be filed...*"

[24] Only those persons, who reside I n or maintain a domicile, place of business, or property in the United States, are eligible to be debtors.

great; almost any entity can file; its filing is presumed to be in "good faith". [25] The ultimate result of the reorganization, the reorganization plan, should be filed in 'good faith'. This criterion is strictly observed in that regard.

2.2 Continuing Operations

Importantly, Chapter 11 is a proceeding that allows a large and complex company, like the airline, to '*continue operations*' while in bankruptcy, managing its own affairs on a day-to-day basis. [Section 1107(a)]. [26] [27] This generally means that the airline ('s management) shall remain engaged as a so-called 'Debtor In Possession' (DIP). It should be noted, that this is indeed within some restrictions of the Bankruptcy Code, however. Namely, any 'out of the ordinary' or 'special' activities do require a special court approval. For example, for the airline DIP, such an exceptional matter could be selling its major assets (i.e. aircrafts or aircraft engine). Furthermore, after filing for chapter 11 bankruptcy reorganization, in order to be able to continue any of its operations, the DIP needs to obtain (new/additional) "interim-financing" mostly for the entire period of the reorganization procedure (which may be quite lengthy). Under section 364 of the US Bankruptcy Code, the debtor can seek approval of Bankruptcy Court to obtain such financing. This category of financing is also referred to as 'DIP financing' and is mostly provided by banks in the US such as Chase Manhattan Bank, Citibank and Bank of America. [28] Since the potential successes of a reorganization heavily depend upon the business' outlook to continue operations (during Chapter 11) (i.e. creates leverage, negotiating power and independence) throughout the proceedings "DIP financing" is well described as being a determining factor.

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[25] Strategic Bankruptcy: How Corporations and Creditors Use Chapter 11 to Their Advantage (hereafter referred to as "Book, page..." by Kevin J. Delaney, page 114; Filing a petition for bankruptcy may either be voluntary or involuntary (section 301 and 303 Bankruptcy Code); This '*good faith requirement*' in filing a Chapter 11 petition generally relates to the underlying question of whether the business, or parts thereof, is basically sound so as to justify its reorganization. Also see Book Delaney (hereinafter referred to as Book) at page 114

[26] Book, page 116

[27] Book, page 116

[28] See also, February 2003, "DIP Financing: Breathing New Life Into Ailing Companies", by James G. Connolly, Fleet Capital Corporation

2.3 Additional Financing –Interim- Bankruptcy

The Bankruptcy Code provides for two different ways to obtain additional financing. [29] The airline debtor may request an "order on cash collateral" from the court or seek that the court grant a lender a "super-priority lien" on the assets or property of the airline debtor.

'Cash collateral' may include accounts receivable, cash, negotiable instruments, documents to title, securities, deposit accounts, and also rent if pledged as security for a readily available loan or line of credit. As said, the Bankruptcy Code, however, requires the debtor to obtain court approval before it may use such cash collateral. Until the court issues this 'order for use', the airline debtor must therefore strictly segregate and account for cash collateral. Since the success or failure of bankruptcy very much depends on the debtor's access to funds to continue operations, a bankruptcy court will generally act quickly by granting an emergency hearing, however.

As a second remedy, the bankruptcy court may also grant a special security position, a so-called "super priority lien" to a lender of funds that are available to the airline, provided that the airline debtor is otherwise unable to find post-bankruptcy financing. Any lender that provides such financing will consequentially obtain liens that are 'super priority' claims that count as senior to all claims existing both before and after the date of the Chapter 11 petition. Banks are particularly induced to lend money to businesses in bankruptcy since the acquired "super priority lien" interest is in practice very effective and strong. In practice, usually, the first bank willing to lend the debtor money during bankruptcy is one that is already owed a considerable amount from previous loans to the airline. The bank obviously acts out of its own best interest as it protects its previous loans from 'super priority liens' from another entity. The business is kept afloat with additional DIP financing.

As a further condition for new financing, the bank may request a so-called 'cross-collateralization', which essentially means that assets of the airline debtor, which are obtained after bankruptcy, shall help secure any of the particular pre-bankruptcy loans, as well as the financing obtained during and after bankruptcy. [30]

2.4 Reorganization Plan

The reorganization under Chapter 11 consists of different stages. Under Chapter 11, certain types of debtors are categorized and highlighted. [31] In general, what happens during reorganization is that creditors look to the debtor's future income to satisfy their claims rather than claiming immediate satisfaction. In this view, the debtor retains control and possession over its assets and pays its creditors based upon future income.

In this respect, the reorganization plan is the very essence of a reorganization procedure; it is both the incentive and the result to all concerned. It can be roughly described as a complex contract specifying the debts owed to creditors, the terms of payment and the new structure or organization of the business of the airline

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[29] see also Press Release United Airlines; available at: http://www.ual.com/ual/asset/customer_brochure_120902.pdf

[30] US Airways utilizes third party service providers to process credit card transactions. As a result of the Chapter 11 filing, these providers have required additional cash collateral to minimize their exposure. If US Airways fails to meet certain financial or non financial covenants, these providers can (i) require additional cash collateral or additional discretionary amounts upon the occurrence of certain events; and (ii) under certain circumstances, terminate such credit card processing
agreements: Cash collateral may include accounts receivable, cash, negotiable instruments, documents to title, securities, deposit accounts, rent if they are pledged as security for a readily available loan or line of credit. The Bankruptcy Code however, requires the debtor to obtain court approval before the debtor may use such cash collateral. Until the court issues this order, the debtor must strictly segregate and account for any cash collateral. Since the success or failure of bankruptcy very much depends on the debtor's access to funds to continue operations, a bankruptcy court will act quickly by emergency hearing to hear a debtor's application for use of cash collateral. Then also a special security position, a so-called 'super priority lien' can be granted by the court to a lender that loans a debtor money during the bankruptcy if the debtor is otherwise unable to find post-bankruptcy financing. This mechanism is used to induce banks into lending money to businesses in bankruptcy: the acquired "super priority lien" is very effective and strong since it even has seniority in any property of the debtor that was already secured by a previous lien, if the holder of the previous lien receives adequate protection; in effect this lien takes priority over all other claims, including some prior liens. Usually the only bank willing to loan the debtor money during bankruptcy is one that is already owed a considerable amount from previous loans. The bank is largely trying to protect its previous loans by keeping the business afloat with additional financing. As a condition for these new loans the bank may demand it to be 'cross-collateralized' which means that assets of the debtor obtained after bankruptcy help secure its pre-bankruptcy loans as well as its loans made after bankruptcy. See US Airways; UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Washington, D.C. 20549, FORM 10-K.—ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934; available at http://www.usairways.com/about/investor_relations/reports/2002_report.pdf.

debtor. [32] The plan provides the blueprint or codification of the new relationship between the airline debtor and its key creditors, re-launching it as a (financially) healthy, restructured and reorganized entity.[33]

2.5 A Breathing Spell from Liabilities-section 362 USC 11

"..IN THE MEANTIME, US AIRWAYS WILL MARSHAL ALL OF ITS RESOURCES TO CONTINUE ITS EXCEPTIONAL SERVICE RECORD AND CUSTOMER FOCUS, WHICH HAS CONSISTENTLY PLACED IT NEAR THE TOP IN THE U.S. DEPARTMENT OF TRANSPORTATION'S MONTHLY STATISTICS FOR ON-TIME PERFORMANCE, BAGGAGE DELIVERY, AND CUSTOMER SERVICE.." [34]

Pursuant to section 362 (a) 11 U.S.C.:

"...the filing of a bankruptcy petition 'operates as a stay applicable to all entities of, "among other things", (1) the commencement or ...continuation [of a] proceeding against the debtor that was or could have been commenced before the commencement of the case...and (3) any act to obtain possession of property of the estate..or to exercise control over property of the estate..."

This section in the Bankruptcy Code is mostly referred to as the "automatic stay provision", which allows the debtor to block actions against its assets that might otherwise impede reorganization or impair the value of its estate. Specifically stayed is "*any act to obtain possession of . . . or to exercise control over property of the estate.*" [35]

The scope of the automatic stay is very broad and encompasses all reorganization proceedings. [36] In this view, even actions taken to cancel a contract are

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[31] Actually: Chapter (9) 11 (12 and 13)

[32] Any interested party may file a plan of reorganization with the court. [Section 1121(b)]. After negotiating and drafting the reorganization plan, it is then submitted to all the different, separate classes of creditors for their approval. The reorganization plan lists, among other things, all of the claims that exist against the debtor and establishes the manner in which those claims will be paid or otherwise satisfied. Section 1123(a) specifies the elements, which a plan must contain, and section 1123(b) specifies those elements that a plan may contain.

[33] See section 1123 paragraph d and e

[34] August 19, 2002; US AIRWAYS GROUP INC (U); adapted from "form 8-K" Item 5 under 'Other Events'

[35] 11 U.S.C. section 362(a)(3) (1994)

[36] See also later on in this thesis (in particular, the following pages, page 40 and following, page 76 and following)

"proceedings" within the scope of the automatic stay despite the informal and non-judicial nature of such actions.

Importantly, any action taken in violation of the automatic stay is void.[37] Among other things, the stay functions to defer debt payments on any legal liabilities that arose before the commencement of the reorganization. Moreover, pursuant to 11 U.S.C. section 362(a)(3), the secured creditor no longer has to be paid any interest. In this view, by application of the automatic stay provisions of Chapter 11, the airline only has to pay for so-called current expenses. This obviously means a significant reduction in its operating costs, even if only for a short term. During the entire period in which a reorganization plan requires confirmation, the automatic stay will in principle remain effective. Consequently, creditors are blocked in their actions (provided that they can apply for court relief); assets cannot be repossessed or reinvested in a more productive venture. From the airline debtor's perspective, however, the automatic stay provision affords an ailing business significant relief and advantages. [38]

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[37] Kalb v. Feuerstein, 308 US 433, 438, 84 L. Ed. 370, 60 S. Ct. 343 (1940); In re Victoria Grain Co. Of Minn. 45 B.R. 2,6 (Bkrtcy. D. Minn. 1984); However, the automatic stay does not apply to contracts entered into by the debtor postpetition. Such contracts may be terminated by the non-bankrupt party in accordance with the terms of the contract without relief from the stay. In re New England Marine Servs., Inc., 174 B.R. 391, 397 (Bankr. E.D.N.Y. 1994).

[38] It should be noted in this connection that section 362 certainly is not a very popular provision amongst competitor airlines that are not under "bankruptcy protection". It is mainly this provision that stimulates cries over unfair advantage and anti-competitive effects; see also 61 J. Air L. & Com. 1017, May , June 1996 The reorganization plan lists, among other things, all of the claims that exist against the debtor and establishes the manner in which those claims will be paid or otherwise satisfied. Section 1123(a) specifies the elements, which a plan must contain, and section 1123(b) specifies those elements that a plan may contain. In the majority of cases, after the plan has been filed with the bankruptcy court, the plan proponent must obtain the acceptance of the plan by a required minimum of the creditors and shareholders. However, before the plan proponent may solicit acceptance of the plan, the plan proponent must provide creditors and shareholders of the debtor with a copy of the plan and a Disclosure Statement, which must contain "adequate information" as provided for in the Bankruptcy Code (section 1125). Section 1129 of the Bankruptcy Code establishes the requirements for confirmation of a plan. These requirements may be concurrently referred to as the 'good faith' requirement since the plan must be filed in good faith and comply with all of the provisions of Chapter 11 (section 1129(a)(3) and further). In this light, an important minimum requirement is that the plan must be in the "*best interest*" of the creditors. In order to satisfy this test, the distributions to be made to different categories of creditors must be no less than the amount these creditors would receive in the event that the debtor is liquidated; i.e. the distributions that would be made under a Chapter 7 proceedings [Section 1129(a)(7)]. In addition, the plan must also be "*fair and equitable*" – which means that the plan may not unfairly discriminate against similarly situated creditors. [Section 1129(b)(2)]. The final effect of confirmation of the plan is that it discharges the debtor of all debts that (still) exist up to the date of confirmation. The confirmed plan of reorganization is definite and binding on the debtor as well as on all the other parties involved. All creditors are held to comply with the terms and conditions of the plan, including those creditors, which may have voted against the plan. [Section 1141(a)]. The plan is a codification of the new relationship between the debtor and its creditors, re-launching the company as a (financially) healthy,

The automatic stay is often viewed as one of the fundamental protection that is offered to a debtor under US bankruptcy law. It is really intended and effectively gives the debtor *a breathing spell* from its creditors; to stop collection and foreclosure efforts, enabling the debtor to reorganize her finances or businesses and/or liquidate assets in a steady manner in the meantime (i.e. during reorganization or negotiations). [39] In reverse, the automatic stay allegedly also is of some benefit to creditors in the sense that it promotes the orderly administration of the estate, facilitating equality in distribution among claimants. [40]

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restructured and reorganized entity. See 46 Am. J. Comp. L. 165, article 'choice of law relative to security interests and other liens in international bankruptcies'.Actually: Chapter (9) 11 (12 and 13) As mandatory contents count: - classification of claims and interests asserted against and in the debtor (section 1123(a)(1); - specification of any class that is not impaired (meaning: section 1124 (1) and (2)); - specification of the treatment of any impaired class (1123(a)(3);- provision of identical treatment for each claim or interest of a particular class, unless a holder consents to being treated differently section 1123 (a)(4);- explanation of method of implementation of plan section 1123 (a)(5);- provision of inclusion in the debtor's charter of a prohibition on the issuance of nonvoting equity shares section 1123(a)(6);- provision that all provisions are consistent with the interests of creditors and equity shareholders and public policy with respect to the selection of officers and directors section 1123(a)(7). See Book, at page 128; page 116; February 2003, "DIP Financing: Breathing New Life Into Ailing Companies", by James G. Connolly, Fleet Capital Corporation see also Press Release United Airlines; available at: http://www.ual.com/ual/asset/customer_brochure_120902.pdf

[39] Some courts have also held that terminations for default are similarly stayed. In re Corporacion de Servicios Medicos Hospitalarios de Fajardo, 805 F.2d 440 (1st Cir. 1986); Harris Prods., Inc., ASBCA No. 30426, 87-2 BCA 19,807 (both finding that pending default terminations based on pre-petition facts are stayed); see also: FOURTH SYMPOSIUM ON AMERICAN/CANADIAN INSOLVENCY LAW FEBRUARY 24, 2003, Ass. of the NY City Bar; Article "NY CHAPTER 11 OUTLINE—"The Basics"" Robert S. Hertzberg

[40] Insolvency and Bankruptcy Law, D. Bechara, from The Freeman, a publication of the Foundation for Economic Education, Inc., September 1986, Vol. 36, No. 9. also available at www.libertyhaven.com, last checked November 3, 2003 ; (a) The Automatic Stay (Injunction): Section 362(a) permits a debtor a brief reprieve from the actions of its creditors. Upon the commencement of a bankruptcy case, and without the necessity of a formal order of the Bankruptcy Court, Section 362 of the Bankruptcy Code provides for an automatic stay or injunction against acts of or by creditors against the debtor. The automatic stay automatically stays numerous types of acts which creditors may take against the debtor; seven of those automatically stayed are: (i) the commencement or continuation of judicial or administrative proceedings against the debtor based on a claim which exists against the debtor prior to the commencement of the bankruptcy proceedings [Section 362(a)(1)]; (ii) the enforcement of a judgment contained prior to the commencement of the bankruptcy case against the debtor or against property of the debtor [Section 362(a)(2)];(iii) any act to obtain possession or control over property of the debtor [Section 362(a)(3)]; (iv) any act to create, perfect or enforce any lien against property of a debtor [Section 362(a)(4)];(v) any act to collect or recover a claim against the debtor that arose prior to the commencement of the bankruptcy case [Section 362(a)(6)]; (vi) the set off of any debt owing to a debtor that arose prior to the commencement of the bankruptcy proceeding [Section 362(a)(7)]; and (vii) the commencement or continuation of a proceeding before the United States Tax Court [Section 362(a)(8)]. Section 362(b) excludes 17 acts from the provisions of the automatic stay (injunction) covered under 362(a). Of the 17 acts which are not subject to the automatic stay provisions, two of the more important ones are: (1) criminal proceedings against the debtor [Section 362(b)(1)] and (2) the commencement or continuation of a proceeding for the collection of alimony, maintenance, or support [Section 362(b)(2)]. In addition to accepting certain acts in the provisions of the automatic stay, the Bankruptcy Code also allows for the modification, termination, or annulment of the

2.6 Assumption or Rejection of Executory Contracts

As a consequence of the applicability of section 362 (a), pursuant to the application of section 365 (d) (2), the airline debtor may also evaluate whether to assume or reject executory contracts. Whereas this provision shall be discussed in more detail in the next chapter, it nonetheless also deserves attention in this chapter. This is because of the fact that it is mostly called upon in combination with section 362, the automatic stay provision.

The combined objective and impact of these provisions to the airline debtor is to provide it with a significant and effective breathing spell to suspend the normal operation of rights and obligations between the debtor and his creditors. The debtor allegedly is offered the opportunity to formulate a reorganization plan that returns more to creditors than they would receive in a straightforward liquidation:

Upon a petition for chapter 11, a contract is no longer immediately enforceable. Section 365 offers the debtor airline a choice: i.e. either to assume or reject the contract. Therefore, a contract may never be enforceable again by the adoption of a reorganization plan. [41] When negotiating its reorganization plan, the airline debtor shall generally try to assume contracts that are critical to its ongoing business (i.e. flights and transportation service in the ordinary course of business). [42] This essentially means that the airline debtor shall cure all defaults under these contracts by payment of amounts due during the Chapter 11 procedure. Upon its advocating the assumption of a contract before the court in order to obtain court protection against potential relief actions of creditors from the applicable

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automatic stay provisions under certain conditions. One such example under which the automatic stay provisions may be modified, terminated, or annulled, is if a bankruptcy petition is filed in "bad faith."

[41] Equipment Leasing and the Bankruptcy Code 7-22, The Bankruptcy Code, in EQUIPMENT LEASING -- LEVERAGED LEASING (2d ed. 1980).

[42] In re L.H. & A. REALTY COMPANY, INC., Debtor. FIRST NATIONAL BANK OF VERMONT, Plaintiff, v. L.H. & A. REALTY COMPANY, INC., Defendant. Bankruptcy No. 85-212. Adv. No. 85-75. United States Bankruptcy Court, D. Vermont. Jan. 28, 1986: The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into

automatic stay, the debtor airline shall generally, explicitly argue that these contracts are vital to the airline's survival during Chapter 11 (e.g. the argument of the contract being essential for preserving consumer confidence is preserved). [43]

Contracts that will qualify as particularly essential to the airline's continuing of operations generally include:

1. IATA Membership Agreement;
2. IATA Clearing House Membership;
3. Multilateral Interline Traffic Agreement -- Passenger;
4. Multilateral Interline Traffic Agreement -- Cargo Interline Traffic Participation Agreement -- Passenger;
5. Interline Cargo Claims Agreement;
6. Multilateral Agreements for Passenger and Cargo Interline Services Charges – United States;
7. Universal Air Travel Plan Participation Agreement;
8. IATA Currency Clearance Service;
9. All Bank Settlement Plans regions in which the airline is a participant;
10. All Cargo Agency Settlement Systems regions that the airline is participating in;
11. Cargo Network Services Corp. Agreements;
12. Air Traffic Conference Interline Traffic Agreement/"Deeds of Undertaking" in order to provide international travel entities assurances that, should the issuer of the ticket fail to remit monies paid by the customer/passenger to the debtor airline, the debtor airline will nonetheless honor the ticket.);

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bankruptcy citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 340 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6296-97.

[43] As adapted from: US Airways Bankruptcy News, Issue no. 5, September 2002; In this context, however, a special provision, which evolved from earlier law protecting equipment financiers, is of particular interest to an airline debtor: section 1110, pursuant to which any secured party may not be stayed from repossessing its collateral, either automatically or by the court if such party has a *'purchase-money equipment interest'* in *"aircraft, aircraft engines, propellers . . . or spare parts" owned by an airline that holds a so-called ' section 401 Certificate'"*, provided that the debtor does not make a timely assumption and cure of its obligations to

13. Air Traffic Conference Interline Air Cargo Procedures Agreement;
14. Code sharing Agreements as a significant source of passengers and revenue;
15. IATA-Clearing House related agreements.

In conclusion, the combination of section 362 and 365 may in principle offer the airline debtor an effective "breathing spell", which can be applied particularly advantageously by the specific airline debtor. This may be one of the main characteristics of a chapter 11 providing relief in the case of suffocating balance sheets (i.e. that carry too burdensome liabilities).

2.7. Relief for Secured Creditors

Obviously, taking into consideration the above, the breathing spell surely is not welcomed by the general airline creditor. The airline's creditor's right to take measure upon contractual default will be blocked as soon as the Chapter 11 procedure is initiated.

The Bankruptcy Code does offer a specific category of creditors (i.e. the secured creditors) the opportunity to obtain some "adequate protection" from the debtor by means of a motion of relief during the automatic stay. Consequently, the automatic stay may be lifted or modified by creditors (i.e. section 362 (d), which shall be discussed in more detail in chapter 5). [44] This relief, however, is not easy to obtain since courts generally recognize and therefore protect the general purpose of chapter 11: i.e. to give the debtor some breathing space from its creditors, especially during the first 120 days of the bankruptcy.[45]

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the secured party. See Glenn S. Gerstell & Kathryn Hoff-Patrinos, Special Protections Under Section 1110 of The Bankruptcy Code, in AVIATION INDUSTRY BANKRUPTCY ISSUES.

[44] Ibid. 40, Insolvency and Bankruptcy Law, D. Bechara; "*..A secured creditor may therefore wish to dispose of the property in which he has a security interest beforehand in order to at least partly recover the amount owed by the airline debtor directly. The unsecured creditors, however, may oppose such proposal, since in practice the disposal of the property often amounts to a liquidation of the business, eliminating any opportunity for recovery of debts..*" from paragraph "consumer bankruptcies."

Additionally, the airline's competitors are – to say the least- not too enthusiastic when it comes to applicability of the automatic stay. This is because of the fact that the breathing spell generally results in an unequal level 'economic playing field'. By operation of chapter 11 (i.e. including the automatic stay) the airline debtor is generally offered new leverage, which it may translate in lowering ticket prices. Obviously, arguments of –distorted- competition are raised.

Whereas it is argued, that historically most airline reorganizations eventually resulted in liquidation, that in the event of 'unsuccessful reorganization', the phenomenon of 'continued operations' during reorganization often wastes assets that creditors would have received in immediate liquidations, the most pregnant argument against reorganization is the argument of distorted competition, which comes from the competitor airlines.

Allegedly, debtor carriers' below-cost fares, as made possible by the Chapter 11 protection, will force the financially healthier carriers to lower their fares on competing routes; " *...this pricing advantage transmits the protected carriers declining financial condition to other, solvent carriers much as a virus is transmitted from the sick to the healthy...*".[46] Without disposing of this argument as invalid, to discuss this in more detail will be beyond the scope of this thesis, however.

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[45] http://www.uscourts.gov/bankbasic.pdf; at: Book, the Bankruptcy Basics, as written by the bankruptcy division of the Administrative Office of the United States Courts, at page 67, checked latest October 24, 2003.

[46] *"...The airline industry is characterized by substantial price competition. Fare discounting by competitors has historically had negative effect on the Company's* [being American Airways] *financial results because the Company is generally required to match competitors' fares to maintain passenger traffic. During recent years, a number of new LCCs have entered the domestic market and several major airlines, including the Company, implemented efforts to lower their cost structures. In addition, several air carriers have sought to reorganize under Chapter 11 of the United States Bankruptcy Code, including United and US Airways. (Effective March 31, 2003, US Airways emerged from its Chapter 11 restructuring.) Successful completion of such reorganizations has resulted or would result in significantly lower operating costs for the reorganized carriers derived from labor, supply, and financing contracts renegotiated under the protection of the Bankruptcy Code. Historically, air carriers involved in reorganizations have undertaken substantial fare discounting in order to maintain cash flows and enhance customer loyalty. Further fare reductions, domestic and international, may occur in the future. If fare reductions are not offset by increases in passenger traffic, changes in the mix of traffic that improve yields and/or cost reductions, the Company's operating results will be further negatively impacted. As discussed in Part A of Item 1, the Company has stated that its survival cannot be assured until labor and other costs are lowered significantly.* From: Part E of Item 1.See 10-K Form of American Airways

CHAPTER 3 -The Strategy

The Corporate Strategy of Bankruptcy Reorganization

If you do not have a strategy, you just throw a dart at a wall, draw a circle around it and say that the target was hit; it may always and unfortunately be the wrong target.

1. Introduction

As in any strategy, it is clear that several factors shall determine the level of success. This also is the case in the reorganization effort of an airline. Preliminarily, throughout reorganization it should always be recognized and acknowledged that the airline industry is vulnerable to several structural risks that are particular to the industry but at any time beyond its control or reach.

Many factors are significant to take into account throughout the reorganization. Of particular interest firstly, is the factor of cost. This is a factor that may serve both as an incentive to start reorganization as well as a thread throughout the reorganization of an airline. Another factor that definitely is key is time. With this is meant a timely recognition of certain conditions that lead towards a required intervention by the operating procedure as provided under Chapter 11 bankruptcy reorganization.

As will be shown, directly linked to the intervention through reorganization under Chapter 11, is the fact that during reorganization, the airline debtor requires a solid cash flow (interim financing) in order to continue operations and survive through the reorganization.

Among many others, these specific factors shall now be explored as particularly adding or detracting to successfulness of the airline's reorganization efforts.

2. *Special Risks to be Recognized*

Accompanying the airline industry's uniquely wide reach is its vulnerability to many risks and uncertainties. A reorganization plan may one day as perfectly balanced, planned, calculated and acceptable, it should be recognized that at any time the airline might be faced with the unexpected. Concurrently, the scene and outlook is immediately different. The calculus is changed.

Among the many risks and uncertainties facing the airlines are the airline's pricing environment. In the current economic climate many low cost carriers enter the market, which competitive actions may have a particular detrimental effect; but in any case may completely change the airline's outlook. Obviously, changes in general (inter) national economic conditions shall also have its consequences for the airline. Any fluctuation in foreign exchange rates and jet fuel prices shall cause for an instable and unpredictable cash flow, which especially during reorganization is not easy to leverage out. [47] Additionally, governmental and regulatory actions and other political conditions like new developments affecting labour relations or the company's airline partners (e.g. a halt to any government subsidies) may put the airline in a difficult bargaining position. As any other business in reorganization also the outcome of any pending material litigation (e.g. product liability; personal injury) may harm the airline's outlook. Uncertainties and risks particular beyond the control of the airline, however, are the future level of air travel demand, its future load factors and yields, its costs for security, the cost and availability of aviation insurance coverage and war risk coverage and the price and availability of jet fuel. The airline is dramatically vulnerable since in all of these specific areas any adverse impact of for instance terrorist attacks; the threat or outbreak of epidemics, hostilities or war, no real anticipation nor control is possible.[48]

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[47] "*..Escalating fuel prices, which show no immediate signs of decreasing, in part due to the war in Iraq and domestic turmoil in Venezuela, Nigeria or other oil producing regions. American's average cost pergallon of fuel has risen from 66.5 cents in February 2002 to 91.0 cents in February 2003...*" see Form 10-K American Airlines

[48] Source: KLM "Commentary to 2002 AUDIT"

3. The Factor of Cost Control

"...United Airlines was determined to avoid this day...; did everything within its control to bring its costs into line with the reduced revenue environment...slashed costs in every aspect of its operations except for safety-delaying or canceling capital investments; reducing schedules, downsizing the airline, cutting non-aircraft expenditures, bargaining for concessions from vendors, furloughing employees and eliminating scheduled pay increases for salaried and management employees..."[49]

As the ATA Report rightly observes, besides cash preservation and cautious growth, for airlines, controlling and managing costs is absolutely critical for survival.

In this context, labour costs need to be recognized as one of the airline's largest cost component, generally amounting to roughly 35 percent of operating costs. [50] As a second largest cost fuel may be mentioned. A particularity of this cost is that it almost exponentially increases under the precarious world politics and a faltering world economy. Additionally, the costs of airport delays also are increasing, currently amounting to $ 3.2. billion.[51]

It should be mentioned that especially this factor shall be the guiding post to, throughout and after the airline's reorganization. As discussed, the reorganization under chapter 11 offers the airline a unique forum to review its current costs and liabilities.

4. The Warning Signs; Planning and Timing[52]

Obviously, any strategy involves "clever planning and perfect timing". An analytical phase is necessary to understand the 'business' status'.

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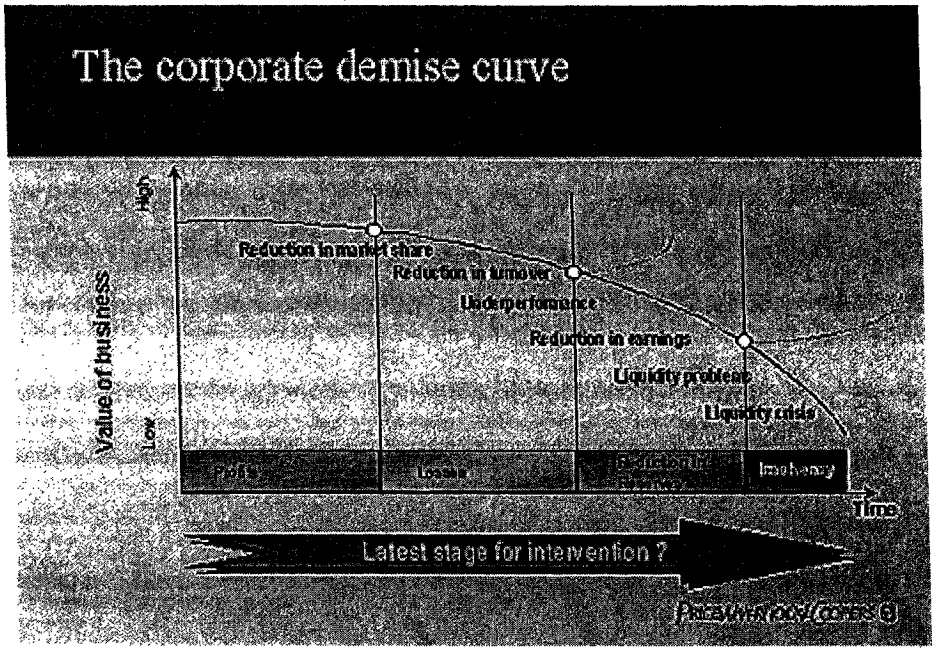
[49] INFORMATIONAL BRIEF OF UNITED AIR LINES, INC. at page 5 and following

[50] Based on recent contract settlements, labour rates are expected to increase steeply says the ATA report: "State of the US Airline Industry, ATA, 2002; a report on recent trends for US Air Carriers"; at page 2, 5 and following.

[51] Airline Bankruptcies and Workouts: The airline's perspective, G.W. Buhler Schnader Harrison, March 2002

[52] Book, page 114



Definitely there are some warning signs; one of the easiest is missed financial projections.

Also, reviewing the cash cycles of the airline may be enlightening, as well as identifying the revenue streams and operational expenses flow, including the terms of the credit facilities.

Then, the circumstances surrounding the situation of each potential debtor, including that of any airline, are unique. The successes of any intervention by reorganization may depend upon recognizing the different signals. As may be concluded from the above figure, any crisis has a so-called 'build up', which may either happen in a quick or more moderate flow. In any case, indications that intervention is needed may be: the airline loosing market share, facing a reduction in turnover, its underperformance, reduction in earnings, liquidity problems or crisis. It should be noted that the timing of the intervention might become a strategy on its own.

The likelihood of the successes of reorganization obviously depends on many factors, including, but not limited to whether or not cooperation of major creditors is likely, the debtor's corporate structure, and also whether for instance lien

arrangements (already) affect the debtor's assets. In any case, before starting a Chapter 11 procedure it may be advisable for the airline to have arranged interim financing, to have drafted a scheme of vital contracts, to have made an inventory of burdensome liabilities and have a work proposal to its employees. Obviously no assurances of enforceability exist for the airline during the reorganization itself, in any case it may crystallize out the pain points in a sort of equal level playing field, which shall definitely be of advantage to the airline during the reorganization process. Directive preparations shall also safe the airline precious time and cost. In this view, an effective and efficient reorganization may actually depend on the moment of intervention, which should be carefully chosen and preferably be before the moment of real crisis and loss of control. It should be remembered that Chapter 11 could explicitly be called upon, also before the company's state of emergency. This is helped by the fact that no longer good faith is required at the time of petitioning for Chapter 11 relief.

5. The Factor of Cash flow

The strategic intervention of Chapter 11 will have immediate implications for the airlines' cash flow. Therefore a number of difficult (strategic) decisions will have to be made by the airline's management both before and during reorganization. The immediate effect of a bankruptcy filing namely is the cut off of most sources of cash flow. In order for the airline to be able to continue operations during reorganization, the airline's management may preferably have a plan prepared, which outlines how fuel payments, ad hoc maintenance costs, and payroll payments are arranged for.

In this view, an analysis of the airline's source of revenue is particularly helpful. The chief basis of revenue of the average airline definitely lies in its scheduled passenger business. However, airlines may also derive (additional) revenue from:

- Transporting mail and freight on both international and domestic routes;
- Performing contract maintenance work;

- Domestic and international charter flights;
- Selling fuel to other carriers;
- Revenue contract related to "frequent flyer's program". [53]

From the perspective of its scheduled passenger business, the airline's revenue generally may come from three different sources: credit card sales, interline clearing accounts such as the International Transport Association (IATA) Clearinghouse, the Airline Clearing House (ACH) and travel agent receivables through for instance the Airline Reporting Corporation (ARC). [54] At all time, the level of resultant impact of initiating Chapter 11 will depend in large part on the level of cash flow readily available. [55]

The advantages and positive effects of rapid notice to government agencies, lessors and creditors can therefore not be overstated. As a precaution against undesirable and irreparable interferences in its cash flow, the airline should –as a strategy- definitely notify at least the key players that are mentioned in the above paragraph. Essentially, its communication should have the purport of the airline planning to conduct business as usual and reorganize quickly, emerging as restructured, more ready for the fray.[56]

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[53] UAL Motion for entry of an order pursuant to sections 105, 363, page 5 and following.

[54] Website IATA, checked latest October 24, 2003; as well as Airline Bankruptcies and Workouts: The airline's perspective, G.W. Buhler Schnader Harrison, March 2002;

a. Credit Cards: The timing and frequency of this cash flow is unpredictable. Upon the airline filing for bankruptcy, the credit card companies will generally turn to the self-help remedy, which means that the flow of remittances will stop until an arrangement is worked out and approved by the bankruptcy court;

b. Clearinghouses: Each month, the member airlines will remit or debit for the net amount due or owing from the airline. An airline's default in making its clearing house payments will have drastic consequences; the clearinghouse rules call for immediate notification to all member airlines, which causes withholding of goods, services and in general the signal that the airline is in serious trouble;

c. Travel Agencies: These proceeds are remitted weekly to the airline. However, this will only involve the revenue of agents in cash payments. The airline contemplating filing for Chapter 11, should wait until it has received as many payments as it can collect.

[55] Tulane Law Review June, 1985, Admiralty Law Institute Symposium on Admiralty Interface: Bankruptcy v. Maritime Rights, CHAPTER 11 Strategies and Techniques; creditors committees, effective use of plan provisions, Mark M. Jaffe

[56] Airline Bankruptcies and Workouts: The airline's perspective, G.W. Buhler Schnader Harrison, March 2002.

CHAPTER 4

Resolution of Liabilities, Interplay and Competition

1. Introduction

Generally, airlines are enormously multi-complex businesses. They operate technically sophisticated, expensive equipment, are subject to rigorous safety regulation, require large amounts of capital and credit, a vast array of purchased goods and services to sustain operations – all in an intensely competitive industry. The following provides a summary of those sections of the Bankruptcy Code that most directly affect a defaulting airline.

Historically, the United States Bankruptcy Code virtually gives the airline industry its own specific status. As *Blackstone* already recognized the potential benefit to society of freeing a legal entity from prior debts, "*so that the bankrupt by the assistance of his allowance and his own industry, may [again] become a useful member of the commonwealth*", similarly to the airlines, US Bankruptcy Code Chapter 11 may be a viable strategy. [57]

Competing interests surrounding the defaulting airline in reorganization particularly involve the government or general public (e.g. environment, safety), the airline competitors, the travelling public, airline vendors, financers and airline employees (e.g. labour unions).

A multitude of competing interests generally accompany bankruptcy reorganization. Bankruptcy reorganization may be viewed as a high stakes game of each particular interest trying to shape the facts and the law in its own favour, aiming to be elevated at the expense of another interest. With the adoption of several specific provisions in the Bankruptcy Code, the objective of balancing some of these most characteristic competing interests is captured, however. In this

[57] Blackstone's Commentaries on the Laws of England; Book the Second - Chapter the Thirty-First : Of Title by Bankruptcy

view, several bankruptcy provisions may directly affect and be strategically called upon by the airline during reorganization, therefore warranting for some further analysis in this specific chapter:

a. *Section 365* [assumption/rejection or assignment of executory contracts]
   This provision, whereas already discussed in the previous chapter, shall again be explored, however, now from an entirely different angle;
b. *Section 1113* [the special status of a collective bargaining agreement]
   Of similar interest to the airlines is section 1113. This provision regulates the status of collective bargaining agreements and offers the reorganizing airline the possibility to resolve one of its core liabilities: labour cost;
c. *Section 541;* [the airline debtor's assets; "airport slots" and operating licences]
   Some specific provisions exist with respect to whether airport slots and operating licenses are assets in the airline debtor's estate;
d. *Section 1110* [aircraft equipment financing]
   Since the airline hardly ever owns its aircraft (equipment) outright, applicability of section 1110 is of particular interest. Pursuant to this provision, under certain strict conditions, aircraft equipment financers may repossess despite applicability of the automatic stay.

2. Section 365[58]

2.1 The Choice; 'Rejection or Assumption of executory contracts'

As already discussed in the previous chapter, the framework provided for in section 365 is an obviously critically important provision in a Chapter 11 reorganization procedure.

[58] Bankruptcy Law Fundamentals, by Richard I. Aaron, 2001 Chapter 9. Administration of the Bankruptcy Estate, s 9.04 ASSUMING OR REJECTING EXECUTORY CONTRACTS--BANKRUPTCY CODE §365; see also 11 USC § 365, discussed in Norton Bankruptcy Law and Practice 2d, Chapter 39.

As any other business, the airline is party to numerous contracts and leases. From the airline's perspective, an equipment lease would be an example of a contract that it may wish to suspend or cancel. The airline may want to reduce the scope of its operations and therefore consider reducing its fleet. Besides allowing the defaulting airline to reject a contract all together, section 365 also permits partial adjustments to contracts. With the adoption of this provision, the US bankruptcy code employs a unique mechanism for allowing a reorganizing airline to shed its "burdensome obligations" and move forward:

2.2 Requirements for assumption of contracts

The airline debtor may not assume a contract or a lease that is in default unless, at the time of the assumption:

- It has cured the default (section 365 (d)(10) or (d)(3)) or provided adequate assurance the default shall be promptly cured; or
- It has provided adequate assurance of future performance under the specific contract or lease (section 365 (b)(1).

The effect of assumption is to make its bankruptcy estate liable on the contract so that any claim for damages resulting from breach would then have a priority in distribution among unsecured creditors. [59] The airline debtor's right to assume a contract is, however, not unilateral since it is always subject to the court's approval. If the contract is rejected, any resulting claim for damages is treated as a so-called pre-petition unsecured claim.

2.3 Termination Event

Pursuant to section 365 (d) (2) the airline debtor faces general time constraints on its decision to assume or reject a contract. This generally means '*any time prior to confirmation of the reorganization plan*'. Specifically, the airline will, in principle, only have 5 days within which it may assume or reject the lease of an aircraft terminal or gate, at the expiration of which the lease is deemed rejected.

[59] Equipment Leasing-Leveraged Leasing, Chapter 7:1.1

The so-called start of this 5-day period (or for any other period upon which the assumption/rejection decision has to be made) is indicated by the so-called "*termination event*". [60] However, pursuant to section 365 (d)(6) and (d) (9), this (5-day) period may also be extended if there is a '*cause*'. This is generally left to the court's discretionary evaluation:

The court may, upon request of any party to such contract, order the debtor to decide within specified limits of "reasonable time". The criterion of 'reasonableness' leaves considerable discretion to the court in taking into consideration all of the particular circumstances of each case. In this view, the bankruptcy court is generally inclined to give the airline debtor some leverage in time, since for instance, assumption of a lease contract will automatically mean a (definite) expense and priority claim against the estate. In its considerations the court will always aim to balance the business needs and interests of the airline debtor against the concerns of the creditor. [61]

2.4 Pre-petition Contractual Waiver of Applicability of Automatic Stay

In view of the debtor's right to (initial) protection as provided for under section 362 or 365, of particular interest is whether a so-called pre-petition (contractual) waiver of particular rights as generally acquired under the Bankruptcy Code is enforceable. Importantly, only rarely, the courts have held that a contractual waiver is enforceable. If enforceable, however, that generally is only under certain specific conditions and circumstances.

As a general rule, in re Transworld Airlines may be cited. In this case, the court held that courts should not enforce a debtor's pre-petition contractual waiver of its ability to assume or reject an contract. It was considered as particularly incompatible with the meaning and basic purpose of chapter 11 which is – '*.to*

[60] The time of the court granting relief from automatic stay with respect to the equipment necessary for an effective reorganization.

[61] Equipment Leasing and the Bankruptcy Code, 17-31; The time of the court granting relief from automatic stay with respect to the equipment necessary for an effective reorganization; and Equipment Leasing and the Bankruptcy Code 17-18.

maximize the return to creditors by allowing a debtor in possession to "renounce title to and abandon burdensome property if such action is in the best interests of the estate..." [62]

In sum, as a consequence of section 365 (d) (5) an airline debtor faces having to make significant choices within specific (time) restrictions.

3. Assumption: Some Important Qualifications Under Section 365

3.1 'Executory Contract'

As addressed, in general, section 365 (a) permits the airline to assume or reject any "executory contract". [63] For the purpose and scope of applying section 365 the definition of 'executory contract' is conclusive. The term "executory contract" is not defined in the bankruptcy code, however. Different courts apply different standards to determine the existence of an executory contract. However, the definition that is adopted by most courts in the US is as follows:

'...a contract under which the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other...' [64]

Courts still have differing opinions varying from either liberal to more restrictive, however. [65] The legislative history of the code further suggests that it was the intention of the drafters to include contracts on which performance remains due to some extent on both sides. [66]

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[62] In re Trans World Airlines, Inc., 261 B.R. 103 (Bankr. D. Del. 2001); see also paragraph 4.3 of this Chapter

[63] H.R. Rep. No. 95-595, 1st. Session 347 (1977)

[64] Equipment Leasing-Leveraged Leasing, Chapter 7:1.1

[65] Liberal; a contract may be viewed as executory even if the performance by one party is limited to an agreement to refrain from taking an action in the future (see In re Select-a-Seat Corp., 625 F. 2D. 290 (9TH Cir. 1980)); Restrictive: a contract is 'executory' only when the debtor has a performance obligation in the future (see In re Craig, 144 F.3d 593 8th Cir. 1998; promissory note is not an executory contract since one party has fully performed and is merely awaiting payment performance of the other party); See also: Equipment Leasing-Leveraged Leasing, Chapter 7:1.1

Of a particular concern to the airlines is whether a 'lease' is to be re-characterized as an 'executory contract or financing/security contract'. Namely, all the protections and advantages afforded under section 365 may be lost, if the contract is a security agreement.[67] An equipment lease would clearly seem to be an executory contract, however in practice contracts are not as easily evaluated. This is because of the fact that presently the leasing practice nowadays entails a hybrid of different contract involving many different structures and objectives. Therefore it is in any case important to realize that no absolute certainty for any party exists as to whether a bankruptcy court will consider for instance a specific 'equipment lease contract' as an 'executory contract' under section 365. In this view, the airline debtor's strategic use of section 365 can only be anticipated to a certain extent since –due to the hybrid criteria as provided therein - it remains unsure whether in practice this section may be availed of by the airline debtor.[68]

3.2 "Burdensome"

The distinctive evaluation of whether a contract is to be qualified as 'burdensome' (i.e. will enhance or diminish the value of the airline's estate), and if so, either as a whole or just in part, definitely entails a proper analysis. In this sense, the airline debtor acts as its own fiduciary. This however, does not mean that the airline will not be closely monitored by its creditors and the bankruptcy court.

An interesting feature of section 365 in this respect is, that the airline debtor may validly (try to) argue that the contract is 'separable' from other contracts that were part of the same transaction. The debtor may thereby seek to assume and assign the 'favorable' contract while rejecting the unfavorable. This strategy is of course

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[66] 11 USC § 365, discussed in Norton Bankruptcy Law and Practice 2d, Chapter 39.

[67] In re PSINet. Inc. 271 B.R. 1,9-39 (Bankrtcy. S.D.N.Y. 2001): 'How the agreement is styled or named is not conclusive; nor is the court bound by the language used by the parties to the agreement or any designations placed therein. In re Triplex Marine Maintenance Inc. 258, B.R. 659, 666 (Bankrtcy. E.D. Tex. 2000)

[68] Similarly, there is no such guarantee as to the so-called popular 'synthetic lease' which involves a transaction in which the lessor is treated as the property owner for tax purposes in order to qualify for depreciation and often a portion of the lease term payments, while the lessee retains control over the equipment and may purchase the property at the end of the lease. This lease can either be regarded as (a) a true lease/executory contract or (b) a contract for absolute ownership by the lessee accompanied by a secured obligation to repay debt.

fervently called upon and may be characterized as a strategic feature of the Chapter 11 procedure. The determination as to the (in)divisibility and economic sensibility of such disaggregation (i.e. "the approval"), is still finally left to the discretion of the court, however.

3.3 "True lease" [69]

Beyond the 60-day period, leased aircraft equipment may for example be used, provided that an assurance of '*adequate protection of the security interest*' as is required under section 362 and 363, is given.

However, this requirement to timely perform the (re-negotiated) contractual obligations only applies to so-called 'true leases'. Therefore, airline debtor may consider arguing that the transaction concerned cannot be characterized as 'a true lease' but to the contrary is e.g. a disguised security device. [70] In other words, the lease might be successfully re-characterized as a security agreement thereby circumventing additional requirements of section 362 and 363.[71] Obviously, the airline debtor bears the burden of proof of such qualification. [72]In order for the airline to be successful in this endeavor, however, it can generally be said that the contract concerned should pass the so-called '*bright line four-part test*' as applied

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[69] Section 365 (d) (10) defines the term "true lease"

[70] With the fever of J.K. Rowling's "Harry Potter" still lingering in the air, the transfiguration of one thing to another may be found in bankruptcy law in addition to the Hogwarts School. 4 Despite the intentions of parties to a lease transaction, a bankruptcy case may result in the recharacterization of a lease to a financing transaction, without the use of witchcraft or wizardry. A concern in bankruptcy cases is whether a lease will be recharacterized as a financing transaction. This concern stems from the fact that if a lease is recharacterized as a secured loan (assuming all requirements for granting and perfecting a security interest are satisfied), the lessor will lose the protections and advantages afforded by Section 365 of the Bankruptcy Code. From: NORTHEAST BANKRUPTCY CONFERENCE, JULY 11 - 14, 2002, "WHEN A CLAIM IS NOT THE SAME AND A LEASE IS NOT A LEASE: EQUITABLE SUBORDINATION UNDER § 510(c) OF THE BANKRUPTCY CODE AND RECHARACTERIZATION OF LEASES" by Kevin J. Walsh and others.

[71] In this case, the agreement does not have to be assumed or rejected under section 365; the debtor need not cure past defaults or provide adequate assurance of future performance under section 365 (b).

[72] Factors in determining whether a transaction is a lease or sale may include: (1) Whether the lessee is given an option to purchase the equipment, and, if so, whether the option price is nominal; (2) whether the lessee acquires any equity in the equipment; (3) whether the lessee is required to bear the entire risk of the loss; (4) who pays all charges and taxes imposed on ownership; (5) whether there is a provision for acceleration of rental payments; (6) whether the property was purchased specifically for lease to this lessee; and (7) whether the warranties of merchantability and fitness for a particular purpose are specifically excluded by the lease agreement. Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977). Whether a transaction is characterized as a lease or sale is not conclusive, but rather it is the intention of the parties that is controlling,

by the US Bankruptcy Courts. [73] Interestingly, case law indicates that, when applying this test, courts are in any case quite reluctant to accept the intent of parties as was spelled out in the "lease contract" as conclusive evidence.[74]

Also, as a discretionary measure, the courts may 'disaggregate' the relevant contract into separate contracts. For instance, the courts may distinguish between a service agreement, which will generally fall under section 365, and then a separate security interest agreement, which is not liable to assumption by the airline debtor under 365.[75]

3.4 Some Final Considerations

In sum, whereas its objective is to offer clear guidance for the *'fair and uniform treatment'* of all of the airline debtor's obligations, the countless types of contracts and number of different circumstances highly complicate the application of section 365.[76]

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that intention to be determined by the facts of each case. Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977)

[73] UCC section 1-201 (37) reads as follows: '... a transaction creates a security interest if (1) the lessee's obligations are for the term of the lease and may not be terminated by the lessee; and (2) one of the following four conditions apply (i) the original term of the lease is equal to or greater than the economic life of the goods, (ii) the lessee is bound to renew for the remaining economic life of the goods, (iii) the lessee has an option to renew for the remaining economic life of the goods for nominal consideration, or (iv) the lessee has an option to become the owner for nominal consideration...'; see also Equipment Leasing-Leveraged Leasing, 7-14; In making the determination between lease and disguised financing, how the agreement is styled or the name of the transaction in question is not conclusive. In re Integrated Health Servs., Inc., 260 B.R. 71, 75 (Bankr. D. Del. 2001). A court is not bound by the language used by the parties to the agreement or any designations placed in the agreement by the parties. In re Triplex Marine Maintenance, Inc., 258 B.R. 659, 666 (Bankr. E.D. Tex. 2000).

[74] "*...As a practical consideration, the lessor should certainly cover all of its bases and include in its lease a proper grant of a security interest in the equipment subject to the lease in compliance with Revised Article 9 of the UCC. The lessor should also insure that it has taken all steps necessary to perfect its interest in the equipment. These precautionary measures will insure that in the event the lease is recharacterized as a secured financing, the lessor will, in fact, have a perfected security interest in the equipment subject to its lease....*" From: Northeast Bankruptcy Conference, July 11 - 14, 2002, article: When a claim is not the same and a lease is not a lease: equitable subordination under § 510(c) of the bankruptcy code and recharacterization of leases, by Kevin J. Walsh and others

[75] Boullion Aircraft Holding Co. v. Western Pacific Airlines, Inc. (In re Western Pacific Airlines, Inc.), 219 B.R. 305 and 221 B.R. 1 (D. Colo. 1998), appeal dismissed, 181 F.3d 1191 (10th Cir. 1999).

[76] See Commission Introduction of Proposal to Congress to amend section 365, at 1113 and further " section 365 has been amended repeatedly over the past decades and now spans over thirteen pages in a typical version of the Bankruptcy Code."; The Commission proposes e.g. clarification as to the meaning of 'rejection' and 'assumption' of contract

Together with the abolition of the insolvency requirement within the Bankruptcy Code (i.e. "the company's state of insolvency" as a requirement to be able to file for bankruptcy protection under Chapter 11), companies that are inconveniently confronted with so-called 'burdensome contracts' shall obviously be inclined to consider the possibility of filing for bankruptcy relief just in order to cancel or amend unworkable contracts. [77]

While the application of section 365 shows promise for the airline debtor, it should nevertheless not be assumed that filing Chapter 11 generally and always extends the time to cure defaults under the contracts. The court shall obviously take into account many factors in its evaluation and its decision.[78] Furthermore, even if a court holds that an "executory contract" exists, which may be cured and assumed by the debtor, the contract must generally be assumed in its *'entirety'*. With this is meant including any cancellation penalty and/or default provisions, which may nonetheless be a demerit for the airline debtor.

4. Assignment of Contracts

Another important clause is 365 (f) in combination with 365 (b). These provisions allow the airline debtor to assign an executory contract to a third party provided that cumulative requirements are met.[79] Section 365 (k) further provides that once a contract is assigned, the bankruptcy estate will have no further liability for performance.[80] In the case of an assignment of a contract, the assignee directly is liable for all aspects of contract performance. The airline debtor will not be permitted to 'subcontract' virtually the entire contract as a disguised form of assumption, which, considering the formal requirements under section 365 (f)

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[77] Mr. D. Bechara, in The Freeman, a publication of the Foundation for Economic Education, Inc., September 1986, Vol. 36, No. 9, also available at www.libertyhaven.com, last checked November, 2, 2003.

[78] Equipment Leasing and the Bankruptcy Code 7-21; and Equipment Leasing and the Bankruptcy Code, 17-31.

[79] These cumulative requirements are firstly, adequate assurance pursuant to section 365 (b) and secondly, assurance of a future performance by the assignee.

[80] Bankruptcy Code section 365 (f) permits the trustee or debtor to assign an unexpired lease or other executory contract to a third party upon satisfaction of two conditions: (i) the debtor must assume the lease under section 365 (b) subject to court approval and the cure, compensation and adequate assurance requirements; and (ii) the assignee must provide adequate assurance; take the lease 'cum onere', meaning in its entirety with all its burdens.

might be more attractive, however. Finally, it is important for the parties involved to realize that contract clauses that purport to prohibit assignment are not enforceable to prevent an assignment by the airline debtor during chapter 11 bankruptcy, so long as all of the requirements of section 365 (f) are met.

4.1. Particular Exceptions to Assignment

From the airline's perspective, a noteworthy provision under section 365 is section 365 (c). This section namely provides that certain types of leases and executory contracts may –absolutely- not be assumed by the debtor or assigned to a third party. Amongst these is the restriction with respect to airport landing slots.

a. Airport Landing Slots

In re Braniff involved the assignment of leases for aircraft landing slots by Braniff Airways to another airline. Under the Washington Airport Act FAA regulations, the United States Government, who qualified as a third party to the leases, was excused from accepting performance from this assignee. The court found that the Act and the regulations were "applicable law" within the meaning of section 365(c)(1)(A) and that the assignment was therefore barred. [81]

b. Personal Service Contracts

Contracts that may not be assigned would include personal service contracts and other agreements for which applicable law does not permit a delegation of duties;

C. Contracts to make a loan or extend financing

Contracts that are to make a loan or extend financial accommodations to the debtor are not subject to assignment under section 365.

[81] 70 Am. Bankr. L.J. 95, 1996 National Conference of Bankruptcy Judges American Bankruptcy Law Journal Spring, 1996 and Equipment Leasing and the Bankruptcy Code, 17-31 and further.

5. Anticipatory Repudiation

Of similar interest is that some courts have held that terminations for default are stayed by operation of the bankruptcy code's automatic stay provision. [82] In re National Environmental Waste Corp. the court held that: "*...executory contracts are property of the bankruptcy estate and termination of an executory contract requires relief from the automatic stay; termination of a contract without relief from the stay is an act to exercise control over property of the estate which violates § 362(a)(3).)...*" [83]

Specifically, the airline debtor must beware that creditors may still take the initiative by trying to terminate the contract before the actual petition for bankruptcy reorganization. This is because of the fact that such pre-bankruptcy termination of the contract shall surely block the defaulting airline from either curing or assuming the contract. Whereas such termination may constitute a material default of the creditor under the agreement, the creditor may nevertheless take this loss consciously and decide to go through with termination as it may be preferable to having to face the more substantial costs of waiting during a lengthy bankruptcy reorganization. Additionally, if the airline debtor notifies the creditor of its intent to discontinue operations or if officers of the airline debtor orally state their intent to reject the contract, the creditor may argue in court that such acts constituted "*anticipatory repudiation*". Upon the creditor availing himself of this argument, justification is looked for by the creditor to terminate the agreement 'pre-petition' (i.e. before the filing of bankruptcy), regardless of whether or not the debtor is in default at that time yet. This practice, which may also be referred to as the ''doctrine of anticipatory repudiation' is a codification of the principle that the US Uniform Commercial Code gives any creditor the right to demand assurance of due performance if it has reasonable grounds for insecurity. In this view, should the airline debtor fail to respond within a reasonable time (mostly 30

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[82] See generally: In re Corporacion de Servicios Medicos Hospitalarios de Fajardo, 805 F.2d 440 (1st Cir. 1986); Harris Prods., Inc., ASBCA No. 30426, 87-2 BCA 19,807 (both finding that pending default terminations based on prepetition facts are stayed); Communications Technology Applications, Inc., ASBCA No. 41573, 92-3 BCA 25,211 (board holds that the automatic stay provisions nullify termination for default received two days after the petition was filed);

days), the agreement shall be deemed repudiated. Then if this repudiation substantially impairs the value of the agreement, which will generally be the case, the creditor may exercise all of its remedies available under the agreement and is allowed –in anticipation- to cancel the agreement. The airline debtor is left with no remedy.

5.1 Waiver or Deference of Termination Date

Importantly, a lease that is terminated or has expired by its own terms prior to the petition of bankruptcy filing by the airline debtor, cannot be resurrected in the bankruptcy case. The only argument left to the airline debtor would be that it might be successful in proving that negotiations with the lessor as well as any other actions taken before the filing of Chapter 11 –i.e. during an (out of court) workout- should be considered as constituting a waiver or deference of the termination date or event of the lease by the lessor.

Often this is an important issue in a chapter 11 procedure: numerous courts have addressed whether a pre-petition waiver of particular rights under the Bankruptcy Code would be enforceable after a bankruptcy filing. In short, contractual waivers of an automatic stay may be held enforceable under certain circumstances; however such will be rather exemption than rule since the court has established that a debtor's pre-petition waiver of its ability to assume or reject an executory contract should not be enforced for reason of incompatibility with the basic purpose of chapter 11, which is to maximize the return to creditors by allowing a debtor in possession to "*renounce title to and abandon burdensome property if such action is in the best interests of the estate.*" [84]

Importantly, in viewing section 365 as potential tool of 'reorganization strategy' it should be concluded that that there is no guarantee as to such applicability, despite

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[83] 191 B.R. 832, 834 (Bankr. E.D. Cal. 1996)

[84] In re Trans World Airlines, Inc., 261 B.R. 103 (Bankr. D. Del. 2001) as has already been discussed in paragraph 4.2 of this Chapter.

labeling a contract or transaction concerned as 'an executory contract or 'a (true) lease'.

6. Section 1113[85]

Labor is considered to be the largest single operating cost of airlines. Any legislation involving labor contracts therefore is of a specific and great significance to the airline industry. [86] Consequently, airlines almost always look

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[85] Full text of 11 USC Sec. 1113 (01/26/98) TITLE 11 - BANKRUPTCY CHAPTER 11 – REORGANIZATION:
Rejection of collective bargaining agreements (a) The debtor in possession, or the trustee if one has been appointed under the provisions of this chapter, other than a trustee in a case covered by subchapter IV of this chapter and by title I of the Railway Labor Act, may assume or reject a collective bargaining agreement only in accordance with the provisions of this section.(b)(1) Subsequent to filing a petition and prior to filing an application seeking rejection of a collective bargaining agreement, he debtor in possession or trustee (hereinafter in this section "trustee" shall include a debtor in possession), shall –make a proposal to the authorized representative of the mployees covered by such agreement, based on the most complete and reliable information available at the time of such proposal, which provides for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably; and provide, subject to subsection (d)(3), the representative of the employees with such relevant information as is necessary to evaluate the proposal. (2) During the period beginning on the date of the making of a proposal provided for in paragraph (1) and ending on the date of the hearing provided for in subsection (d)(1), the trustee shall meet, at reasonable times, with the authorized representative to confer in good faith in attempting to reach mutually satisfactory modifications of such agreement. (c) The court shall approve an application for rejection of a collective bargaining agreement only if the court finds that - (1) the trustee has, prior to the hearing, made a proposal that fulfills the requirements of subsection (b)(1); (2) the authorized representative of the employees has refused to accept such proposal without good cause; and (3) the balance of the equities clearly favors rejection of such agreement. (d)(1) Upon the filing of an application for rejection the court shall schedule a hearing to be held not later than fourteen daysafter the date of the filing of such application. All interested parties may appear and be heard at such hearing. Adequate notice shall be provided to such parties at least ten days before the date of such hearing. The court may extend the time for the commencement of such hearing for a period not exceeding seven days where the circumstances of the case, and the interests of justice require such extension, or for additional periods of time to which the trustee and representative agree. (2) The court shall rule on such application for rejection within thirty days after the date of the commencement of the hearing. In the interests of justice, the court may extend such time for ruling for such additional period as the trustee and the employees' representative may agree to. If the court does not rule on such application within thirty days after the date of the commencement of the hearing, or within such additional time as the trustee and the employees' representative may agree to, the trustee may terminate or alter any provisions of the collective bargaining agreement pending the ruling of the court on such application.
(3) The court may enter such protective orders, consistent with the need of the authorized representative of the employee to evaluate the trustee's proposal and the application for rejection,as may be necessary to prevent disclosure of information provided to such representative where such disclosure could compromise the position of the debtor with respect to its competitors in the industry in which it is engaged. (e) If during a period when the collective bargaining agreement continues in effect, and if essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate, the court, after notice and a hearing, may authorize the trustee to implement interim changes in the terms, conditions,wages, benefits, or work rules provided by a collective bargaining agreement. Any hearing under this paragraph shall be scheduled in accordance with the needs of the trustee. The implementation of such interim changes shall not render the application for rejection moot.(f) No provision of this title shall be construed to permit a trustee to unilaterally terminate or alter any provisions of a collective bargaining agreement prior to compliance with the provisions of this section.

[86] To illustrate that the cost of labor often proved the greatest difference in operating costs between (after) Chapter 11 and non-Chapter 11 airlines: e.g. on September 24, 1983, Continental Air Lines filed for

first for employee concessions, in the form of wage cuts or changes in work rules, to boost their productivity in times of a low cash flow. [87]

The difficulty, however, in a Chapter 11 proceeding, is the court having to evaluate and balance all of the competing interests of bankruptcy.[88] Whereas labor laws generally seek to preserve employees' rights to bargain collectively, bankruptcy law's (competing) objective is to facilitate a quick recovery of the defaulting company. [89]

"...It appears that the only successful airlines today are the original low-cost carriers or restructured mainline carriers. As we are currently seeing with airlines in the United States, the labour costs of most legacy North American carriers are simply untenable in the new airline environment. There cannot be the successful restructuring without a radical wholesale revision to work rules and changes under the collective agreements governing the company's 31,000 unionized employees.." [90]

6.1 Collective Bargaining Agreements

"...The collective bargaining agreement states the rights and duties of the parties. It is more than a contract; it is a generalized code to govern a myriad of cases, which the draftsmen cannot wholly anticipate . . . . The collective agreement covers the whole employment relationship. It calls into being a new common law -- the common law of a particular industry or a particular plant . . . . A collective bargaining agreement is an effort to erect a system of industrial self-government. " [91]

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bankruptcy relief, rejected its collective bargaining agreement, and laid off 12,000 employees. Two days later, 4,200 employees were reinstated at half their salaries. As a result, in 1988 a captain employed by American Airlines earned on average $ 12,386 per month, while a captain by Continental (Chapter 11) only earned $ 5480. (Adapted from book)

[87] www.unitedairlines.com, March 17, 2003

1113 (c) Procedural Filing Preserves Company's Ability to Meet; see Terms of Debtor-in-Possession Financing Aviation Week & Space Technology: December 16, 2002 United Flying Headlong Into An Uncertain Future; ANTHONY L. VELOCCI, JR./NEW YORK.

[88] Joanne F. Casey, President, Intermodal Association of North America, Greenbelt, Maryland, article: Harmonizing a Diverse Industry, Trfcw, May 4, 1998, at 70 (recognizing the existence of competing interests in the intermodal transportation industry; see also generally Douglas G. Baird & Thomas H. Jackson, Cases, Problems, and Materials on Bankruptcy 37-43 (2d ed. 1990) (discussing theoretical concerns with bankruptcy law and the competing interests of creditors and debtors).

[89] D. Bechara, in The Freeman, a publication of the Foundation for Economic Education, Inc., September 1986, Vol. 36, No. 9, also available at www.libertyhaven.com, last checked November 3, 2003.

[90] April 1, 2003; as said by Milton, Air Canada, Press Release "Air Canada to Restructure Under CCAA" at website of Canada NewsWire Ltd, checked last October 24, 2003

[91] In United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574, 578-80, 4 L. Ed. 2d 1409, 80 S. Ct. 1347 (1960), as declared by the Supreme Court; See also United Steelworkers v. Am. Manufacturing Co., 363 U.S. 564, 80 S. Ct. 1343, 4 L. Ed. 2d 1403 (1960)

The 1926 Railway Labor Act governs how airlines (and railroads) should negotiate with unions representing their employees. The underlying and historical purpose of this specific piece of legislation is to avert service interruptions that would otherwise harm interstate commerce. [92] At one point - besides the negotiation procedure as provided by the Railway Labor Act- airlines had only to take into account the applicability of section 365, however. In this respect, collective bargaining agreements were considered as being "executory contracts". As will be shown, this resulted in conflict, however.

Obviously, upon the court's adopting the open criterion under section 365 with respect to collective bargaining agreements, many airlines sought out the venue of Chapter 11 for purpose of rejecting labour contracts. For instance, Braniff Airways filed for Chapter 11 bankruptcy in 1982 for it could not continue operating because of a paralyzed cash flow. [93] The airline attempted to renegotiate new labour relations with its employees, however was only successful with a limited part of the employees only. The airline was forced to turn to the bankruptcy court requesting rejection of the collective bargaining agreements. In its claim, the airline argued that the rejection was required in order for the reorganization to take place. Rejection of the labour contracts was duly authorized by the court.[94]

As another example of strategic use of applicability of section 364, Eastern Airlines may be listed. By just using the threat of filing chapter 11, Eastern

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[92] Congress fashioned a specialized statutory scheme to effectuate its policy of self-adjustment of the common carrier industry's labor problems. International Ass'n of Machinists v. St., 367 U.S. 740, 759, 6 L. Ed. 2d 1141, 81 S. Ct. 1784 (1961). Concerned with the public's need for safe, reliable and convenient transportation, Congress created a comprehensive procedure for resolution of disputes between labor and management. The basic theory of the RLA is to compel the parties to negotiate their differences in good faith. If they reach an impasse, they must then follow a series of procedures set forth by the RLA. 45 U.S.C. §§ 152, 156. Only after these procedures have been exhausted may the parties abandon the status quo and resort to self-help. See Brotherhood of R.R. Trainmen v. Jacksonville Terminal Co., 394 U.S. 369, 378-80, 22 L. Ed. 2d 344, 89 S. Ct. 1109

[93] 11 USC, 1110 (a) (1)

[94] 1984 National Conference of Bankruptcy Judges, American Bankruptcy Law Journal Fall, 1984, 58 Am. Bankr. L.J. 293, Rosalind Rosenberg; Book, page 68 and following.

Airlines succeeded in gaining significant concessions from its employees and the unions representing them.

Nonetheless, the airline debtor's right under section 365 to reject any (executory) contract stood exactly opposite to the prohibition of the National Labor Relations Act. Under this Act no unilateral changes in collective bargaining agreements were namely allowed. [95] Also the Railway Labor Act prescribes airlines to (re) negotiate with unions representing their employees, employees enjoying the right to collective bargaining (i.e. right to vote on wages, benefits and working conditions), as well as the right to withhold their services or strike.

Under the National Labor Relations Act, a judicial standard was developed for determining whether it was possible for an (airline) debtor to reject a collective bargaining agreement during reorganization in re NLRB v. Bildisco and Bildisco, 465 U.S. 513 (1984). In this case, the Supreme Court namely held that a debtor could reject a collective bargaining agreement upon the debtor showing that the collective bargaining agreement burdens the estate and "*after careful scrutiny, the equities balance in favour of rejecting the labour contract.*" [96] These equities would for instance specifically include the inevitability and possibility of liquidation, the impact of claims on the debtor and its employees, and also good faith dealings between the labour union and the debtor.[97]

US airlines are currently pushing for changes to the National Railway Act, however.[98]

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[95] 61 Executory Contracts in Bankruptcy -- government and special contracts vs. terminating government contracts, November 1998 Civil Resource Manual 61

[96] In re Bildisco, 465 U.S. 513, 79 L.Ed.2d 482, 9 C.B.C2d 1219 (1984)

[97] See In re Alabama Symphony Ass'n, 155 B.R. 556 (Bankr. N.D. Ala. 1993); In re Blue Diamond Coal Co., 147 B.R. 720 (Bankr. E.D. Tenn. 1992) (both with comprehensive discussion of historical evolution of this issue).

[98] CESTA, which is a nearly 500-member coalition of local and state agencies and travel providers, backs the airlines in their call for changes to this Act.

6.2 Railway Labour Act in recent dispute

"*..The Railway Labor Act has failed to prevent strikes, it encourages acrimonious negotiations and it leads to agreements that dangerously weaken the airlines; It is an antiquated law, written in a different era for a different industry...*" [99]

The American Air Transport Association ("ATA"), which lobbies on the airlines' behalf –argues that the current system as required by the Railway Labor Act harms communities and the nation's economy. Allegedly the Act no longer reflects the needs of the nation's transportation system. Furthermore, the Act would stimulate service disruption from a strike, work slowdown or even bankruptcy, thereby having even more serious implications for the overall economy.

On the other hand, however, airline union leaders do still defend the Railway Labour Act. Accordingly, the system is claimed to give both sides an incentive to reach consensual settlements and maintains a healthy balance in the negotiating process.[100] In 2002, senator John McCain, led an effort to change this Act, by proposing the introduction of a special arbitration panel that would settle disputes upon a federal mediator's declaration of a 'labor impasse'. This would ultimately make it harder for unions to strike. This legal proposal, however, stranded in a subcommittee.

6.3 Legislative response

Because of the proliferation of business bankruptcies as a strategy to avoid (pending) liabilities with respect to labour, legislative response was held necessary.

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[99] Remarks of Carol Hallett, President and CEO, Air Transport Association, to the International Aviation Club of Washington, June 18, 2002

[100] "*....This latest attempt by conservative lawmakers and some airline CEO's to 'fix' a law that is clearly not broken is nothing but a smokescreen to give management a permanent advantage at the bargaining table..*" said GVP Roach in Railroading the Act, Labor Law Under Attack: at website http://www.iamaw.org/publications/spring2003/railroading.htm

To a certain degree, the Federal Judgeship Act of 1984 reformed the 'strategic 'love at first sight' bankruptcies' with the introduction of section 1113. .[101] Consequently, at present section 365 in conjunction with 1113 of Chapter 11 facilitate the airlines' effort in rejecting collective bargaining agreements like employment contracts.

" ...A big unknown is whether the airline will attempt to invoke Section 1113 of the bankruptcy code that would allow United to reject what it considers the most counterproductive labor agreements. It will depend on how much progress the airline is able to make in coming weeks, Buhler said. "Creditors will be eager to see evidence that management and labor can work together to get the job done. If they can't, pressure will increase to use this weapon of last resort." [102]

6.4 A New Era

The adoption of section 1113 introduced a completely new era much to the horror of the airlines. After successfully having relied on the open criterion as provided in the 1984 Supreme Court decision (In re Bildisco), whereby airline management was allowed to view bankruptcy as a method of ridding themselves of onerous collective bargaining contracts as a means to sharply reduce the often exorbitant and burdensome labor costs, section 1113 particularly changed the outlook.

Before the adoption of section 1113, airline management originally attempted to use chapter 11 to avoid obligations to pay health, life and disability benefits of retirees. However, such was not acceptable either. For this purpose, next to section 1113, Congress also passing the so-called 'Retiree Benefits Bankruptcy Protection Act' in 1988. Concurrently to the adoption of this act, section 1114 and section 1129(a)(13) was added to the Bankruptcy Code, effectively aiming to prevent abuse of Chapter 11. [103] A trend in cutting back some of the advantages airline debtors obtained by filing for bankruptcy relief may be seen.

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[101] In re Bildisco, 465 U.S. 513, 79 L.Ed.2d 482, 9 C.B.C2d 1219 (1984).

[102] Aviation Week & Space Technology: December 16, 2002; United Flying Headlong Into An Uncertain Future, by A. L. Velocci jr. New York.

[103] American Bankruptcy Institute Journal, December/January, 2000, Column Turnaround Topic, REFLECTING ON BUSINESS BANKRUPTCIES, From the Pre-Code Era Into the New Millennium, Gerald P. Buccino, Steven M. Gol.

6.5 Relationship between section 365 and 1113

'.. *It was the special objective of section 1113 of the Bankruptcy Code to prevent employers from using the act of a bankruptcy filing to obtain an automatic 'breathing spell' from their labor obligations, although the stay promises such a spell with respect to other obligations*'. [104]

As explained, helped by section 365, labor contracts qualified as any other executory contract so that an airline debtor during reorganization was in principle able to –quite easily- reject a collective bargaining agreement. [105] With the introduction of section 1113 this "easy venue" was blocked, however.[106]

Firstly it should be noted that despite its restrictions, section 1113 might also provide airline debtors some leverage so as to at least modify existing labor contracts. With the application of section 1113 such decision to modify may no longer be taken unilaterally, however. Presently, in order for management to reject a collective bargaining agreement, some procedural requirements and standards must first be met. The defaulting airline must now first bargain with the union prior to modifying or rejecting any collective bargaining agreement.

6.6 Criterion of Absolute Necessity

Today the largest percentage of major Chapter 11 cases, is initiated by airlines with significant unionized labor. [107] As a first requirement, management may only propose to the labor union representatives those modifications in employee benefits that are *absolutely necessary* in order to permit reorganization of the debtor. In essence, a collective bargaining agreement and/or labor contract can in essence, only be changed upon the debtor showing the court that the action is necessary to save the company from going out of business. [108]

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[104] Report on Eastern Airlines Bankruptcy proceedings, March 9, 1989
[105] Continental Airlines filing Chapter 11 on 24th of September 1983
[106] American Bankruptcy Institute Journal, December/January, 2000, Column Turnaround Topic, REFLECTING ON BUSINESS BANKRUPTCIES, From the Pre-Code Era Into the New Millennium, Gerald P. Buccino, Steven M. Golub
[107] Report United Airways
[108] Court may approve rejection of agreement if it finds: that
the debtor made a proposal;

6.7 Without good cause

In any event, labor unions may not refuse the debtor's proposal '*without good cause*'. In short, the US courts generally use the so-called "nine point test" in determining whether a rejection of the agreement under section 1113 should be supported.

Under the "Nine point Test" a chapter 11 debtor bears burden of proof under section 1113 by preponderance of evidence that: [109]

(1) The debtor has made a so-called modification proposal to union;
(2) The proposal is based on the most complete and reliable information available at time;
(3) The proposed modifications are necessary to permit reorganization;
(4) The proposed modifications assure that all creditors, debtor, and all affected parties are treated fairly and equitably;
(5) The debtor has provided union such relevant information as is necessary to evaluate proposal;
(6) Between the time of making proposal and the time of hearing on approval of rejection of existing contract, debtor has met with union at reasonable times;
(7) In meetings the debtor has conferred in good faith in attempting to reach mutually satisfactory modifications of collective bargaining agreement;
(8) The union has refused to accept the proposal without good cause; and
(9) The balance of equities clearly favors rejection of an agreement.

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the union rejected the proposal without good cause; and
the balance of equities clearly favors rejection of the agreement. (§ 1113(c)).
Also see: In re Maxwell Newspapers, Inc., 146 B.R. 920 (Bankr. S.D.N.Y.); In re Alabama Symphony Ass'n, 155 B.R. 556, 573 (Bankr. N.D. Ala. 1993 (discusses widely accepted nine point test for showing to support rejection). See also Int'l Union, UAW v. Gatke Corp., 151 B.R. 211 (N.D. Ind. 1991) (discusses split in circuit courts of appeals as to meaning of "necessary" modifications to CBA allowable under 1113(b)(1)(A)); In re Ionosphere Clubs, Inc., 1992 WL 73850 (S.D.N.Y. 1992) (interim relief under § 1113(e) denied).

[109] In re Walway Co. (1987, BC ED Mich)

6.8 Balances of Equity

Pursuant to section 1113 (c), the courts may always jump to the rescue of the airline debtor and refer to "the balances of the equities" in order to –nevertheless- grant a rejection of the agreement. [110] In this respect, some of the determining factors that may be taken into consideration by the court in balancing equities to determine propriety of Chapter 11 debtor's rejection of collective bargaining agreement or the debtor's good faith in attempting to reach mutually satisfactory modifications of such agreement under section 1113 would include:

(1) The likelihood and consequences of liquidation if rejection is not permitted;

(2) The likely reduction in value of creditors' claims if bargaining agreement remains in force;

(3) The likelihood and consequences of strike if bargaining agreement is voided;

(4) The possibility ad likely effect of any employee claims for breach of contract if rejection is approved;

(5) The cost-spreading abilities of various parties, taking into account number of employees covered by bargaining agreement and how various employees' wages and benefits compare to those of others in industry; and

(6) Either good or bad faith of parties in dealing with debtor's financial dilemma. [111]

6.9 Final Considerations

In sum, to use section 1113 to modify labor contracts, airline debtors must strictly comply with all of the terms and conditions to obtain court approval; it no longer is the easy venture it once was. Still, presently, considering the fact that labor

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[110] In re Continental Airlines Corp. 38 B.R. 67, 69 (Bankr. S.D. Tex) the bankruptcy court recognized there was a tension between the federal labor law and bankruptcy law policies and observed that its resolution would have to occur on a case-by-case basis; it declared itself bound by equitable principles to weigh and balance the competing interests of parties and to attempt to reach an accomodation between the various statutes if possible. The Court continued however, that the focus should be on whether the debtor, the assets of the estate and the interests of the substantial creditor's groups and the equity security holders will suffer more from the denial of the relief requested than would the interest of the Unions from granting the relief. This indicates that factors important in bankruptcy law are considered as the main importance.

costs are quite substantial for any (struggling) airline, although the Chapter 11 provisions regarding the rejection and assumption of executory contracts may not be as effective as they used to be, rejection can still be the initial venue and attractive strategy. Not for nothing, today the large percentage of the major Chapter 11 cases is initiated by airlines with significant unionized labor. [112]

" ...In United Air Lines' bankruptcy filing, the company vows to join forces with employees and other stakeholders to remake itself into an "efficient and vibrant airline" that will emerge from Chapter 11, "able to rise to the competitive challenges" it faces..." [113]

In sum, as airlines encounter turbulent financial times, it could well be the labor costs that are key to either the survival or collapse of the company in the re-organization process. In this view, the most effective strategy of the management of an airline may be to show that a change and renegotiation of the provisions of the labor agreements is desirable or necessary to save the organization. Often just by filing Chapter 11, an airline may get concessions from its employees that it would ordinarily not be able to get under normal circumstances.[114] The United Airlines case is a clear example of this. In their evaluation, bankruptcy courts strive to foster recognition between all parties that one side's financial interests are inextricably tied up with the other's. [115]

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[111] See: In re Truck Drivers Local 807, etc. v Carey Transp., Inc. (1987, CA2 NY) 816 F2d 82, 16 BCD 85, 16 CBC2d 799, 125 BNA LRRM 2093, 106 CCH LC P 12322

[112] Report United Airways

[113] Aviation Week & Space Technology: December 16, 2002; United Flying Headlong Into An Uncertain Future ANTHONY L. VELOCCI, JR./NEW YORK

[114] In re Continental Airlines Corp. 38 B.R. 67, 69 (Bankr. S.D. Tex) the bankruptcy court recognized there was a tension between the federal labor law and bankruptcy law policies and observed that its resolution would have to occur on a case-by-case basis; it declared itself bound by equitable principles to weigh and balance the competing interests of parties and to attempt to reach an accommodation between the various statutes if possible. The Court continued however, that the focus should be on whether the debtor, the assets of the estate and the interests of the substantial creditor's groups and the equity security holders will suffer more from the denial of the relief requested than would the interest of the Unions from granting the relief. This indicates that factors important in bankruptcy law are considered as the main importance.

[115] Airline Bankruptcy Virus Must Be Stopped, AVIATION WEEK AND SPACE TECHNOLOGY, May 3, 1993, at 66 and the Bankruptcy Strategist July 2001, section: Vol. 18; No. 9; Pg. 1Practice Tips; Chapter 11: An Acquisition Opportunity For Financial and Strategic Buyers By Harvey R. Miller and Shai Y. Waisman.

7. Section 541 (a); the Airline Debtor's Bankruptcy Estate

The focus of this next paragraph will be to flag the legal issues involving the interplay between bankruptcy reorganization and the regulation of several aviation related subjects in the specific context of the airline debtor's estate. Firstly addressed will be, whether airline landing rights and air traffic "slot" allocations may be considered as "assets" of the estate of the airline debtor. Definitely, it is of specific interest to the airline to have a comprehensive chapter 11 estate. Additionally, the interplay between bankruptcy and a few other aviation related US government regulations with respect to operating licenses, is briefly noted.

7.1. Including Airport Slots?

Pursuant to section 541 (a) 11 U.S.C. a bankruptcy petition creates an estate comprised of *"all legal and equitable interests of the debtor in property..."*. As with the scope of the automatic stay, the definition of "property" for purposes of the Bankruptcy Code is definitely quite comprehensive. [116] This definition generally includes all kinds of property, including tangible and intangible property (contractual rights).[117]

In principle therefore, this bankruptcy estate of an airline encompasses all of the airline's property interests, including all of its contractual rights and duties. *"..The temptation to conclude that the slots are property of the estate under section 541 of the Code is a great one, especially considering the impact upon a debtor airline..."* [118]

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[116] In re Wegner Farms Co., 49 B.R. 440, 442 (Bkrtcy N.D. Iowa 1985): see also previous paragraph on 'automatic stay'

[117] 11 U.S.C. 541(a)(2), (7). Property includes, among other things: bank deposits and accounts, checks, insurance owned by debtor, land sale contracts, leased property, accounts receivable, airport slots, assets of a corporation in which the debtor is a shareholder, cars and other vehicles, community property, crops, deposits, escrow funds, stock exchange seats, franchises, licenses and permits, livestock, marital property or obligations such as alimony, and various personal property. For a complete listing, see 11 U.S.C.A. 541 and accompanying notes (Supp. 2000).

[118] In re Air Illinois, 53 Bankr. 1 (Bkrtcy. S.D. Ill. 1985)

7.2. Value of slots [119]

AIRPORT SLOTS ARE ESSENTIAL FOR THE PROVISION OF AIRLINE SERVICES TO AND FROM CONGESTED AIRPORTS. A SLOT IS DEFINED IN EU LAW AS "... THE SCHEDULED TIME OF ARRIVAL OR DEPARTURE AVAILABLE OR ALLOCATED TO AN AIRCRAFT MOVEMENT ON A SPECIFIC DATE AT AN AIRPORT COORDINATED UNDER THE TERMS OF THE REGULATION...". THE NUMBER OF POTENTIAL SLOTS AT AN AIRPORT IS LIMITED BY THE AVAILABILITY OF RUNWAY, TERMINAL AND STAND CAPACITY. [120]

The market value of a slot is similarly determined according to the specific location of the airport, the time allocated, the season, the category of operators able to use it (airlines or commuters), and any other factors linked to availability of gates. Another important element that influences the value of a slot is the operative limitation related for example to noise abatement procedures or runway limitations. [121] Therefore, the market value of slots is not homogeneous and of equal value. For instance, slots that allow aircraft of all sizes like those that permit aircraft to fly at peak times are obviously worth more. [122]

Significantly, only once the 'slots' have been allocated do they immediately gain value due to the fact that other airlines, which do not have enough slots or have

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[119] Draft proposal for a European Parliament and Council Regulation (EC), amending council regulation (EEC) n. 95/93 of 18 January 1993 on common rules for the allocation of slots at community airports.

[120] Article 2(a) of European Regulation 95/93.; Auctioning airport slots a report for treasury and the department of the environment, transport and the regions, January 2001, available at:www.dotecon.com

[121] Some of the most significant transactions occurred in recent years: In 1990, United Airlines paid 60 million American dollars for twenty-one slots and the use of gates at O'Hare airport. In the same year, American Airlines bought fourteen slots at La Guardia and Washington National airport. On that occasion it was said that slots at such busy airports were generally sold for a value that ranged between 500,000 and 1 million American dollars per slot, the price being determined according to its time and its takeoff and landing rights. In 1991, USAir bought ten slots at Washington National and twelve slots at La Guardia for 16.8 million American dollars (that is $760,000 per slot). USAir also bought eight slots at La Guardia airport for 6 million American dollars (that is $750,000 per slot). American Airlines bought twelve slots at La Guardia airport and ten slots at Washington National for 21.4 million American dollars (that is $970,000 per slot). Continental bought thirty-five slots at La Guardia airport taking on a debt worth 54 million American dollars from Eastern Airlines (that is $1.5 million paid per slot). Delta bought six slots at La Guardia airport for 3.5 million American dollars (that is $585,000 paid per slot). In 1996, it is said that a new entrant on the market was forced to pay approximately 2 million American dollars for a single slot at La Guardia airport, from: note 37-39 in 1996 Emory University School of Law, Bankruptcy Developments Journal, 12 Bank. Dev. J. 845, Note & comment: flying at risk: how should bankruptcy interact with aviation safety enforcement? Article by Kenneth A. Clark

[122] report: auctioning airport slots a report for treasury and the department of the environment, transport and the regions January 2001 available at:www.dotecon.com; at page 43 and further: "*...Although airports recoup the costs of allocation indirectly through charges on airlines for runway, stand and terminal facilities, such charges are related to general measures of passenger numbers and infrastructure use and do not reflect the scarcity value of these resources. Moreover, whilst these charges are currently differentiated by time of day, this variation is small and does not reflect the relative economic value of peak and off-peak slots.*"

slots at (non-peak) times, want to acquire them. [123] Due to a discrepancy between air travel growth and growth of airports, airport slots became 'rare goods'. As a result, airport slots presently have a high economic value in spite of the fact that they were never bought initially. [124] Nowadays, airlines are more than prepared to pay high sums of money for them. Since the possession of a good airport slot, could surely guarantee the airline of high chances of success; it could also represent a strong barrier to, if not keep out, competition. In sum, the major airlines avoid selling slots, whatever the price.

7.3. Nature of the slot market

The basic characteristic of the airport slot market would be that slots are not goods in the sense that the seller cannot 'produce' them. Slots have a value only because they facilitate air travel to and from airports. Slots allow an airline to land or takeoff at an airport in a certain time and day of the week. Restricted airport capacity translates into restricted aircraft capacity. [125] As addressed, airport slots do not represent an intrinsic value on their own. Slots can only be created by a third party, for instance in the US this is the FAA (Federal Aviation Authority). The FAA does not make up any part of the market, however, neither as a buyer nor as a seller.

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[123] Ibid. (the trade in such circumstances can be defined as "secondary trading").

[124] Ibid. "Secondary Market" and the 'Use-it-or-Loose-it Rule": *as the primary means of allocation, there is benefit in establishing a secondary market. A so-called secondary market is necessary to allow efficient reallocation of slots in the event that circumstances change mid tenure or even mid-season. It complements a primary auction by reducing aggregation risks and providing a forum for sale of part-season slot usage rights is recommended. The development of a single exchange with specific rules for slot trading, rather than a series of bilateral deals, in order to maximise transparency and liquidity, and prevent any market power abuse should only apply to carriers with sufficiently large shares of slots. With market-based pricing, there is no reason why a carrier without market power should be prevented from holding unused slots. Holding seldom-used or unused slots to provide operating flexibility is efficient where the value of such flexibility exceeds the market price of the slots. Allowing greater flexibility would reduce barriers to expansion and promote competition. Where slots were unused and provided no flexibility benefits, there would be a strong incentive to sell them on the secondary market. Even where carriers would not want to sell a slot outright in order to retain flexibility, they would have a strong incentive to lease slots to other carriers, retaining the right to recall them on short notice. Therefore, a more discriminating application of the 'use it or lose it' rule in a market-based regime would lead to at most limited (if any) holding of unused slots. Only where carriers have possible anti-competitive reasons for hoarding unused slots should the 'use it or lose it' rule be triggered. This could be conditional on the proportion of slots that a carrier held.* From: Report: "Allocating Scarce Airport Slots"; http://www.pc.gov.au/inquiry/airports/finalreport/appendixh.pdf

Adding to the "hybrid" concept of a "slot" is that in essence, from a technical point of view, is only a space in time that can be used by an aircraft to take off and land. In this light, for instance German legal doctrine argues that time, in a certain place, is something that belongs to the common good (i.e. public). German legal doctrine continues that with ownership over airport slots is referred to having equal rights to using (limited) air space only (i.e. "*gleichberechtigte Teilhabe am begrenzten Gut Luftraum,*"). However, German doctrine does not accept nor welcome the concept of free disposal over airspace. This theory interferes with current practice of trade in slots, however.

The above discussion is of particular interest in the context that, despite the fact that both in the US and in Europe slot allocations by different Aviation Authorities were never meant to constitute a property right, in practice a so-called "hidden" market (generally referred to as "grey market") in the trading of slots has developed. The fact that this is market that is not particularly transparent makes it difficult, however, to estimate its exact size and economic value. Nevertheless many leads do exist that show that it is a market of substantial interest and value. Actually, in practice, major carriers will even strategically consider to buy out smaller companies if not only in order to acquire their slots. [126]

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[125] From: Report: "Allocating Scarce Airport Slots"; http://www.pc.gov.au/inquiry/airports/finalreport/appendixh.pdf

[126] Article 8.4 of the Regulation (CEE) No 95/93 In the preamble of this study, it was noted that there is a strong "hidden" slot market in Europe; that consists of trading, exchanges with monetary compensation, and purchases of companies, all with the unique aim of achieving slots. The fact that these economic transactions take place in a "hidden" context is mainly due to the "cryptic" element of Article 8.4 of the 95/93 Regulation. In fact, it is not clear and does not explicitly explain how slots should be given up, nor does it clarify the relationship between the carrier that holds a slot and the slot itself.
Article 8.4 states that "slots may be freely exchanged between air carriers or transferred by an air carrier from one route, or type of service, to another, by mutual agreement or as a result of a total or partial takeover or unilaterally." Any such exchanges or transfers shall be transparent and subject to confirmation of feasibility by the co-ordinator that:
a) airport operations would not be prejudiced;
b) limitations imposed by a Member State according to Article 9 are respected; a change of use does not fall within the scope of Article 11, which includes safety measures to ensure that the transfer of slots does not hinder free competition or give advantage to certain carriers on particular air routes that enables them to block any possible new entrants;

Worldwide, problems exist(ed) for courts to determine the value of airport slots within an airline debtor's bankruptcy estate. In the US, slots were initially and explicitly not meant to be subject to property rights: the FAA stated that "*[s]lots do not represent a property right but represent an operating privilege subject to absolute FAA control.*"

7.4 Airport Slots: "property"? [127]

A key objective and correlating concern for an airline operating during bankruptcy reorganization, is to retain all the assets, which are necessary to conduct cash-generating operations. In allowing for reorganization, whereas "*US Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap'....*", accordingly, the bankruptcy estate, upon commencement of the case, should capture "all legal or equitable interests of the debtor in property". The Supreme Court has affirmed this by holding that "property" is to be interpreted broadly in favour of the bankruptcy estate, noting that "*the reorganization effort would have small chance of success . . . if property essential to running the business were excluded from the estate.*". In this respect, even some business and occupational licenses may be labelled as 'property' for bankruptcy purposes.[128]

For many defaulting airlines, the possession of slots enables them to attract the needed assistance of outside investors, effecting a successful reorganization. As noted, while operating the debtor's business, according to US Bankruptcy Code chapter 11, the debtor airline may "use, sell, or lease" the property of the estate,

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[127] See John Balfour, Who really owns the slots? A legal view, Presentation at the London Strategy For Overcoming Slots Limitation Congress, June 27, 2000 and also see: E. Giemulla & R. Schmid, Wem gehört die Zeit?, Z.L.W. 51 (1992), and Nochmals - Wem gehört die Zeit?, Z.L.W. 259 (1991). On the question regarding the ownership of time, it would be interesting to note that during the Middle Ages, the concept of renting with interest was condemned because it was not possible to sell time, since it is common and equally accessible to all: "*Queritur an mercatores possint licite plus recipere de eadem mercatione ab illo qui non possit statim solvere quam ab illo qui statim solvit. Arguitur quod non, quia tunc venderet tempus et sic usuram committeret vendens non suum.*" Le Goff, Tempo della Chiesa e Tempo del Mercante, Turin 3 (1977)

[128] Pension Benefit Guaranty Corp. v. Braniff Airways Inc. , 700 F.2d 935, 942 (5th Cir. 1983) (court prohibited from using section 105 to protect landing slots since slots are not property of estate). Cf. In re Gull Air Inc. , 890 F.2d 1255 (5th Cir. 1989) (debtor had limited proprietary interest in landing slots)

subject to certain restrictions upon transactions "other than in the ordinary course of business". [129]

The important question therefore seems to be whether the bankruptcy estate of the airline includes "airport slots"?

7.5 Case law

a. In Re American Central Airlines Inc.[130]

In this case it concerned a binding legal contract that governed the allocation of slots at O'Hare airport, Chicago. This contract contained a so-called "*use it or loose it*" provision, which forces a surrender of slots if the slot is not operated to the specified initially assigned capacity. Since the automatic stay was not lifted, the defendant was not permitted to enforce this contractual ("use it or loose it") provision against the airline debtor. The court held that (contrary to In re Illinois and In re Braniff Airways), the airline debtor had a contractual interest in slot allocation, whereby section 362 (a) was made applicable to airport slots. [131] Therefore, any act to enforce this contractual provision against the airline debtor would constitute an act to obtain possession of property of the estate and attempt to exercise control over property of the estate. Since such act violates section 362 (a) (3) it is therefore without effect.

Interesting is the court's re-evaluation of the In re Illinois decision, in which the Illinois court relied on a plain reading of 49 U.S.C. section 1371 (i) of the FAA: "*...no certificate should confer any proprietary, property or exclusive right in the use of any airspace, federal airway, landing area, or navigation facility..*" Contrary to this court, the Iowa court finds that this statute only bars the Civil

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[129] Kenneth E. Clark, Emory University School of Law, Bankruptcy Developments Journal, 12 Bank. Dev. J. 845, NOTE & COMMENT: FLYING AT RISK: HOW SHOULD BANKRUPTCY INTERACT WITH AVIATION, 1996, at 853.

[130] In re American Central Airlines Inc., 52 B.R. 567; 1985 Bkrcty court of Iowa

Aeronautics Board from creating a property right in airspace. It continues that '*..no equivalent provision exists, barring the FAA from creating a property interest through a grant of access to an airport...Also, the mere fact that an interest exists by the mere grace of government no longer precludes the interest from being treated as a property right...* '. [132]

b. In re McClain [133]

The authoritative decision is In re McClain Airlines. The reason for this is that initially the Civil Aeronautics Board expressly did not want to create property rights in air transportation. So despite a codification of such in section 1371 (i) of the Federal Aviation Act, the court in this case, however, followed the abovementioned American Central Airlines court and determined that airport slots should be considered as property of the debtor's airline estate.

In reaching its decision the Court relied on the following;

" *The continuing vitality of the abolition of 'property rights' as set forth in 14 C.F.R. s 93.223(a) should be considered in light of current administrative developments. (that is, the buy-sell proposal which permits maximum reliance on market forces to determine slot distribution following the initial allocation of slots).*[134] Additionally, the court noted, that the enactment of this rule was so as to "*minimize the need for government intervention*" and permit for '*a market in slots that will effect a long-range stability in carrier planning and marketing*'. [135] In the Gull Air Inc. case, the court also discounted the FAA's statement that the buy-sell rule created no proprietary rights in slots. [136] In this case, the Court also referred to the McClain decision.

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[131] In re Air Illinois, 53 Bankr. 1 (Bkrtcy. S.D. Ill. 1985): the court, however did acknowledge that: *'the temptation to conclude that slots are property of the estate under section 541 is a great one, especially considering the impact upon a debtor airline.. "* and In re Braniff Airways Inc., 700 F. 2d. 935 (5th Cir. 1983)
[132] Matter of Matto's Inc. 9 B.R. 89,91 (Bkrtcy. E.D. Mich. 1981)
[133] In re McClain Airlines, Inc., 80 B.R. 175 (Bankr. D. Ariz. 1987)
[134] McClain, 80 B.R. at 177
[135] In re Gull Air, Inc., 890 F.2d 1255 (1st Cir. 1989), at 1259-60
[136] In re Gull Air, Inc., 890 F.2d 1255 (1st Cir. 1989).

In sum, while the FAA attempted to refute the creation of proprietary rights through its pronouncement in mentioned 14 C.F.R. section 93.223(a), the court – repeatedly- decided to the contrary by concluding that any pronouncement was not to detract from the reality that an actual market for these slots exists; that airlines possess a (limited) proprietary right in allocated slots even if that interest is encumbered by conditions imposed by FAA regulations (i.e. approval required for allocation, transfer and disposition of slots). [137] Noteworthy, however, is that in evaluating the property rights of slots in the context of a bankruptcy, the court determined that if the government had properly and permanently withdrawn slots from a debtor airline under appropriate federal administrative law, the debtor and debtor's estate would in that case still rightly lose the property rights in such slots. [138]

c. Conclusion

It can be concluded that these judgments in the context of bankruptcy, at least to a great extent forced the FAA to recognize slots for what they are: in light of the buy-sell rule they are in fact rights of property that may have to be defended in case of bankruptcy. Nonetheless, the FAA continues to claim that the qualification of slots as property, as upheld by the Bankruptcy Courts "[has] not been found in any other context." [139]

7.6. Status of "airport slots" within Europe

In Europe, it has (not yet) been definitely decided nor codified whether airport slots are property within a bankruptcy estate. Nonetheless the Preambule to the 2000 Draft Proposal for a European Parliament and Council Regulation Amending Council Regulation (EEC) No 95/93 of January 18, 1993, on Common Rules for the Allocation of Slots at Community Airports suggest this is not the case: "*...Whereas it is necessary to clarify that slot allocation must be considered as a concession system giving air carriers the entitlement to access the airport*

[137] Gull Air, 890 F.2d at 1260
[138] In re GULL AIR, INC., 890 F.2d 1255,

facilities by landing and taking-off at specific dates and timings for the duration of the concession period; whereas therefore slots do not constitute any property rights...."[140] However, at the same time in art. 8a, § 1 of this Regulation the following is stated:

Slots may be:

- *Transferred by an air carrier from one route or type of service to another route or type of service operated by that same air carrier;* [141]
- *Transferred (i) between parent and subsidiary companies, (ii) as part of the acquisition of the majority of the capital of an air carrier, or (iii) in the case of a total or partial take-over when the slots are directly related to the business taken over;*
- *Exchanged, one for one, between two air carriers where both air carriers involved undertake to use the slots received in the exchange.*

Additionally indicative, is that this Regulation provides that, in the case of joint operations, code-sharing and franchise between air carriers, only one of the participating air carriers can apply for the required slots. [142] This surely does imply some kind of "property status". Furthermore, under the Regulation the air carrier actually operating the service is thereby also assuming responsibility for meeting the operating criteria required to maintain its slot precedence. Additionally, upon discontinuation of code sharing operations, the slots so used will still remain with the air carrier to whom they were initially allocated. All of these factors indicate that the EU (bankruptcy) courts may, contrary to the introduction of the Regulation indeed have a similar attitude as the US court towards assessing that airport slots are 'an asset' in an airline debtor's estate.

In sum, despite their predominant 'unphysical nature', in practice airport slots have an important 'market value' both in the US and Europe. In any case, both jurisdictions allow airlines to transfer and lease slots. This may imply that airport

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[139] In re United Airlines, Inc., No. 27151, B.R. (May 3, 1993).
[140] REGULATION (EC) No 894/2002 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL; 27 May 2002 amending Council Regulation (EEC) No 95/93 on common rules for the allocation of slots at Community airports
[141] See Draft Proposal, supra note 75, at art. 8a, § 2(a). Article 8a, § 2(a) states: "Leasing of slots shall be considered as transfers within the meaning of this paragraph."
[142] art. 8a, § 6

slots can constitute 'property rights' or are considered as an "asset" at least so far as is warranted for or to the degree these slots are of specific value in an airline debtor's bankruptcy estate.

7.6. Air Carrier Operating License

Federal airline safety regulation is a clear example of the police powers, which are exempted from bankruptcy's automatic stay 11 U.S.C. section 362(b)(4). Although, bankruptcy and aviation laws seem plain and non-conflicting and US federal airline safety regulations are a clear example of police powers, that are exempted from the reach of the bankruptcy's automatic stay, in practice, though, the bankruptcy and regulatory powers do not stand absolutely separately. The safety regulations may even be restrained by the application of the bankruptcy court's broad equity powers. This may be because of the fact that an exercise of the FAA's police power may have major financial implications for an airline's bankruptcy estate. Surely the airline with a valid operating license clearly holds a more valuable asset for reorganization than the same airline whose federal license has been revoked. The debtor airline's strategy may thus be so as to oppose a revocation of such license.

Another very important question is whether an air carrier operating license or certificate is to be considered an asset in the airline debtor's estate.The US district Court ruled in Re Horizon Air that an air carrier-operating certificate is a significant property interest, which entitles the holder to commence airline operations, which in turn involves a considerable investment of capital. [143] The court continues with:

".. *Although the F AA may order the surrender of an air carrier operating certificate at any time, until such action is taken, the holder has a possessory interest in the certificate. The mere fact that the certificate is issued and regulated by the FAA does not preclude the certificate from being treated as a property right*".

[143] Nevada Airlines v. Bond, 622 F.2d 1017, 1019-20 (9th. Circuit 1980)

In Re Pan American World Airways another court had already determined that a certificate of public convenience and necessity is to be deemed as valuable property and should not be lightly dealt with once the certificate holder starts operations, which necessarily involve a considerable investment of funds and create employment. [144] In sum, in this case the FAA Air Carrier Operating certificate was to be treated as property of the airline debtor's estate. With this decision the court overrode two other aviation, non-bankruptcy law related federal statutes, however. This conflict was considered as of no immediate importance, however. Namely under section 541 (c) (1) (A) of the Code, property of the airline debtor becomes property of the estate notwithstanding any applicable non-bankruptcy law provision "that restricts or conditions transfer of such interest by the debtor". Furthermore, the court held that the fact that the air carrier-operating certificate is not transferable or non-assignable does not prevent it from becoming property of the bankruptcy estate either. In sum, it was held that property comes into the estate subject to any restrictions on its use or conveyance that may be imposed by non-bankruptcy law.[145]

8. Conclusion

It can be concluded that a key objective and correlating concern for an airline operating during bankruptcy reorganization, is to re-evaluate and re-negotiate the burden on its estate and at the same time to retain all of its assets, which are necessary to conduct cash-generating operations, which is duly acknowledged by the US bankruptcy court. As a leitmotiv of this book, the United States Bankruptcy Code virtually gives the airline industry a specific status; the bankruptcy code aims to resolve some of the most common concerns in the context of potential default of an airline. Having discussed the particularities with

[144] Pan American World Airways, Inc. V. Boyd, 207 F. Supp. 152, 156 (D.D.C. 1962)
[145] United States vs. Whiting Pools Inc. 462, US 198, 203 (1983): 'Property' is to be interpreted broadly in favour of the estate, noting that 'the reorganization effort would have small chances of success....if property essential to running the business were to be excluded from the estate. " Even some business and occupational licenses have been held to constitute property rights for bankruptcy purposes.

respect to the coefficient of 'labour' and 'airport slots' and 'operating licenses'; the next chapter will illustrate the coefficient of 'aircraft equipment'.

CHAPTER 5

Section 1110 –Financing of Aircraft Equipment

"Clearly we would have preferred to complete our restructuring outside of the Bankruptcy Court, particularly in light of our significant progress to date. A major element of our strategic plan and the key to the future financial health of the company is to mark our aircraft lease rates to market, but without the support of certain of our aircraft lessors, we felt obliged to protect the assets of the company, including the continued use of our aircraft while the restructuring is finalized...."

"Whether or not there was an initial need for these provisions, their existence has become largely addicting to the financing industry, and now the industry claims it would simply cease financing of the relevant equipment if the protections were removed " [146]

1. Introduction

Section 1110 regulates aircraft equipment financing within the context of airline bankruptcy reorganization. Often this provision is referred to as providing extraordinary protections to a specified class of aircraft financiers, the results of which may be uniquely far reaching for airlines in reorganization. [147] This mostly is because of the fact that depending on the scope of applicability of this provision, the airline debtor's discretionary powers in relation to its aircraft equipment leases, are curbed. [148] Characteristic to aircraft equipment financing is its 'international resonance': whereas aircraft equipment enjoys a specific property status under international air law, domestic laws may nonetheless

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[146] The report of the House of Representatives concerning the proposed 1110 stated." H.R. Rep. No. 95-595, at 239 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6198-200.

147 Jason J. Kilborn "Thou can not fly high with borrowed wings, Airline Finance and Bankruptcy Code Section 1110", at George Mason Law Review, Fall, 199.

[148] Interesting from an equipment lessor's point of view is that, pursuant to sections 365 (d)(4) and 365 (d)(3), if the airline debtor is the lessee under a "non-residential" lease, the debtor must assume or reject within a specified time period of 60 days after the bankruptcy filing, or such additional time as the court may determine, or the lease will be deemed rejected. [148] In this light, subject to certain exceptions, the debtor is required to timely perform all its obligations, including the payment of rent, arising after bankruptcy until assumption or rejection. The court order to timely perform shall include the obligation to pay taxes and insurance premiums and to maintain aircraft equipment. The court may, however, order otherwise as well: It may order that payments shall be less than the contract rent or lease term payment, for instance.[148] According to section 363 (e) the court can, however, upon request of the creditor, also prohibit or condition the debtor's use of equipment as necessary to provide adequate protection to the creditor. This may entail the order of periodic cash payments, an additional lien or replacement lien or a so-called super-priority administrative expense claim as defined in section 361.

undesirably interfere. Consequently, the property status of aircraft equipment (i.e. rights of ownership, priority of security rights etc.) within the airline debtor's estate to some extent somewhat questionable. In this perspective, both the doctrine of accession and the different choice of law venues under international air law deserve attention. [149]

2. The "Extraordinary Protection"

".... Section 1110 protects a limited class of financers of aircraft...and should be narrowly construed; repossession under section 1110 is exception rather than rule, and protections afforded to a lessor under section 1110 must be read in harmony with section 364 and chapter 11's overall purpose of rehabilitating the debtor and allowing it to continue business..." [150]

In the United States, airlines virtually enjoy a specific status under the Bankruptcy Code. The predominant example of this is Section 1110. This provision specifically sets out a unique legal framework in the context of airline bankruptcies in order to ensure a strong (inter) national financing practice balancing the interests of both the airline in reorganization and the financer/owner of aircraft equipment.[151] Tying both the airline and the financer together is the fact that the nature of the airline industry is extremely capital-intensive.

3. The Uncontested Importance to Aircraft Equipment Financers

Section 1110 is meant to resolve some of the common concerns and uncertainties that financers may have in the context of potential default of an airline. In this respect, a specific concern is whether the underlying legal documents shall be (equally) enforceable in all relevant jurisdictions.

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[149] In this view, additionally, one of the first concerns is that the best legal methods are employed so that the specific financing contracts with respect to the equipment are enforceable in all relevant jurisdictions; and that secondly a perfected security interest or claim to the equipment exists in the event that the agreement, with respect to repayment, cannot be enforced through normal collection.

[150] Bouillion Aircraft Holding Co. vs. Western Pacific Airlines, 1998 DC Colo, 216 BR 437, 15 Colo Bankr. Ct. Rep 82, 31 BCD 1327

[151] Sandor E. Schick, Business Lawyer, When Airlines Crasch: Section 1110 revisited, September, 1992

The first of the many risks is posed by the size of the financing. Generally, transportation (aircraft) equipment always represents one of the highest-cost investments. Secondly, aircraft equipment also has a very long economic life, with similarly long financing terms. However, despite this long expected life, the equipment may nevertheless be subject to rapid deterioration in value if not regularly used and maintained. Finally, the equipment is mobile, raising the risk that it may be difficult to locate and recover as collateral in the event of default of the airline. For financiers, these risks are particularly magnified by the current economic and financial distresses; as discussed the airlines are momentarily plagued by turbulence and vulnerability.[152]

Taking the above into account, any financer would benefit to know that its (security) interest or claim to the aircraft equipment exists under any circumstance, including bankruptcy (reorganization). Given the complexity, diversity and often magnitude of aircraft equipment financing transactions, financers seek – indeed, mostly demand—maximum protection for their investment. More in particular, they seek protection from the worst-case scenario of an airline bankruptcy.

4. The Uncontested Importance to the Airlines[153]

It is argued that the ability for financiers to recover the aircraft after default under the financing agreement despite the effective automatic stay as a result of filing Chapter 11, has induced a large number and variety of aircraft equipment financing structures, which is claimed to be extremely beneficial to the economically vulnerable airline industry.

Since aircraft (equipment) specifically involves exceptionally high-cost and long-term investments, airlines are generally forced to arrange financing of their

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[152] American Bankruptcy Law Journal, Winter, 1987 , 61 Am. Bankr. L.J. 1

[153] Section 1110 refers to Chapter 11 U.S.C. paragraph 1110 ; Equipment Leasing Leveraged Leasing, Fourth Edition, Volume 1, I. Shrank and A.G. Gough, 17:6.1

aircraft (equipment) acquisitions. [154] In Seidle v. GATX Leasing Corp., 778 F.2d 659, 663 (11th Cir. 1985) the court referred to the legislative purpose of section 1110, which was "*to encourage new financing of . . . airplanes.*", which was to facilitate fleet modernization. [155]

The collateral required for the financing is mostly by the equipment itself, which however, is subject to rapid deterioration (especially if it remains in the hands of a bankrupt during potentially lengthy reorganization proceedings (aircraft are then generally parked (i.e. special aircraft graveyards)). In this light, section 1110 was deemed necessary. Whereas virtually all other categories of creditors must endure substantial delays before receiving any payment on their claims in case of a bankruptcy reorganization procedure, aircraft (equipment) financers, in contrast, are protected under section 1110.

With this protection is meant, that according to this provision, within 60 days after the start of the reorganization, aircraft financers are entitled to a cure to any default under the financing agreement (i.e. receive payment). Upon any default after the lapse of these 60 days, aircraft equipment financers may repossess the equipment in which they have 'interest'.[156] In this view, since the financers are given a right to current payments under the lease or are otherwise permitted to re-possess their aircraft collateral, financers are particularly relieved from delays attendant to a general reorganization proceeding. Accordingly, the possibility of either deterioration or possible loss of their (aircraft) collateral is typically curbed, whereby more favorable financing rates are promoted. It is therefore argued that

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154 George Mason Law Review, Fall, 1999, Article "Thou can not fly high with borrowed wings, Airline Finance and Bankruptcy Code Section 1110", at page 1, referring to footnote 6: "The cost of a brand new Boeing jetliner, for instance, ranges from approximately $ 35 million for the Boeing 717-200 to in excess of $ 230 million for the Boeing 777-300ER", also see Boeing Commercial Airplane Prices, at http://www.boeing.com/commercial/prices (last visited July, 14, 2002).

155 See for an elaborate overview also: George Mason Law Review, Fall, 1999, Article "Thou canst not fly high with borrowed wings, Airline Finance and Bankruptcy Code Section 1110; and also In re Air Vermont, 761 F.2d at 132: "Congress did intend to extend extraordinary protection to financiers of aircraft in order to encourage investment in new equipment for air carriers.")

156 64 Am. Bankr. L.J. 109, 1990 National Conference of Bankruptcy Judges, American Bankruptcy Law Journal Spring, 1990, Article: "Section 1110 of the Bankruptcy Code: Time for Refueling?" by James W. Giddens, see also Sandor Schick article at 111.

the airline would probably not obtain –at least not as easily- financing without such specific legal protection to a financer.

In short, protection under section 1110 is significant to both the aircraft financers and the airlines. As noted, section 1110 is intended to promote the financing of aircraft equipment. More specifically, this section aims to balance the (competing) interests of chapter 11 airline debtors with those of financiers (creditors). The interests are both competing and substantially quantified in a reorganization procedure: the stakes are specifically high for both parties. The airline will want to buy and finance its equipment to either continue operations or expand businesses at a restructured, controlled and lower cost of financing; and in the event of default always strive to get as much time as possible in order to be able to decide what equipment it would need to retain in its reorganized -more cost efficient- fleet. Similarly, financiers require security and protection in their property interest. [157] Equipment financing carries with it extraordinary risks, which in the US is held to justify an extraordinary protection (i.e. section 1110) for aircraft equipment financers and airline debtors alike.

4.1 Financing of aircraft acquisition; Analysis

"Hawaiian Airlines Gets Relief From Aircraft Lessor .....HONOLULU, July 23, 2003 -- In continuing negotiations with its aircraft lessors aimed at reducing its fleet costs, Hawaiian Airlines, Inc. today announced that Boeing Capital Corp. (BCC) has granted the company a third extension of the 60-day period under Section 1110 of the U.S. Bankruptcy Code. During this period, no action may be taken on the part of the aircraft owner while the parties negotiate new lease terms. Subject to court approval, the new expiration date will be August 31, 2003. Joshua Gotbaum, trustee for Hawaiian Airlines, said, "Boeing's willingness to extend this protection is an expression of goodwill toward Hawaiian Airlines, which we appreciate." On March 21, 2003 Hawaiian Airlines filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the

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[157] " Use and Disposition of Property Under Chapter 11 of the Bankruptcy Code: Some Practical Concerns", by Levit, 53 Am Bankr L J 275, Summer 1979; see also Gerstell; Hoff-Patrinos. Aviation Financing Problems Under Section 1110 of the Bankruptcy Code. Winter 1987; Goldman; Album; Ward. Repossessing the Spirit of St. Louis: Expanding the Protection of Sections 1110 and 1168 of the Bankruptcy Code. 41 Bus Law 29, November 1985; and Schroeder; Carlson. Airplanes in bankruptcy. 3 J Bankr L & Prac 203, March/April 1994 Jacob; Meises. The 1994 amendments to Section 1110 of the Bankruptcy Code: the issues left up in the air, 5 J Bankr L & Prac 349, May/June 1996.

U.S. Bankruptcy Court for the District of Hawaii in Honolulu. The company is seeking to restructure agreements on Boeing 717-200 aircraft and Boeing 767-300ER aircraft it leases from BCC, both directly and through owner trust arrangements. "[158]

Obviously, a substantial financing practice exists in which a multiplicity of different innovative financing structures that may be chosen from by the airline. [159] Some typical structures -without suggesting providing a comprehensive analysis- include a so-called "asset-based finance", in which the so-called 'revenue generating value' of the aircraft that is financed, will be the primary source of repayment. [160] An airline may further finance its acquisition of aircraft by either using its own funds or by borrowing funds from a bank or lender, or also by leasing the aircraft for a fixed term. In the latter, when a lease is used, a lessor in effect finances the acquisition. Both leasing and borrowing implicate the applicability of section 1110. [161] [162] Against this background, it is argued that

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[158] News Release Hawaiian Airlines, website http://www.hawaiianair.com/about/corporate/NewsRelease/Section_306.asp

[159] Equipment Leasing Leveraged Leasing, Fourth Edition, Volume 1, I. Shrank and A.G. Gough, 17:6.1; Recent bankruptcies and threatened bankruptcies among major airlines highlight the importance of provisions of the Bankruptcy Code that provide special benefits for financers of aircraft and aviation equipment as discussed by D. Bechara, in The Freeman, a publication of the Foundation for Economic Education, Inc., September 1986, Vol. 36, No. 9., also available at www.libertyhaven.com, last checked November 3, 2003.

[160] D. Bechara, in The Freeman, a publication of the Foundation for Economic Education, Inc., September 1986, Vol. 36, No. 9.

[161] 5.2.3. The full text of Section 1110: In order to be able to explain the scope of applicability of this provision, reference should first be made to the literal text of section 1110. This provision literally reads as follows:

Aircraft equipment and vessels:

(a) (1) Except as provided in paragraph (2) and subject to subsection (b), the right of a secured party with a security interest in equipment described in paragraph (3), or of a lessor or conditional vendor of such equipment, to take possession of such equipment in compliance with a security agreement, lease, or conditional sale contract, and to enforce any of its other rights or remedies, under such security agreement, lease, or conditional sale contract, to sell, lease, or otherwise retain or dispose of such equipment, is not limited or otherwise affected by any other provision of this title or by any power of the court.

(2) The right to take possession and to enforce the other rights and remedies described in paragraph (1) shall be subject to section 362 [automatic stay] if—

(A) Before the date that is 60 days after the date of the order for relief under this chapter, the trustee, subject to the approval of the court, agrees to perform all obligations of the debtor under such security agreement, lease, or conditional sale contract; and

(B) Any default, other than a default of a kind specified in section 365(b)(2), under such security agreement, lease, or conditional sale contract—

(i) That occurs before the date of the order is cured before the expiration of such 60-day period;

(ii) That occurs after the date of the order and before the expiration of such 60-day period is cured before the later of— the date that is 30 days after the date of the default; or

the expiration of such 60-day period; and that occurs on or after the expiration of such 60-day period is cured in compliance with the terms of such security agreement, lease, or conditional sale contract, if a cure is permitted under that agreement, lease, or contract. The equipment described in this paragraph— is— an aircraft, aircraft engine, propeller, appliance, or spare part (as defined in section 40102 of title 49) that is subject to a security interest granted by, leased to, or conditionally sold to a debtor that, at the time such

together with the introduction of section 1110 (i.e. a specific status of aircraft equipment financers amongst all of the other typical airline creditors) the airlines shall essentially be enabled to obtain financing against competitive rates.

4.2 Overview of Remedies of Financiers Available under the Bankruptcy Code

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transaction is entered into, holds an air carrier operating certificate issued pursuant to chapter 447 of title 49 [49 USCS §§ 44701 et seq.] for aircraft capable of carrying 10 or more individuals or 6,000 pounds or more of cargo; or a documented vessel (as defined in section 30101(1) of title 46) that is subject to a security interest granted by, leased to, or conditionally sold to a debtor that is a water carrier that, at the time such transaction is entered into, holds a certificate of public convenience and necessity or permit issued by the Department of Transportation; and includes all records and documents relating to such equipment that are required, under the terms of the security agreement, lease, or conditional sale contract, to be surrendered or returned by the debtor in connection with the surrender or return of such equipment.

Paragraph (1) applies to a secured party, lessor, or conditional vendor acting in its own behalf or acting as trustee or otherwise in behalf of another party.

(b) The trustee and the secured party, lessor, or conditional vendor whose right to take possession is protected under subsection (a) may agree, subject to the approval of the court, to extend the 60-day period specified in subsection (a)(1).

(c)
(1) In any case under this chapter, the trustee shall immediately surrender and return to a secured party, lessor, or conditional vendor, described in subsection (a)(1), equipment described in subsection (a)(3), if at any time after the date of the order for relief under this chapter such secured party, lessor, or conditional vendor is entitled pursuant to subsection (a)(1) to take possession of such equipment and makes a written demand for such possession to the trustee.

(2) At such time as the trustee is required under paragraph (1) to surrender and return equipment described in subsection (a)

(3), any lease of such equipment, and any security agreement or conditional sale contract relating to such equipment, if such security agreement or conditional sale contract is an executory contract, shall be deemed rejected.

(d)
With respect to equipment first placed in service on or before October 22, 1994, for purposes of this section___ the term "lease" includes any written agreement with respect to which the lessor and the debtor, as lessee, have expressed in the agreement or in a substantially contemporaneous writing that the agreement is to be treated as a lease for Federal income tax purposes; and the term "security interest" means a purchase-money equipment security interest.

[162] 61 Am. Bankr. L.J. 1, 1; In Re Pan Am Corporation, et al., Debtors No. 91 Civ. 1659 (MBM), US District Court for the Southern District of New York, 125 B.R. 372; 1991 U.S. Dist. LEXIS 3131; Bankr. L. Rep. (CCH) P73,855 March 18, 1991: "*...The terms "lessor," "leased" and "lease" are not modified in any way that suggests that the statute was not meant to apply to lessors in a sale-leaseback transaction. The one phrase of 11 U.S.C.S § 1110 which does modify the term "lessor" -- "whether as trustee or otherwise" -- is expansive, rather than restrictive. Therefore, by its terms, the statute protects all "lessors," and courts should not impose the additional requirement that the lease also involve equipment new to the airline, unless the literal result would be "demonstrably at odds with the intention" of Congress...*"

In case of default, aircraft equipment financers generally have a few remedies under the bankruptcy code. [163]

a. Section 362 (d)

As a first resort, pursuant to section 362 (d) –which is already summarily discussed in the previous chapter- the financer may obtain a remedy through the intervention of the bankruptcy court. According to this provision, the equipment financer may, as a "party in interest", petition before the court to obtain relief from the general automatic stay for cause of "lack of adequate protection". Provided that the airline debtor does not have equity in the aircraft equipment; or upon its failure to claim that such equipment is necessary to an effective reorganization – the financer may request the court for one of the following specific remedies under section 362 (d): [164]

i. Make a request for compensation by the airline debtor; such as an order for a (periodic) cash payment to the financer to the extent that the automatic stay results in a decrease in the value of the financer's interest in the collateral; or;

ii. Make a request for an additional or replacement lien; or;

iii. Make a request for any other relief 'as appropriate' (i.e. current interest payments)

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Bankruptcy "freezes" the assets of the debtor. This means, that in principle every creditor is barred from collecting or repossessing the assets belonging to the company that is subject to a bankruptcy procedure. As was already explained before, the (voluntary) filing of a reorganization petition under US Chapter 11 commences the so-called 'automatic (judicial) stay' with the main purpose of creating 'breathing space' for the debtor to reorganize its business and deal with its creditors in an orderly manner. Consequently, the principal effect of the debtor will also be protected against any act of a creditor to obtain possession of property of or from the debtor's estate, to collect a claim against the debtor that arose before the filing or to enforce a lien that secures such a claim against the debtor. However, pursuant to section 1110, a (limited) exception to the effects of the automatic stay is provided. Aircraft equipment financers have been granted a special position during the bankruptcy reorganization procedure. Section 1110 provides financiers with the right to take possession of and to sell, lease or otherwise retain or dispose of equipment under certain conditions. Assuming, that all the requirements are met, section 1110 permits the eligible financier, following a 60-day waiting period, to take repossession and enforce any of its other rights or remedies under the applicable financing documentation, notwithstanding any other provision of the Bankruptcy Code, unless the debtor airline cures all defaults under the agreements and agrees to perform all of the obligations thereunder.

164 However, the argument of a declining value of the equipment financer's collateral (i.e. aircraft equipment) alone shall not be enough for the financer to obtain such relief from the automatic stay though.

b. Section 365

Additionally, pursuant to section 365, the financer shall have the general right to apply to the court to obligate the airline debtor to decided within a specified period of time whether it either chooses to assume or reject the aircraft equipment lease. By full operation of section 365, an express liability is imposed on the airline debtor for compensation to the financer of the "*reasonable value of the use*" of the leased aircraft. This is because of the fact that with the normal requirements of section 365, all past defaults must be cured and the airline debtor must similarly agree to perform all future obligations. Provided that the airline debtor qualifies as 'lessee' (which requirement was illustrated in the previous chapter), it will have a few options to choose from under section 365:

a. Elect not to assume the contract (reject the contract);
b. Assumption of the contract (prior to confirmation of the reorganization plan);
c. Assumption/Entering into a new (executory) contract (during the reorganization proceedings).[165]

In any case, the airline's bankruptcy estate shall be liable for the reasonable value of the use and occupancy of the leased property during the period between filing bankruptcy and assumption or rejection of the lease. [166] Upon assumption under section 365 (either prior to confirmation or during the reorganization) the estate becomes fully liable for performance of the entire contract as if bankruptcy has never happened. [167] In this respect, the airline must firstly cure all defaults, secondly, compensate the potential other party for any pecuniary losses arising from such default and thirdly, provide adequate assurance of future performance

[165] See: GATX Leasing Corp. v. Airlift Int'l, Inc. (In re Airlift Int'l, Inc.), 761 F.2d 1503, 1508 (11th Cir. 1985) (upon assumption estate becomes liable for performance of the entire contract as if bankruptcy had never intervened)
[166] In re Rhymes Inc. 14 Bankr. 807, 808, Bkrtcy. D. Conn. 1981
[167] In re Steelship Corp. 576 F. 2d. 128, 132 (8th Circ. 1978)

under the agreement. [168] Furthermore, the potential breach of a contract, which is initially entered into during reorganization and has been assumed under section 365, shall result in a "priority administrative expense claim" pursuant to the applicability of section 503 (b).

Such priority within the bankruptcy estate shall only be accorded, however, upon the concurrent qualification as "an actual cost or expense of preserving the estate".[169] It is argued that the reasoning behind awarding such priority is, that the airline debtor makes a conscious decision to keep the contract alive as being in the best interest of the estate. Therefore, the debtor should also be bound by the terms of that agreement: "*...If it receives the benefits it is held to equally adopt the burdens*". In the event of default after the bankruptcy petition, within the context of section 365 there is no room for the concept of compensation for 'actual use value' to the financers. The defaulting debtor shall be fully liable for the amount that was stipulated in the assumed contract.

'... GATX too, could have gone the route of Airlift's other mortgagee's and repossessed the aircraft leaving Airlift "dead in the water". But GATX instead chose to enter a post-petition agreement with Airlift as embodied in the section 1110 stipulation. This agreement was an actual necessary cost of the estate and materially benefited Airlift. Airlift cannot now walk away from the terms and obligations of that post-petition agreement leaving GATX in an inferior position than it would have been if it had exercised its right to repossession in the first place..." [170]

c. Section 1110

An agreement under section 1110 equally puts the airline debtor in the position of having made a post-petition agreement.[171] While a section 1110

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[168] section 365 (b) (1)
[169] In re Chugiak, 18 Bankr. 292, Bkrtcy D. Alaska, 1982
[170] Ibid. In re Airlift Inc.
[171] In re Airlift Inc. at 15 (An agreement under 11 U.S.C.S. § 1110 puts the debtor in the position of having made a postpetition agreement to carry on a prepetition executory contract without assuming the full burdens of that contract. Because of the unique obligations imposed by the agreement, the ordinary distinctions between leases and mortgages under bankruptcy do not apply. Rather, because neither a lease nor a mortgage is fully assumed under this section, the obligations of the debtor to make payments is embodied in the agreement itself.)

stipulation resembles a section 365 assumption of contract action, it does nevertheless differ. When an airline debtor enters into a section 1110 agreement with its equipment financer, it is not liable for performance of the entire contract.

Furthermore, as provided under section 1110, the aircraft equipment financer may –in principle- directly invoke its right of re-possession and accordingly, take action without the intervention of the bankruptcy court. It should however, be noted, that in practice, this right accorded under section 1110, however, inevitably is also subject to the implementation and adjudication by the court. Among the limitations to the financer's right to exercise its rights under section 1110 are: [172]

a) Delays or required judicial intervention if an obstinate airline debtor refuses to handover the aircraft equipment upon an order for repossession of the financer. During the time that the bankruptcy court is evaluating a debtor's motion, the aircraft financer cannot fully enjoy the economic benefits of possession since during this period it is still practically unable to sell, lease or otherwise turn over the aircraft.[173]
b) According to the so-called "equities of the matter", a court may determine that, while implicitly acknowledging a right to possession of the equipment financer, the financer may nevertheless not exercise its right to repossession. Such is affirmed by the bankruptcy court in re Airlift International In this case the court determined that a repossession of the aircraft would cause the aircraft to be taken off the FAA maintenance program, which would have such an detrimental and adverse effect on the value to potential purchasers, that the right to repossession was not allowed to be exercised by the financer.[174]

[172] In re Airlift International Inc. v. GATX Leasing Corp., 761 F.2d 1503, 1985 U.S. App.
[173] Air Vermont, Inc. v. Beech Acceptance Corp., 44 Bankr. 446 Bkrtcy D. Vt. 1984
[174] Bankers Trust Co v. Seidle (in re Airlift International Inc.) 70 Bankr. 935 (Bankr. S.D. Fla. 1987)

4.3 Developments

The present version of section 1110 of the Bankruptcy Code aims to remove the unilateral right of a financer to repossession, and instead gives the airline debtor-in-possession the choice of either returning the collateral to the possession of the financer or of performing under the security agreement or lease according to its 'pre-bankruptcy terms'. In this view, section 1110 provides both the airline debtor and the equipment financer with important leverage. However, it is important to realize that this provision originates from a historical series of amendments by US Congress, all of which had the common objective of– gradually- wanting to expand the class of protected creditors in order to conform to the latest financing practices. As so expanded, the protected creditors under section 1110 now include "*a secured party with a purchase-money equipment security interest in, or a lessor or conditional vendor of*" aircraft. As further discussed below, commercial state law, not federal bankruptcy law defines the categories of financers who are within the protection of section 1110.

4.4 Interpretation

In anticipation of the fact that aircraft financing is a type of equipment which by its very nature is very complex, under section 1110 aircraft financers are intended to receive protection without forcing financing transactions into all too hybrid or outmoded forms. [175] Whereas, respectively, the application of section 1110 obviously depends upon the given interpretation of the provision, a few basic principles underlie section 1110:

Firstly, the specific terminology used should be read as consistent with state law definitions of normal commercial relationships, including those in the Uniform Commercial Code (U.C.C.). Secondly, section 1110 applies to specific types of financing only e.g. purchase-money and lease financing. The terminology that is used in this view therefore, is '*section 1110 type of financing*'. A sale-leaseback

transaction may qualify as such for instance, which at the same time, typically is one of the most common and widely used financing methods since to the airline it provides low cost financing for fleet modernization. Complex financing techniques such as cross-collateralisation, modification of terms of the lease agreement, or prior ownership of leased equipment should not disturb the application of section 1110. Moreover, section 1110 only affects the obligations of the debtor with respect to retaining the use of the aircraft.[176] Finally, in resolving issues in reorganization that involve section 1110 aircraft equipment, normal commercial and bankruptcy law should determine any of the questions that do not directly concern this provision. Such may include the order of priority of liens, the obligations and rights of a lessor or a secured party under its lease or security agreement, and the specific level of need for adequate protection there under.

In sum, interpretation of section 1110 according to the principles mentioned above, is intended to ensure the purpose of section 1110, which is to provide security and protection to a specific category of 'high risk financers in the airline industry' – without unnecessarily harming the rights of other secured or unsecured creditors –. In contrast to its very own purpose, historically, ambiguities existed with respect to the interpretation of this provision, which caused for concurrent uncertainty, however. Consequently, controversial court rulings exist.[177] To clarify and remove the ambiguities, US Congress amended section 1110 twice, first in 1994 [178] and again in 2000 then as part of a much larger aviation bill, the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century, (Public Law No. 106-181), which was signed into law on April 5, 2000. [179] These amendments made several other so-called "pro-financier" changes to the

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[175]Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 201(a), 108 Stat. 4106, 4119

[176] This is because -besides using what is likely to be an airline's least expensive source of capital -- its own capital-a sale-leaseback enables the airline to retain use of existing equipment and therefore continue operations during the time lag between ordering and delivery of new equipment.

[177] In re Western Pacific Airlines, 219 B.R. 305, 1998 WL 110663 (D. Colo. 1998)

[178] Wendell H. Ford Aviation Investment and Reform Act for the 21st Century, Pub. L. No. 106-181 (relevant sections codified as amended at 11 U.S.C. §§ 1110 and 1168) (2000); Pub. L. No. 103-394, 108 Stat. 4106

[179] Equipment Leasing Leveraged Leasing, Fourth Edition, Volume 1, I. Shrank and A.G. Gough, 17:6.1; see also KEN GREENE'S LEASE AND LAW LETTER June 2000 Volume 13

provision. In essence, under these amendments, aviation financers were provided with a broader exception to the powers of the bankruptcy court to enjoin repossession and sale.[180]

4.5 Scope of Application

Spurred by a series of major airline bankruptcy cases, US courts were forced to address some significant issues relating to the applicability of section 1110, specifically in the context of the many different innovative financing structures. [181] Although the basic rules of section 1110 are relatively straightforward, as illustrated, a number of issues do nevertheless complicate their application. In this view, the main complication would be the lack of clarity with respect to the scope of application; i.e. whether the provision applies and if so, to what category or type of security interests. Specifically whereas section 1110 was initially limited in its application to security interests that are '*purchase money equipment security interests*', according to the amended provision (i.e. section 1110.03 (1) (a)), a more broad application was introduced. Consequently, section 1110 affords protection to security interests of all kinds.

Additionally, the application of section 1110 is (further) complicated in its interaction with several other provisions of the Code. [182] For example, questions arise in applying and enforcing the provisions of section 1110 in conjunction with section 365 (the power of the debtor to reject an executory contract or unexpired lease as was explained earlier on). Additional issues arise in defining the relationships between section 1110 and sections 105, 361, 362, 363, 544, 547 and 1147. To discuss these in detail will be beyond the scope of this thesis, however.

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[180] John Hoyns, Summary of Bankruptcy Code Section 1110 As Amended by April 2000 legislation
[181] 69 Am. Bankr. L.J. 167, Aviation Finance revisited: the 1994 Amendments to section 1110 of the Bankruptcy Code, spring 1995, K. Hoff-Patrinos.
[182] Section 1110.05

5. Repossession; Retention or Rejection of Aircraft; "the Concept of a Rolling Cure"?

5.1 Benefits of the "60-day Grace Period"

Section 1110 provides aircraft equipment financers with an important benefit. Namely, when an airline seeks to reorganize the financer may still, despite the bankruptcy, be entitled to either receive current payments or to repossess the aircraft. Essentially, section 1110 gives the airline debtor 60 days after the date of filing for bankruptcy relief (meaning the official commencement of the reorganization case) during which the debtor is protected by the automatic stay. This period of 60 days may be referred to as the airline debtor's "grace period". [183] During this grace period only, financiers may not obtain repossession of the 'protected equipment'. Only upon concluding a "section 1110-agreement" (i.e. the "section 1110-cure") the airline debtor may protect itself against the financer exercising its right to repossession after the lapse of the grace period. Absent the airline debtor effectuating the "section 1110 cure", no provision in the Bankruptcy Code and no power of the court shall limit the rights of financers under section 1110.

In essence, a "section 1110-agreement" is a court-approved agreement between the airline debtor and the equipment financier, in which it is stipulated that the airline shall perform all obligations under the pre-petition security agreement, lease, or conditional sale contract, and the airline debtor agrees to cure any default that occurred before it filing for bankruptcy. [184] If such an agreement is not timely in place the financier is expressly permitted to sell, lease, or otherwise retain or dispose of equipment repossessed under section 1110. [185]

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[183] Bankruptcy Bulletin, Amendments enacted to strengthen remedies of financiers of transportation equipment, October 2000, J.B. Stuart.

[184] J.B. Stuart, Bankruptcy Bulletin, Amendments enacted to strengthen remedies of financiers of transportation equipment, October 2000

[185] The amendments represent a significant change from the old version which made section 1110 only a limited exception to specific Bankruptcy Code provisions pertaining to the automatic stay under section 362, and the related powers of a bankruptcy court to permit a debtor to use, sell, or lease estate property under section 363; to "cram down" a dissenting secured creditor through a non-consensual plan of reorganization under section 1129; or to issue an extraordinary injunction. Under the old version, only enumerated powers

An important and complicating characteristic of section 1110 is therefore, that it places pressure on the airline's management to quickly decide which aircraft equipment it intends to retain and which it wants to reject. The following factors may determine that decision:

a. The particular "*cure amount*": the total of all pre-petition and post-petition rent, reserves, mortgage and other payments as required under the lease or mortgage, less any security deposits; In this perspective, depending upon the different cure amounts for different equipment; the airline debtor, shall obviously choose that category of equipment which is least expensive to retain; The age and condition of the aircraft, i.e. the time since the last major check and engine overhauls;
b. The amount of any airline equity obtained in the aircraft; If the airline already obtained equity in the equipment such would surely qualify the particular equipment as an asset in the estate, which naturally is less attractive to reject;
c. The (amount of) rent, reserve or level of interest rates; rents and interest rates generally are market rate. However, time wise, aircraft equipment leases are by nature concluded for a long period of time. In this view, the interest rates that were competitive in 1980 may be less than rates in 2000. In its decision or renegotiation with respect to equipment leases, the airline shall try to retain the 1980 since it represents an asset with respect to the year 2000 lease.
d. The amounts held (or required to be hold) in security deposits and in the reserve accounts; such may determine the particular attractiveness of retaining one lease opposite to the other.
e. The length of the contractual (lease) term (including renewals) remaining; many leases contain a particular clause that upon its end, the airline may

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of the court would not affect the right of a section 1110 financier to take possession of covered equipment in compliance with the underlying contractual documents; also see Treas. Reg. 1.167 (a)-11 (e) (1) (i);

choose to buy the particular equipment; obviously such is an asset for the airline that must be taken into account when having to choose.

f. The compatibility of the aircraft with the airline's strategic plans. This may include the different objectives of the airline with respect to load factors, costs, fuel use etc.[186]

The airline may also defer its decision to assume the contract until the confirmation of the reorganization plan. However, a negotiated, early assumption (at the time of the cure for example) affords the lessor a degree of certainty that all pre-bankruptcy petition obligations, including those that may exceed any security deposits, will be enhanced to administrative priority claims. [187]

In conclusion, section 1110 on the one hand protects the airline debtor by precluding a financier from seeking immediate relief from the automatic stay to repossess its equipment during the 60-day grace period. On the other hand, section 1110 benefits the financier by requiring the debtor to cure all defaults (including other than those based on financial contractual conditions) within 60 days and to meet all of the post-petition obligations on a current basis. This is a unique benefit, offered to no other type of creditors provided that their contracts have not been assumed under the already discussed Bankruptcy Code section 365, which – as illustrated- governs the assumption and assignment of executory contracts. [188]

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[186] Airline Bankruptcies and Workouts: the Airline's perspective; G. W. Buhler, Schnader Harrison Segal & Lewis LLP

[187] Airline Bankruptcies and Workouts: the Airline's perspective; G. W. Buhler, Schnader Harrison Segal & Lewis LLP.

[188] (Executory contracts are contracts under which some performance remains due on both sides.); Before its amendment, section 1110 required that, for the debtor to be protected by the automatic stay, it had to cure any default that occurred after the commencement of the case "before the later of the date that is 30 days after the date of the default; or the expiration of such 60-day period." This means, for example, that if a default occurred on the fifty-ninth day after the date of the order for relief, the debtor would be entitled to cure the default during an additional thirty days from the date of the default. The general idea was that, in exchange for the debtor's performance of its obligations under the section 1110 Agreement, it could retain possession of the Protected equipment even though its defaults would have resulted in the Financier's repossession of the Protected equipment under non-bankruptcy law.

5.2 Ambiguities

The impact of ambiguities in section 1110 with respect to the 'grace period', gained high visibility as a result of certain judicial considerations in the chapter 11 case of Western Pacific Airlines (In Boullion Aircraft Holding Co. v. Western Pacific Airlines, Inc. (In re Western Pacific Airlines Inc. ("WestPac"))[189] During the so-called 'statutory cure' period under section 1110 (i.e. 60 days), WestPac namely had committed to cure existing defaults and perform under the terms of its leases existing before petitioning bankruptcy. After the expiration of 60-days, WestPac however, defaulted on several of the lease payments and ceased operations.

Several aircraft lessors filed motions seeking immediate repossession of their aircraft pursuant to section 1110. The airline, WestPac, however, argued that section 1110 afforded it a rolling right to cure any default within 30 days after the default, regardless of whether the default occurred before or after a 60-day period. The bankruptcy court rejected this line of thinking, which is now referred to as the "concept of a rolling cure". It concluded that once a debtor has committed to cure and perform under section 1110, upon expiration of the 60-day statutory period, the debtor's opportunities to avoid repossession under the statute have been exhausted, and any subsequent defaults are again governed by the terms of the pre-petition lease.

"*...Section 1110 does not afford a debtor 'an open-ended right' to cure all post-petition lease defaults within 30 days after each default. Also, section 1110 (a) (1) (B) (ii) does not afford a debtor a rolling 30-day statutory grace period to cure any default that occurred beyond the initial 60-day period...*"[190]

The airline appealed this decision, whereby the Colorado district court reversed the above mentioned bankruptcy court's decision by concluding that once the conditions set forth in section 1110 have all been satisfied, "*the section has served*

[189] Boullion Aircraft Holding Co. v. Western Pacific Airlines, Inc. (In re Western Pacific Airlines, Inc.), 219 B.R. 305 and 221 B.R. 1 (D. Colo. 1998), appeal dismissed, 181 F.3d 1191 (10th Cir. 1999).
[190] Western Pacific Airlines Inc., 219 B.R. 298, 1998, Bankr.

its purpose" and the "*parties and their leases are governed thereafter by other, generally applicable provisions of the Code*," such as section 365. In other words, the district court concluded that the lessor is not entitled to an automatic lifting of the stay, and the debtor possession is not entitled to a rolling 30-day period to cure the subsequent defaults. Instead, the potential right to lift the stay pursuant to section 1110 terminates, and the lease is again subject to assumption and assignment according to the terms of Bankruptcy Code section 365. Accordingly, the court's decision effectively precluded lessors and financiers from repossessing the equipment, even if defaults occurred long after the expiration of the original 60-day cure period. A lobby of the financing industry, however, resulted in legislative amendments, whereby it was clarified that the debtor was not afforded a rolling 30-day cure period under section 1110. In practice, section 1110, introduces a strict 60-day deadline, generally requiring the airline debtor's management to find sufficient funds either from internal sources (which is highly unlikely since there is the (pendent) filing of bankruptcy) or –as discussed before- possibly through so-called Debtor in Possession (D.I.P.) financing. [191] Such funding will enable the airline debtor to comply with section 1110, thereby protecting itself from financers exercising their right to repossession. Importantly, however, whereas under section 1110 the airline debtor indeed has to cure monetary defaults within the 60-day deadline, it may continue re-negotiations with its aircraft lessors or lenders as to the conditions of the lease (i.e. payment of lease terms). If the carrier is able to obtain agreements from its lessors/lenders, section 1110 also allows the airline for a extension of this 60-day period by the court..

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[191] A company files a petition for relief with the bankruptcy court, in the jurisdiction in which it is incorporated, where it has maintained a residence, principal place of business or principal assets for at least 180 days, or where the bankruptcy case of an affiliate is already pending. Upon the filing of a voluntary petition, the company becomes a "debtor," and its board of directors and management will continue in place as "debtors-in-possession" (DIPs) until the debtor's plan of reorganization is confirmed, Many debtors cannot survive even with use of cash collateral. Instead, a debtor may require a line of credit or other post-petition financing. Section 364 of the Bankruptcy Code permits a debtor to borrow funds and offers protections and priorities to induce lenders to make these loans, which are referred to as debtor-in-possession loans or simply "DIP loans"; see also 2003 ABI JNL. LEXIS 154, American Bankruptcy Institute Journal, September 2003, Chapter 11-"101"

6. Scope of Applicability /Qualifications

The exception, or if looked at it from the aircraft (equipment) financer's point of view, the protection of section 1110 is available only if certain contentious qualifications are met. Having set out the general intent of section 1110 (i.e. balancing the interests of all parties involved), more specifically, under this provision the airline debtor is given an option either to retain the equipment under the terms of the pre-bankruptcy agreement or permit the equipment to be repossessed. In this view, generally four key requirements can be distilled, which are used to determine whether or not a financier qualifies for "protection" under section 1110: [192]

a. Airline-Debtor Requirement

Section 1110 provides that the relevant aircraft (equipment) must be leased to, conditionally sold to, or subject to a security interest granted by *a debtor that*, at the time the transaction is entered into, *'holds an air carrier operating certificate'*.[193] The determining factor in this respect is the date of the underlying financing transaction. This is relevant in order for an airline to qualify as a recognized holder of the proper certificate. [194] Under the provision, interestingly, the airline debtor need no longer be a "citizen of the United States". [195] Whereas at present, air carrier operating certificates are only issued to citizens of the United States, this may have an immediate impact if and when the restrictions on foreign ownership are to be liberalized at a future date. The protection offered in section 1110 may then also be immediately available to financiers of all certificated carriers.

The Life Cycle of a Chapter 11 Debtor Through the Debtor's Eyes: Part I, article by Prof. John D. Ayer, University of California.

[192] Treas. Reg. 1.167 (a)-11 (e) (1) (i); Norton Bankruptcy Law and Practice 2d, William L. Norton, Jr., Current through the February 2002 Update, Analysis Part 13. Chapter 11 Reorganization, Chapter 81. Aircraft Equipment and Vessel Financing Arrangements (Code § 1110)

[193] (pursuant to 49 U.S.C. ch. 447) the certificate shall be issued by the Secretary of the US Department of Transportation for aircraft capable of carrying ten or more individuals or 6,000 pounds or more of cargo.

[194] 11 USC, 1110 (a)(3) (A) (i)

[195] as per 49 U.S.C. section 40102

b. Aircraft Equipment

In order for section 1110 to come into play, it should concern "aircraft equipment". In this view, it should be mentioned that the protection offered to financers in section 1110 includes only a specific (and limited) range of equipment. It must either be an aircraft, aircraft engine, propeller, appliance or spare part, as defined in the Federal Aviation Act. [196] [197] Accordingly, the secured party is not entitled to recover equipment, consisting of trucks, forklifts, a ground power unit, air-search or air start unit from the airline debtor since this equipment does qualify under 49 USCS section 1301 which is incorporated into section 1110: none of this equipment is namely considered as '*appliance*' for it '*is not used or capable of being or intended to be used in navigation, operation or control of aircraft during flight*'. [198] However, maintenance records, logs and manuals relating to aircraft, engines and parts (if in accordance with the terms of the underlying agreement) are also covered, however. These need to be surrendered or returned by the debtor together with the equipment upon the financer exercising its right to repossession. [199]

c. Transaction Requirement/Type of Financier

"*Aircraft equipment financers have financed the acquisition of newly constructed aircraft, financed the acquisition by airlines of used aircraft and have permitted the resale and sublease to third parties of aircraft in which they hold a security interest, with the hope that section 1110 will protect their interests if the airline, which holds the aircraft, files a petition for relief under the Code...*"[200]

If referred to leasing of aircraft equipment this generally refers to many different categories. Firstly, equipment leases are by nature innovative and complex (tax-driven). Another characteristic that determines the existence of a variety of different leases, is the different object of the lease:

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[196] (as defined in 49 U.S.C. §40102).
[197] Section 1110 (a) (3) (A) (i) or as defined in section 40102 of title 49 of the US Code
[198] In re Belize Airways, Ltd. (180, BC SD Fla) 7 BR 601, 6 BCD 1318, 3 CBC2d 315; equipment like trucks, forklifts, groundpower units and air-search airstar unit or any equipment that can be considered an appliance because it is not used or capable of being or intended to be used in navigation, operation or control of an aircraft during a flight.
[199] (as defined in 49 U.S.C. §40102).

1. "new aircraft", aircrafts that are newly constructed,
2. "aircraft new to the airline", which is equipment that is acquired by the airline for its own use for the first time;
3. "old aircraft" , which is equipment up for lease renewals, sale and leaseback or free as collateral for financing;
4. a combination of "old and new aircraft", which is equipment that contains both new and used components. [201]

6.1 The use of section 1110 in practice: an example

In re PanAm Corp. 'sale lease back agreements' were concluded between Pan Am Airlines and General Electric Capital Corporation ("GECC").[202] Pan Am argued, that the Congressional intent behind section 1110 was that this provision applies in financing transactions that involve aircraft equipment, which is "new" to the airline, only. However, did not follow Pan Am in its reasoning and held that "lessor" (as a term that is used in 11 USCS section 1110) also includes those who acquired that status in non-acquisition sale/leaseback transactions. Consequently, section 1110 is not limited to lessors of newly acquired equipment. [203] If the lease is a true lease, rather than a disguised loan, and meets all other statutory requirements -- e.g. qualified equipment, qualified air carrier, repossession clause in lease -- the lessor shall most likely be protected by section 1110.

In re Pan Am Corp., 125 B.R. 372 can therefore now be referred to as providing a guiding principle,: "... *neither the words and structure of the statute, nor the legislative history of either § 1110 or that section's Bankruptcy Act predecessor, indicate that including all lessors within the protection of § 1110 would produce a result "demonstrably at odds with the intention of its drafters.*" [204] Significantly,

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[200] 64 Am. Bankr. L.J. 109, Spring 1990, 'section 1110 of the bankruptcy code; time for refueling?', article by J.W. Giddens and Sandor E. Schick

[201] Ibid. 64 Am. Bankr. L.J. 109, Spring 1990

[202] 1991, SD NY, 130 BR 409, CCH Bankr. L. Rptr P 74277

[203] In re Pan Am Corp. (1991, SD NY) 125 BR 372, CCH Bankr L Rptr P 73855, affd (1991, CA2) 929 F2d 109, cert den (1991) 500 US 946, 114 L Ed 2d 488, 111 S Ct 2248.

[204] Ron Pair Enterprises, 109 S. Ct. at 1031; Caveat: In re Pan Am Corp. No. 91 Civ. 1659 MBM, 125 B.R. 372; 1991, U.S. dis.; Bankr. L. Rep. CCH P73, 855- Non-purchase money secured lenders would still be

(engine) pooling, switching or interchange transactions do not automatically fall outside protection of section 1110 merely because of the fact that the airline debtor has a choice to return similar equipment of similar value and utility to the lessor instead of a particular piece of equipment that was originally leased. [205]

Whereas it may now seem that financers of aircraft equipment (that is newly acquired by an airline) have a secure status, this status may nonetheless still be jeopardized by a number of factors. For instance, if the airline is making progress payments towards the acquisition of an aircraft (i.e. which decreases the actual purchase price to an amount which is less than the loan to be advanced) such portion of the loan technically is not used to acquire the aircraft and can therefore be considered questionable for purpose of applicability of section 1110.[206]

In short, whereas section 1110 expressly provides for a 'safe-harbor definition' of what shall constitute a 'lease' for section 1110 purposes; "…. *A lease is 'any written agreement with respect to which the lessor and the debtor as a lessee, have expressed in the agreement or in a substantially contemporaneous writing that the agreement is to be treated as a lease for federal income tax purposes',* leases that do not literally qualify under this description, however, can still be

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unable to receive statutory (section 1110) protection by using the term 'lease' in their transaction documents because courts look to the substance of transactions rather than their form.

[205] In re Pan Am Corp. 1991, SD NY, 130 BR 409, CCH Bankr. L. Rptr P 74277; "the effective date" of 1994 Amendment to Bankruptcy Code; Equipment first placed in service after October 22, 1994: A covered transaction includes any security interest, lease, or conditional sale of covered equipment involving an eligible carrier.

Consequently, with respect to equipment first placed in service after the (1994) amendment were enacted, the nature of the financing transaction (i.e., "true" lease vs. disguised debt financing; purchase money vs. non-purchase money) is largely irrelevant in determining whether or not there is section 1110 coverage; b) Equipment first placed in service on or before October 22, 1994, a covered transaction (again, provided the other requirements are met) includes --

Any purchase money equipment security interest; meaning *an interest taken or retained by the seller of the collateral to secure all or part of its purchase price, or taken by a person who advances funds or incurs an obligation to enable the acquiring entity to purchase the collateral (but not a non-PMSI general mortgage)*; or Any "true" lease (i.e., not a disguised mortgage); or Any transaction where the documentation includes a "written agreement with respect to which the lessor and the debtor, as lessee, have expressed in the agreement or in a substantially contemporaneous writing that the agreement is to be treated as a lease for Federal Income Tax purposes".

[206] supra note 190, at 17:6.3, at footnote 144

entitled to the benefits of section 1110 to the extent they would otherwise qualify as such a lease in accordance with any applicable commercial state law. [207]

6.2 Tenability of the Transition Rule

In this view, the tenability of the so-called 'transition rule' is particularly interesting. Under a transition rule, a transaction may namely qualify for section 1110 coverage based upon the inclusion of "magic language" in the relevant documentation (e.g. the parties' statement of intention to treat the specific transaction as a lease for federal income tax purposes, regardless of whether the transaction ultimately qualifies for that tax treatment or not).[208] The question whether or not the mere 'magic' inclusion of the required language, without more, makes an agreement a 'lease' still remains unpredictable, however. [209] Whether case law purporting to section 365 (stating that the mere designation of the contract as 'lease' by parties is inconclusive) is of any relevance in this context would be equally interesting as well. To discuss this will be beyond the scope of this article, however.

a. Repossession Rights

The security agreement, lease or conditional sale agreement must expressly provide for a right of repossession in the event of default. [210] By implementing this requirement in section 1110, it is specifically left to parties' own choice and discretion whether or not they wish to (actually) implement the protection of bankruptcy section 1110 in their contractual relations.

It may be concluded that section 1110 definitely gives teeth to the financier's right to exercise its remedies, by specifically requiring the airline debtor to surrender

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[207] I. Shrank and A.G. Gough, Equipment Leasing Leveraged Leasing, Fourth Edition, Volume 1, , 17:6.3; 11 USC 1110 (d)

[208] Norton Bankruptcy Law and Practice 2d, William L. Norton, Jr., Current through the February 2002 Update, Analysis Part 13. Chapter 11 Reorganization, Chapter 81. Aircraft Equipment and Vessel Financing Arrangements (Code § 1110)

[209] *"based upon standard statutory construction, the 'safe harbor' provision can be read as still requiring the underlying agreement to be a lease (as opposed to disguised sale) as a matter of law..."* Equipment Leasing Leveraged Leasing, Fourth Edition, Volume 1, I. Shrank and A.G. Gough, 17:6.3

protected aircraft equipment upon the expiry of the grace period (i.e. as soon as a financier is entitled to exercise its right to repossession). [211]

Interestingly, the financer is authorized not only to take repossession, but also to "enforce any of its other rights or remedies" under the agreement concluded with the airline. Thus, a financer that qualifies under section 1110, if the section 1110 agreement is not in place before the lapse of the grace period of 60 days, it shall be free to pursue its remedies under the applicable law or agreement without first having to obtain relief from the automatic stay. [212]

7. Special Characteristics of Aircraft Equipment

As Thatcher A. Stone puts it: '*..A confusing array of laws, rules, and customs that come into play when aircraft perform as expected (intercontinental travel) and businesses act like businesses (fail sometimes)...*'[213]

Aircraft equipment has some special characteristics, which may have some serious consequences as to determine ownership (of this equipment) during bankruptcy. Having established that aircraft equipment is capital expensive, another interesting characteristic of aircraft equipment is that it moves around easily.

Whereas financing practice exists as to leasing the aircraft body, another substantial financing practice exists as to finance parts of aircraft or aircraft

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[210] 11 USC, 1110 (a) (1)

[211] Wendell H. Ford Aviation Investment and Reform Act for the 21st Century, Pub. L. No. 106-181 (relevant sections codified as amended at 11 U.S.C. §§ 1110 and 1168) (2000). The numerous ambiguities contained in section 1110 gave rise to differing judicial interpretations.Treas. Reg. 1.167 (a)-11 (e) (1) (i); see also: 69 Am. Bankr. L.J. 167, Aviation Finance revisited: the 1994 Amendments to section 1110 of the Bankruptcy Code, spring 1995; The numerous ambiguities contained in section 1110 gave rise to differing judicial interpretations.

[212] Wendell H. Ford Aviation Investment and Reform Act for the 21st Century, Pub. L. No. 106-181 (relevant sections codified as amended at 11 U.S.C. §§ 1110 and 1168) (2000). The amendment eliminates the uncertainty and preserves the benefit of the bargain between the parties by deleting the citizenship requirement and providing that section 1110 applies to any debtor that held the required certificate at the time of the financing transaction. See Wendell H. Ford Aviation Investment and Reform Act for the 21st Century, Pub. L. No. 106-181 (relevant sections codified as amended at 11 U.S.C. §§ 1110 and 1168) (2000).

engines. Since many airlines are suffering tremendously from loss in revenues, practice shows that especially the lease payments under aircraft engine or equipment parts leases are difficult (if not less urgent) to comply with. In this context, it is significant for the aircraft equipment lessor to assess whether he will still be able to enforce his (often preferred) property right in bankruptcy.

As a complicating factor, some jurisdictions have a legal regime that adopts the concept of accession. Accordingly, an aircraft engine solely by being part of the aircraft, may loose its individual legal status, which implies that the legal title to the aircraft includes all that is incorporated into the aircraft (i.e. including the engine). Consequently, the lessor of the aircraft engine, for instance, also looses the right to repossession to the legal owner.

Pertinent U.S. (case) law with respect to the concept of accession as applicable to the repossession of an aircraft engine by an equipment financer shows, that the courts are less likely to apply the doctrine of accession if the particular parts can be removed expediently and with little or no damage to the principal part. If the part is readily removable and interchangeable this shall most likely not result in accession (e.g. engine pooling). However, the specific part may also be intended as an integral part without which the principal is not complete. Ready detachability of the engine from the aircraft; and the intent of the parties as evidenced by the lease agreement involved shall generally be held decisive in this context. Other decisive factors may include: the value of the principal as relative to the part that is being 'added'; whether the property added is identifiable after attachment. [214] [215] Generally, the application of the factors also highly depends on the nature of the part in question that is to be added.

The following case scenario may also illustrate this issue:

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[213] Thatcher A. Stone, University of Pennsylvania Journal of International Economic Law, 'in flight between Geneva and Rome: abandoning the choice of law systems for substantive legal principles in international aircraft finance', Fall 1999

[214] Burroughs v. Garrett, 67 NM 66, 352 P2d 644.

Under an engine lease agreement between an airline (of non-Canadian nationality) and a financer, an aircraft engine is leased. Amongst other things, the agreement stipulates a Canadian choice of law, the engine shall in effect, however be attached to the aircraft in Paris. The agreement further stipulates that and in the event of default, the financer shall have a right to repossess the engine. If the aircraft is not in Canada, but in France or the Netherlands for that matter, the financer of the engine faces some serious difficulties, however, because of subsequent applicability of French law or Dutch law (lex rei sitae) which determines that the engine becomes part of the aircraft. The financer of the engine in theory shall loose its ownership right to the engine to the owner of the particular aircraft to which the aircraft engine is attached. [216]

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[215] Misel Tire Co. v. Mar-Bel Trading Co., 280 NYS 335 (1935); John Snyder, Inc. v. Aker, 236 NYS 28 (1929).

[216] 1 NY Jur Accession, Confusion and Improvements Sec.1 (Lawyer's Co-Operative Publishing Company 2000); Burroughs v. Garrett, 67 NM 66, 352 P2d 644; Please note that, while the choice of law in a written contract between the parties will be treated by New York courts as a major factor in determining the situs of the transaction, there may always be arguments that the situs is the place of incorporation of the engine into the aircraft. If such an argument is successful, these laws will apply with respect to (in)applicability of the doctrine of accession. 1 NY Jur Accession, Confusion and Improvements Sec.1 (Lawyer's Co-Operative Publishing Company 2000); 1 Am. Jur 2d, Accession and Confusion Sec. 2.; Misel Tire Co. v. Mar-Bel Trading Co., 280 NYS 335 (1935); John Snyder, Inc. v. Aker, 236 NYS 28 (1929); 43 ALR 2d 813

CHAPTER 6

The "Multi-Nationality of an Airline"

'..It is being argued that since bankruptcy is a market symmetrical law, a global market would require a global bankruptcy law. A global default, the general default of a multinational company, would then require a single bankruptcy proceeding that can apply rules and reach results that are conclusive with respect to all the stakeholders throughout the global market... [217]

1. Introduction

Some typical problems surround the reorganization efforts of an airline. Among these is firstly, the phenomenon of foreign entities effectively interfering with the Chapter 11 proceedings of an airline. Foreign entities may go for lucratively opting out, simply ignoring and/or circumventing a chapter 11 procedure of an airline (recognition of forum). Secondly, a contractual choice of law may be of serious concern to the reorganizing airline (recognition of law). This is because of the fact that specifically, in the context of international aircraft equipment financing, choice of law is widely used but still a dangerous ground to walk on. This is because simply no transparency or clarity exists. Consequently, the questions of ranking of competing property interests, right to prompt enforcement against assets of the airline are left without a clear answer (recognition of enforcement). [218]

Having previously established that Chapter 11 reorganization may offer unique benefits to key players in the airline industry, this venue shall undoubtedly be purposefully called upon through forum shopping. With this in mind, the specific issues surrounding the extra-territorial application of US bankruptcy reorganization law are particular interesting and shall accordingly be explored.

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[217] 98 Mich. L. Rev. 2276, 2282, A global solution to multinational default, J.L. Westbrook, at 2

[218] To address the problematics left open by the framework offered by the Geneva Convention, in 1998 a study was conducted which will be referred to as the 'Stern study'. This study provided an important background and framework for the UNIDROIT Convention and introduced three principles: the transparent priority principle; prompt enforcement principle and bankruptcy law enforcement principle.

More than ever, tools, solutions and answers are needed so as to facilitate global cooperation and coordination in the context of global restructuring or bankruptcy.

2. Foreign Entities or Counterparts- the Necessity of Payment Doctrine

Under the "necessity of payment" doctrine, pursuant to sections 105 and 363 of the Bankruptcy Code, US bankruptcy courts may uniquely –upon request- issue 'first day payment orders' permitting the airline debtor to pay off foreign creditors even though this would ultimately mean that domestic creditors must go unpaid. [219] With specific reference to the above text, it is generally argued that to obtain such judicial payment order, is extremely significant, if not, the absolute prerequisite to the potential successes of the restructuring of the airline. [220]

In view of the airline's 'multi-nationality', the court order for payment of foreign creditors uniquely recognizes that particular characteristic and will help to prevent the seizure of aircraft in foreign jurisdictions, which definitely is something that the airline particularly is vulnerable to because of its significant foreign operations.

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[219] The "necessity of payment" doctrine "recognizes the existence of the judicial power to authorize a debtor in a reorganization case to pay prepetition claims where such payment is essential to the continued operation of the debtor." Ionosphere Clubs, 98 B.R. at 176; In re Chateaugay Corp., 80 B.R. 279 (S.D.N.Y. 1987); In re Columbia Gas System, Inc., 171 B.R. 189 (Bankr. D. Del. 1994); In re Gulf Air, Inc., 112 B.R. 152, 153-154 (Bankr. W.D. La. 1989); see also In re UNR Industries, Inc., 143 B.R. 506, 519-520 (Bankr. N.D. Ill. 1992) ("Necessity Doctrine may also be used . . . to justify post-petition payments of a wide variety of other types of pre-petition claims, as long as payment of those claims will help to 'stabilize [the] debtor's business relationships without significantly hurting any parties.'"). This doctrine is consistent with the paramount goal of Chapter 11, i.e., "facilitating the continued operation and rehabilitation of the debtor." Ionosphere Clubs, 98 B.R. at 176; see also UNR Industries, Inc., 143 B.R. at 519; Specifically see the Motion for relief by UAL December, 2002: "*By this Motion the Debtors seek entry of an order authorizing, but not requiring, the Debtors to pay, in their discretion and in the ordinary course of business, as and when due, prepetition claims (the "Foreign Claims") owing to certain foreign vendors, service providers, regulatory agencies and governments (collectively the "Foreign Entities"). The Foreign Entities include, among other groups, foreign airports, professionals, vendors, service providers, and utilities. The Debtors also request that all applicable banks and other financial institutions be authorized and directed to receive, process, honor and pay all checks presented forpayment of, and to honor all fund transfer requests made by the Debtors related to, the claims that the Debtor requests to pay in this Motion, regardless of whether such checks were presented or fund transfer requests were submitted prior to or after the Petition Date; provided, however, that: (a) funds are available in the Debtors' accounts to cover such checks and fund transfers; and (b) all such banks and other financial institutions are authorized to rely on the Debtors' designation of any particular check as approved by the attached proposed Order. .. The Debtors further propose that the satisfaction of the Foreign Claims shall not be deemed in any way to be an assumption or adoption of any agreements that relate to such operations...*"

This is because of the fact that if the debtors' outstanding pre-petition obligations to foreign entities are not satisfied, the foreign entities or counter parts shall start action under their domestic laws and before their domestic courts, which could obviously, severely disrupt the airline debtors' foreign operations. [221]

Additionally, foreign entities may block the airline debtor's reorganization by arguing not to be subject to the jurisdiction of the US bankruptcy court and thus not subject to the automatic stay whereby consequently, the foreign entities could sue the airline debtor before their domestic courts, subsequently obtaining foreign judgments against the (US) airline debtor's estate, and then also seek to enforce those judgments against the airline debtors' foreign assets or the airline's aircraft that are located outside of the US.

Foreign governments could even attempt to revoke the airline debtors' landing rights or bring civil and/or criminal actions against the airline debtor's officers and directors for failure to pay certain government fees and other charges, which actions will again very likely create operational chaos or obstruct the airline's operations. This could eventually also lead to the DOT 's suspension of the airline's so-called route authority.[222] In addition to all that, it shall be cumbersome and expensive, and in some cases impossible, for the airline debtor to prevent or remedy such counter-actions by foreign entities.

In sum, whereas foreign entities may substantially –and negatively– jeopardize or influence the prospects of the airline's reorganization. By operation of the necessity of payment doctrine, however, the continuing service by foreign vendors and/or suppliers is assured, whereby the airline is enabled to continue operating

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[220] In re Pan Am Corp. et al., Nos. 91B 100080 through 10087 (CB) (Bankr. S.D.N.Y) (Order dated Jan. 8,1991)

[221] UAL Chapter 11 procedure: First Day Pleadings 12-08-02 Foreign Vendors Motion.doc; i.e. Motion for relief by UAL December, 2002

[222] The Debtors' route authorizations are valuable assets of their estates and must be preserved from potential forfeiture. All information adapted from: UAL's motion for relief, 2002

overseas routes. [223] For the defaulting "multi-national" airline, the bankruptcy court's recognition of its 'multi-nationality' seems key to a successful re-emergence. Therefore, as a strategy, it is contended that an airline debtor should at least obtain a court order to satisfy all foreign claims.

3. Choice of Law

Whereas typically one of the first treaties in the field of international bankruptcy was a treaty between the Dutch State Utrecht and the Dutch State Holland in 1679, nowadays, both Utrecht and Holland are united belonging to the same country, however. Therefore this specific treaty became obsolete. Nevertheless, worldwide trade and commerce have evolved and are now interdependent and inter-connected, however not united. Therefore the need exists specifically in the particular context of bankruptcy that the problems and (mostly unanswered) questions involving international bankruptcy need to be solved. Undoubtedly, the multinational nature of contemporary businesses shall result in potential applicability of multi-national laws creating ever more complex bankruptcy reorganizations.

"*Aircraft transactions often involve a unique mixture of state, federal and international law*", Schlatterer said; "*The fact that the assets involved are both very valuable and, by nature, mobile, adds new dimensions to the concerns faced in their sale, lease and financing. Now, practitioners won't have to hunt through dozens of disparate sources to find what they need.*" [224]

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[223] 51. Similar relief has been granted in other airline restructuring cases. See In re U.S. Airways Group, Inc., Case No. 02-83894 (Bankr. E.D. Va 2002) (debtors had $8.3 billion in annual revenue; court authorized payment of estimated $15 million per month of foreign claims in the ordinary course of business); In re Trans World Airlines, Inc., Case No. 01-00056 (Bankr. D. Del. 2001) (authorizing payment of $13 million of foreign claims in the ordinary course of business); In re America West Airlines, Inc., Case No. 91-07505 (Bankr. D. Ariz.1991) (debtors had $1.3 billion of annual revenue; court authorized payment of estimated $8 million of foreign claims in the ordinary course of business); In re Pan Am Corporation, Case No. 91-10080 (Bankr. S.D.N.Y. 1991) (court authorized payment of $50 million to foreign vendors and foreign governments); In re Continental Airlines, Inc., Case No. 90-931 (Bankr. D. Del. 1990) (authorizing payment of foreign claims estimated at $20 million in the ordinary course of business); In re Eastern Airlines, Inc., Case no. 89 B 10449 (Bankr. S.D.N.Y. 1989) (authorizing payment of estimated $16 million of prepetition foreign claims in the ordinary course of business).

Specifically, in the context of an aircraft equipment financing transaction, three alternative choice of law systems are available:

a) Parties may ignore all legal regimes except the regime of the country where the aircraft is registered as to nationality under the specific Conventions: the law applicable is determined by the Chicago Convention (i.e. the law of the country that issued the air safety/airworthiness certificate);
b) Parties elect the law of the jurisdiction where the aircraft's nationality is registered for purposes of the Chicago Convention; in this view, whereas parties might stipulate a choice of law clause in all of the financing documents, accordingly, the laws of the country where the aircraft is registered would determine whether such choice of law is permitted or not. Out of the ordinary or public policy provisions might cause some uncertainty, which may have undesirable effects;
c) Parties choose to make applicable the 1948 Geneva Convention on International Recognition of Rights in Aircraft. This Convention provides that contracting states will recognize 'rights in aircraft' that are 'regularly recorded' in the jurisdiction of the aircraft's national registry (as determined by Chicago Convention), provided that the rights are 'constituted in accordance with that country's laws and procedures'. The Geneva framework tries to mitigate exposure to foreign legal risk. [225] In article VII it is in this view stipulated that the law applicable to proceedings of a sale of an aircraft in execution shall be determined by the law of the Contracting State where the execution sale takes place, thereby not giving any guidelines as to how to address the conflict between

[224] From: "CCH Offers One-stop Commercial Aircraft Transactions'; (RIVERWOODS, ILL., February 23, 2001) by Neil Allen

[225] For example, with respect to a foreign registered aircraft, under the Geneva Convention, a US bankruptcy court might be required to enforce a so-called 'super-priority foreign lien' ahead of a US law governed mortgage. Obviously the Geneva Convention does not provide a watertight framework.

laws of the contracting state where the execution sale takes place with the various acquired rights of others (art. I), which implicates the involvement of other national insolvency schemes.

3.1 Multiplicity of Applicable National Laws

As described, a multiplicity of applicable national laws may generally be involved. A diversity of legal regimes exists with respect to matters basic to cross-border financing, which makes the enforceability of legal rights, the perfection and priority of security interests and the remedies available to the beneficiaries of legal contracts highly unpredictable in the context of (international) insolvency.

For instance, if the airline defaults under the financing agreement, it generally faces seizure of the aircraft by its financers in the country of aircraft registry, or the country in which the aircraft is located. The different courts involved may favour the domestic holders of 'regularly recorded priority rights': the court may– despite applicability of contractual choice of law or forum clauses- give preference and impose as a lien, prior to all other liens, liens securing a variety of local creditors, or alternatively the courts with jurisdiction over the "airline's principal place of business" may be turned to, which then also applies its own national law.

a. The Costs Curbed

In the context of cross border financing, the impact of a not very transparent choice of law is most typically felt. Ideally, however, the rights of a financier must not be modified in the context of bankruptcy or insolvency. An "insecure international financing climate" is particularly costly to the airlines since any basis or degree of uncertainty shall be paid by the end-user of the financing: i.e. the airlines. The cost of financing shall be substantially higher in the event of unpredictability or uncertainty of applicable law to the parties' contractual relationship.

Therefore, in order to promote a less costly financing climate for the airlines, the Aircraft Protocol to the Convention on International Interests in Mobile Equipment on matters specific to Aircraft Equipment (Aircraft Protocol) now focuses on these particular issues. In this Protocol, pursuant to articles XI to XIII, a unique international insolvency framework is also introduced:

As a first feature of this Aircraft Protocol, the qualification of "international interest" deserves attention. Such an interest may namely be validated against the airline debtor if, prior to the commencement of the bankruptcy, that interest was registered in conformity with the procedures as set out in the specific Aircraft Protocol. Consequently, upon registration, the proprietary nature of the international interest as represented by a registration shall become impossible to be set aside, nor is a subordination thereof possible on the simple account of a failure to comply with otherwise applicable national "perfection" requirements.

In this regard, Thatcher Stone proposes the following:

'the provision is intended to validate, rather than invalidate'. Accordingly, it shall not affect the validity of an international interest against the debtor in case of an interest that would already be valid under applicable insolvency law. Furthermore no (national or non-consensual) rights or interests as declared as preferential shall have priority in the insolvency over a 'registered international interest'. [226]

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[226] University of Pennsylvania Journal of International Economic Law, Fall 1999, 'in flight between Geneva and Rome: abandoning the choice of law systems for substantive legal principles in international aircraft finance', Thatcher A. Stone, at 496; A study conducted under the auspices of INSEAD and New York University's Salomon Center ("Stern Study"), in September of 1998, concluded that both cross-border asset-based financing and leasing are efficient forms of credit extension where prompt recourse to the value of the underlying asset, in this instance the aircraft, is central to the analysis of overall risk in the transaction. University of Pennsylvania Journal of International Economic Law, Fall 1999, Article IN FLIGHT BETWEEN GENEVA AND ROME: ABANDONING CHOICE OF LAW SYSTEMS FOR SUBSTANTIVE LEGAL PRINCIPLES IN INTERNATIONAL AIRCRAFT FINANCE, Thatcher A. Stone, see note 18; These three principles are laid out as "[1] the transparent priority principle (clarity on the ranking of competing property interests), [2] the prompt enforcement principle (ability to promptly enforce rights against assets generating proceeds and revenues), and [3] the bankruptcy law enforcement principle (ability to enforce [the rights of the financier against an aircraft] in the context of bankruptcy); International Lawyer Summer 2001, International Legal Developments in Review: 2000 Business Transactions and Disputes, cross border insolvency and structural reform in a global economy, ABA; Conneticut Journal of International Law Fall 1999, David H. Culmer at 573; Principle 5; Nakash v. Zur (In re Nakash), 190 B.R. 763, 767 (Bankr. S.D.N.Y. 1996); Connecticut Journal of International Law, Fall, 2001 Symposium-International Insolvency: Bankruptcy in a Global Economy, Global Developments, THE TRANSNATIONAL INSOLVENCY PROJECT OF THE AMERICAN LAW INSTITUTE, Jay Lawrence Westbrook; International Lawyer Summer 2001, International Legal Developments in Review: 2000 Business Transactions and Disputes, cross border insolvency and structural reform in a global economy, ABA

Additionally and interestingly, a provision that is particular similar to the discussed section 1110 of the US Bankruptcy Code is introduced in the Aircraft Protocol. Accordingly, the debtor is required to cure all defaults or otherwise give possession of the aircraft to a creditor within a specified period from the defined insolvency date. It provides that no exercise of remedies as permitted by the Aircraft Protocol may be prevented or delayed in the context of insolvency proceedings after this specified period. In addition, it prevents obligations of a creditor relating to an international interest from being modified in the insolvency proceedings without the consent of the debtor. Lastly, a scheme of priority of the international interest in insolvency proceedings is set out.

In addition, according to article XII of the Aircraft Protocol, courts of a contracting state in which an aircraft object is situated are required to "expeditiously cooperate" with other courts or other authorities administering the principal insolvency proceedings with respect to the airline debtor. It can be noted that this provision clearly is in line with current international efforts in the field of insolvency cooperation and is particularly appropriate in this context given the extreme mobility of aircraft objects.

Recapitulating, the significant issues in the international context of equipment financing have a unique dimension and alarming effect upon the aviation industry; the lack of transparency causes expensive financing costs, finally resulting in unfair airline competition based on a legal dissonance. Undoubtedly it is very

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[226] Conneticut Journal of International Law Fall 1999, David H. Culmer at 573; As to illustrate the consequences of the capital intensivity of the airlines, see also generally George Mason Law Review, Fall, 1999, Article "Thou canst not fly high with borrowed wings, Airline Finance and Bankruptcy Code Section 1110", and also: 6A Norton Bankr. L. & Prac. 2d § 152:2 (1981), Norton Bankruptcy Law and Practice 2d, William L. Norton, Jr., Current through the February 2002 Update Analysis, Part 19. Related Laws and Issues, Chapter 152; International Insolvencies I. Fundamental Principles of Cross-Border Insolvencies in the United States; Conneticut Journal of International Law, Fall 1999, 'The cross border insolvency concordat and customary international law; is it ripe yet?, David H. Culmer; Professor K.H. Nadelmann quote; Banking Law Journal, July/August, 2001, GLOBAL FINANCE AND TRANSNATIONAL FAILURE: COMITY AND THE BANKRUPTCY CODE, Paul L. Lee; Because UNICATRAL chose to endorse the universal approach US should amend Chapter 15 to block bankruptcy judges in continuing to follow a territorial doctrine.

timely for the legal apparatus of the UNIDROIT Convention/Aircraft Protocol to come into play.

4. Extra -Territorial Reach of US Bankruptcy Law

4.1. Introduction

The important remaining question is whether the insular U.S. restructuring forum will finally develop an international perspective?

The long-standing rule of US law is, that congressional legislation will apply only within the United States unless a contrary intent is manifested. This doctrine is also referred to as "*a presumption against extra-territoriality of US law*".

Also, US Bankruptcy law originally did not (expressly) address how a bankruptcy court should address the questions and conflicts raised when the situation arises that two bankruptcy cases are pending one of which not in the US, or when U.S. jurisdiction cannot constitutionally or practically be exercised. In principle, US courts have nonetheless established a practice of accepting general exceptions to the rule of territorial applicability, which is of course, with qualifications and under certain conditions.

While the US Bankruptcy Code generally would govern only actions with some '*significant connection*' with the US, US Courts, relying on the language of the provisions in law, have however, ruled that U.S. bankruptcy law applies also to actions taken with respect to property abroad in which a (U.S.) debtor '*has an interest*'. This practice created the extension of the so-called *'in rem'* jurisdiction over all property of the debtor and promotes comprehensive control, in one (US) forum, over the debtor's assets.

4.2. Sabena Belgian Airlines; the Scope of Chapter 11 Extended

Moreover, in re Laker Airways, Ltd. v. Sabena, Belgian World Airlines, 731 F.2d 909, 925 (D.C. Cir. 1984)) the US court determined that "*where [firstly] the failure to extend the scope of the [bankruptcy -AVV] statute to a foreign setting will result in adverse effects within the United States"; and [secondly] "where the regulated conduct is "intended to, and results in, substantial effects within the United States, US law should be applied.*" [227] As a mitigating factor, if the presumption against extra-territoriality has been overcome or is otherwise inapplicable, it is practice that US law should never be interpreted or used so as to violate the fundamental law of nations if any other construction is deemed possible. Against this background, Congress determined and intended some specific provisions of the US Bankruptcy Code, and certain related provisions of the Judicial Code, to be given extraterritorial effect. Some very important provisions of the US bankruptcy code are now given extraterritorial effect, and may now purposefully be called upon:

4.3 Definition of Bankruptcy Estate

One very important Bankruptcy Code provision that is granted 'extra-territorial effect' is the provision that defines the 'bankruptcy estate'. Pursuant to Bankruptcy Code section 541 the commencement of any bankruptcy proceeding in the US creates an estate that is comprised of the debtor's eligible property "wherever located and by whomever held". [228] The bankruptcy estate thereby extends to and includes any asset of the debtor, wherever the assets may be located, whether within the United States or abroad, in which the (US) debtor has an interest. The claims of foreign creditors are considered as admissible on equal footing with the claims of domestic [US] creditors, and foreign creditors are able to share equally in the proceeds of the bankruptcy estate.

Since the debtor's property located outside the United States also constitutes the property of the estate, the US bankruptcy court may exercise its jurisdiction over

[227] 186 B.R. 807, 817 (S.D.N.Y. 1995), *aff'd,* 93 F.3d 1036 (2d Cir. 1996).

it. This may actually be of interest with respect to the qualification of airport slots as property in the US bankruptcy estate. It may, however, be necessary to obtain the assistance of a foreign court in obtaining effective control of such property. To obtain such assistance, the domestic airline debtor would have to commence an appropriate proceeding in the foreign court. If the nation where the property is located has adopted the UNCITRAL Model Law on Cross-Border Insolvency, this statute contains a number of provisions to facilitate such assistance, however. Alternatively, the US court may consider it appropriate to defer jurisdiction to a foreign court altogether for the determination of the rights of the parties.

4.4 Reach of the Automatic Stay

Another important provision of U.S. bankruptcy law that is most likely to be – purposefully or strategically- invoked extra-territorially is section 362, the 'automatic stay' provision, which is the broadest form of injunction available to parties in a U.S. bankruptcy court proceeding. Its application is automatic in the sense that it applies from the moment a bankruptcy case is filed, whether or not a creditor has received notice of the filing. [229]Any action taken in violation of the stay is either void or voidable (depending on the judicial circuit in the United States where the domestic case is filed). Significantly, under U.S. bankruptcy law, the automatic stay applies world wide, whether or not this is consistent with domestic law in the relevant foreign country.

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[228] Ibid

[229] Service of summons. F.R.Civ.Proc. 4(h)(1) allows for service on a foreign corporation where service could be effected in the U.S. on the corporation's "officer, managing or general agent, or ... any other agent authorized by appointment or by law to receive service of process." This means that a foreign corporation may be amenable to service in the U.S., provided that service can be effected on an officer or agent of that corporation who is located within the U.S. Many cases arising under F.R.Civ.Proc. 4(h)(1) have addressed whether a domestic subsidiary of a foreign corporation will be deemed to be the "agent" or alter ego of the foreign parent for service of process purposes. For example, in Chung v. Tarom, S.A., et al., 990 F.Supp. 581 (N.D.Ill. 1998), the Court addressed whether the service of a summons and complaint on the domestic subsidiary of a French corporation would be effective service on the French parent. In other cases, courts in various U.S. jurisdictions have found there to be an "agency" or "alter ego" relationship between a foreign parent and its U.S.-based subsidiary, so as to allow the U.S.-based subsidiary to be served on behalf of its foreign parent. See, e.g., King v. Perry & Sylva Machinery Co., 766 F. Supp. 638, 640 (N.D.Ill. 1991) (finding that service on Japanese corporation was accomplished by service on its U.S. subsidiary because subsidiary was deemed an "involuntary agent" of its Japanese parent); United States v. International Brotherhood of Teamsters, 945 F. Supp. 609 (S.D.N.Y 1996) (recognizing both the "agency" and "alter ego" theories of service, but declining to exercise jurisdiction because the plaintiff had not presented sufficient evidence to support either theory). Similarly, U.S. courts have also found that in certain circumstances U.S.

In this respect, if any creditor violates the automatic stay anywhere in the world, that creditor is subject to sanctions imposed by the bankruptcy court in the United States. If the creditor is beyond any jurisdictional reach of a U.S. court, the debtor or trustee may obviously have difficulty enforcing the automatic stay in practice, however.

4.5 'In rem jurisdiction'

In re Lykes Bros. S.S. Co. v. Hanseatic Marine Serv. (In re Lykes Bros. S.S. Co.), illustrates the US court practice and broad view of applying this automatic stay provision extra-territorially. In this case, the court found that a German corporation wilfully violated the automatic stay when it caused the post-petition arrest in Belgium of a ship belonging to the debtor in order to enforce its pre-petition debts resulting from the charter of two other ships. Although the German corporation had no direct contacts with the debtor or the United States itself, the US court held that the German corporation was formed and the debts were transferred to it secretly, which was done by the original two creditors after the bankruptcy filing, in a shameless effort to avoid the automatic stay and to disrupt the Chapter 11 plan (i.e. misuse or abuse thereof). The US court found that it had personal jurisdiction over one of the original creditors because the creditor had filed a claim in the bankruptcy case, and thereby had submitted to the jurisdiction of the US court. It found that the second creditor was likewise subject to the personal jurisdiction of the court because the transactions at issue had sufficient contacts with the United States. This case confirms that, US Courts, while relying on the wording of the specific provisions, have ruled that U.S. bankruptcy law applies also to actions taken with respect to property abroad in which a U.S. debtor *'has an interest'* which extends a so-called *'in rem'* jurisdiction over all property of the debtor and promotes comprehensive control, in one forum, over the debtor's assets.

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corporations could be served on behalf of their foreign subsidiaries. See, e.g., Acapalon Corp. v. Ralston

However, it is important to realize, that even though the domestic court may have 'in rem jurisdiction' over the assets of the estate, the court must additionally have 'in personam jurisdiction' over a creditor before it may enforce its sanctions for interfering with estate property during the automatic stay.

4.6 'In personam jurisdiction'

In order for the US bankruptcy court to have 'in personam jurisdiction' a two-part test must always be satisfied. Firstly, the defendant must have at least "minimum contacts" with the relevant (US) jurisdiction. Secondly, the exercise of jurisdiction over the defendant must be "fair and reasonable". After determining whether either of these two conditions is met, personal jurisdiction of the US court may then either be general or specific.

Specific jurisdiction applies where the litigation arises out of the creditor's or debtor's specific action in the relevant forum. In such a case, jurisdiction may be exercised where the defendant has purposefully directed its activities toward the forum. For example, if a foreign corporation enters into a major commercial relationship with a U.S. corporation, it is subject to the US bankruptcy court jurisdiction for the return of preferential transfers arising out of this relationship.

General jurisdiction, in contrast, is required if the litigation does not arise out of the creditor's or debtor's forum-related activities. General jurisdiction may only be exercised where the defendant has had continuous and systematic contacts with the forum jurisdiction. Nonetheless, on a relative note, in re Maxwell Communication Corp. v. Société Générale (In re Maxwell Communication Corp.), the court held that more ties to a foreign jurisdiction, and looser ties to the United States, are necessary to avoid the application of U.S. law to a transaction, which

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Purina Co., 1991 Mo. App. Lexis 1322 (Mo. Ct. App. 1991).

again confirms that US courts are willing to adhere to a broad view of 'extra-territoriality'.[230]

4.7 Towards a Global Reorganization Tool: Terra Cognita

Since not all nations have insolvency laws which provide for reorganization or restructuring, the ability of a foreign or US company engaged in foreign commerce to reorganize under Chapter 11, depends upon the extent of 'effective extraterritorial' effect of the US Bankruptcy Code is awarded or not. The uncertainty that presently exists as a consequence of the present tests and conditions surely do not give US Chapter 11 automatic worldwide application, which may be desired by parties.

It is to the benefit of every commercial party to create *'terra cognita'* in their dealings with their (foreign) commercial parties. Parties traditionally have tried and are still fervently trying to mitigate legal risk and uncertainties by making their dealings subject to contracts with a (U.S.) choice of law and/or (U.S.) choice of forum provisions. Despite the fact that such contract provisions do invoke at least a 'justified reliance' upon familiar substantive and procedural regimes of chosen law, the above mentioned tests and conditions imposed by courts remain, which surely do not add to the use of Chapter 11 as a global reorganization tool.

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[230] Avoidance rules are the rules by which pre-insolvency transactions may be avoided for the benefit of creditors, solely upon economic and temporal factors rather than culpability, including preference and fraudulent conveyance rules, for definition see also Norton Bankruptcy Law and Practice 2d at 152:66
Also: Personal jurisdiction. The key concepts of "alter ego" and "agency" are determinative in this context as well. In Doe v. Unocal, 248 F.3d 915 (9th Cir. 2001), the Ninth Circuit analyzed these concepts in a case involving alleged human rights violations arising out of the construction of natural gas exploration and transportation facilities in Burma. The Unocal decision focused on whether the Court had personal jurisdiction over Total, S.A., a French petrochemical company, because Total had subsidiary holding companies, which operated in California. The Court held that as a general matter personal jurisdiction over a corporate parent cannot be based solely on its subsidiaries' contacts with the forum. Nevertheless, if parent and subsidiary "are not really separate entities [citations omitted], or one acts as an agent of the other [citations omitted], the local subsidiary's contacts can be imputed to the foreign parent." El-Fadl v. Central Bank of Jordan, 75 F.3d 668, 676 (D.C. Cir. 1996). See: Jurisdictional Reach: Liability of Foreign Corporations Based on the Activities of Their U.S. Subsidiaries; July 24, 2001,Los Angeles Daily Journal By Peter S. Selvin.

In practice, even US parties should remain guarded in their assumptions about the protections afforded by US legal norms, particularly if their foreign counter party devolves into bankruptcy or reorganization proceedings under their own foreign law. Namely, whereas 28 U.S.C. section 1471(e) provides: *'The bankruptcy court in which a case under title 11 is commenced shall have exclusive jurisdiction of all of the property, wherever located, of the debtor, as of the commencement of such case"*; and section 362 of the Code furthermore does not limit its scope to property of the debtor in the United States; section 541 of the Code purports to reach assets of the debtor *'wherever located and by whomever held'* a US bankruptcy court, however, importantly does not have jurisdiction to enforce a judgement extra-territorially unless it has jurisdiction over the person or persons against whom it seeks to enforce its orders. As illustrated earlier, this is never a given.

4.8 Worldwide reservations

Foreign courts frequently have difficulty recognizing a reorganization case under Chapter 11 of the U.S. Bankruptcy Code as an insolvency proceeding similar to one under their domestic laws. Namely, the insolvency regimes in most countries require the appointment of an administrator (similar to a trustee in the U.S. bankruptcy system) who takes possession of the assets of the debtor and administers them for the benefit of creditors. Leaving the debtor in possession of the assets, as is typical in a Chapter 11 case in the United States, is generally uncommon outside the United States. The foreign court may not confer rights upon the debtor in possession that are similar to those of an administrator under the local law in that country. The failure of a foreign court to recognize a Chapter 11 case in the United States that has started, has several consequences. In this light, the court may not treat the U.S. case similarly to a local insolvency case; the foreign court may refuse to recognize the status of a U.S. 'Chapter 11 debtor in possession'. Consequently, the US Chapter 11 debtor may not even participate in proceedings in that court or initiate proceedings to collect assets belonging to the bankruptcy estate in the United States. Moreover, a foreign court may permit non-

U.S. creditors to obtain local assets in violation of the automatic stay in the US, without regard to the U.S. segment, denying the rights of creditors (both foreign and domestic) who have filed their claims in the United States. [231]

It can be concluded that essentially the desired extraterritorial effect of the US Bankruptcy Code finds its limitation in the fact that it is left to the domestic court's discretion and recognition of law and/or forum in which it is sought to be applied. This means that ultimately, the effect to be given to a U.S. bankruptcy ruling will vary from country to country. [232]

5. Case Studies: US Courts Deferring to Foreign Courts

Under the doctrine of comity, as a "central" role in the US bankruptcy court's evaluation and interpretation of section 304 of the US bankruptcy code, different conditions are set out for allowing the court to defer to foreign law and

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[231] Airline Bankruptcies and Workouts: the Airline's perspective; G. W. Buhler, Schnader Harrison Segal & Lewis LLP.

[232] Finally, both the future challenges and possible future solutions are evaluated against the background of searching for mitigation of the global problem of 'multinational insolvency'. The need for better coordination is recognized among many national states. The responses include the Model Law on cross-border insolvency promulgated by UNCITRAL (the United Nations Commission on International Trade Law) and the recent European Union Insolvency Regulation. Guidelines may promote commerce between nations by making international insolvencies more predictable, fair, efficient and convenient, which tend to increase the value of companies in liquidation or reorganization. The assets of a corporate enterprise are more likely to be preserved and enhanced if a single forum exercises supervision and control. Moreover, international commerce is encouraged to the extent that participants may rely upon the expectation that if they engage in transactions with a multinational and an insolvency proceeding is commenced in any nation with which the enterprise has a connection, that participant will not suffer discriminatory treatment based solely upon nationality or domicile. While the creditor may still be subject to the practical inconvenience of facing an insolvency proceeding in another foreign country, that risk can be counted as part of the package when dealing with a multinational. The risk of discriminatory treatment should not be a risk of engaging in business with a multinational, however, nor should the risk that the evaluation of a creditor's pre-insolvency claim will be based upon the law of an unanticipated jurisdiction unilaterally chosen by the entity or individual commencing an insolvency proceeding be a risk of such business. Another option that is advocated is to adopt a specific international regime only to companies of a certain size or a certain level of international activity. This is also referred to as a limited application of a universality regime. For example, the regime would only be applicable to large multinationals whereas the application of local policies would be permitted with respect to local enterprises. An example to some extent may be the Aircraft Protocol to the UNIDROIT Convention. Since many local regimes cannot be applied effectively to facilitate bankruptcy of multinationals anyway, it can well be argued that also little is lost locally by international governance of multinationals. The general thread in the context of international insolvency procedures may be an increasing tendency as well as requirement for co-operation or coordination. (See also: Connecticut Journal of International Law, Fall, 2001 Symposium-International Insolvency: Bankruptcy in a Global Economy, Global Developments, THE TRANSNATIONAL INSOLVENCY PROJECT OF THE AMERICAN LAW INSTITUTE, Jay Lawrence Westbrook Norton Bankruptcy Law and Practice 2d, 152:66; Michigan Law Review, June, 2000, Colloquy: International Bankruptcy, A global solution to multinational default, Jay Lawrence Westbrook; On the capital intensive nature of the airline industry, see also generally George Mason Law Review, Fall, 1999, Article "Thou canst not fly high with borrowed wings, Airline Finance and Bankruptcy Code Section 1110"

procedures. [233] Before illustrating the application of this doctrine, it is necessary to realize that the framework provided in section 304 has recently been revised. [234] US Congress adopted, as part of the Bankruptcy Reform Act of 2001, a new Chapter 15 to the Code to govern ancillary cases and other cross-border insolvency matters. While the legacy of section 304 retains considerable importance, it is partly revised as well. [235]

5.1 Phillippine Airways

Important from the viewpoint of international bankruptcy jurisprudence, is the memorandum decision regarding Philippine Airlines Inc. of Judge Carlson. This decision is one of the first decisions under § 304 to address comity in the context of foreign business reorganization.

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[233] Although the U.S. Bankruptcy Courts recognize the economic and efficient administration associated with foreign bankruptcy proceedings, Section 1507 enumerates three specific factors, which the bankruptcy court must consider in determining which relief, if any, should be granted under the petition.

It provides:

"*In determining whether to provide additional assistance under this title or under other laws of the United States, the court shall consider whether such additional assistance, consistent with the principles of comity, will reasonably assure: --*

(i) The just treatment of all holders of claims against or interests in the debtor's property;
(ii) The protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign bankruptcy proceedings;
(iii) The prevention of preferential or fraudulent dispositions of property in the foreign proceedings;

Although Congress incorporated the section 304 (c) factors into Chapter 15, the legislature did make a change here. Since section 304 provided the following factor to be taken into account as well: "*Whether the distribution of proceeds of such estate is substantially in accordance with the order prescribed by U.S. bankruptcy laws*". Whether this factor especially was applied in a protectionist fashion and promoted a territorial approach. Apparently recognizing the disparate treatment of comity among the US bankruptcy courts, comity is removed as a factor and raised to the introductory language of section 1507 (b). This was to emphasize that comity is 'the central concept to be addressed' and to encourage courts to adhere to a universal approach. Nonetheless, in a 'post Chapter 15 case', which may be referred to as in Re Treco, the court found that '*the principle of comity has never meant categorical deference to foreign proceedings*'. Consequently, courts may still rely on pre-Chapter 15 cases since each factor may still be taken into consideration. See also: Although the U.S. Bankruptcy Courts recognize the economic and efficient administration associated with foreign bankruptcy proceedings, Section 1507 enumerates three specific factors, which the bankruptcy court must consider in determining which relief, if any, should be granted under the petition.

[234] Paul L. Lee, Banking Law Journal, 2001, GLOBAL FINANCE AND TRANSNATIONAL FAILURE: COMITY AND THE BANKRUPTCY CODE, July/August 2001; On a critical note it is argued, that the comity consideration included in Section 304(c)(5) seems inconsistent with the other provisions of Section 304(c) which are generally designed to provide protection to the so-called 'local creditors' in the United States. Then again, some argue that on the contrary US court did develop exactly that: a practice of "broadly molding the appropriate relief in near blank-check fashion"

Judge Carlson ruled that comity should be granted to the Philippine rehabilitation proceeding of Philippine Airlines Inc. even though there may not be exact similarity between the U.S. system for reorganizing companies and the system within the Philippines. In Judge Carlson's view, as long as the foreign country's system for rehabilitating distressed companies is codified, provides fundamental fairness to creditors, does not discriminate on the basis of nationality and includes the basic concepts involved in all U.S. bankruptcy cases -- such as a meeting of creditors, a stay against creditor actions, the right to be heard, the ability to file claims, a priority system for classifying and treating claims, and the ability to recover preferences and fraudulent transfers -- that system should be afforded comity.

5.2 In re Canadian Airlines

Canadian Airlines had major corporations in the United States, and many of its creditors were based in the United States.[236]

The court ruled, that now that more countries are allowing distressed companies the opportunity to rehabilitate and restructure their indebtedness under court supervision, more foreign debtors with US assets and operations, will take advantage of the protections offered by section 304 and commence an ancillary proceeding there under to assist in their (domestic) restructuring efforts. [237]

5.3 In re Swissair

Swissair filed a petition with the U.S. Bankruptcy Court in Manhattan to recognize the Swiss automatic stay order and to grant protection of its assets from

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[235] Please also see footnote 233 (ibid.)
[236] 2002, ABI JNL. LEXIS 58, March 2002
[237] In re Phillipine Airlines (PAL): PAL's petition under section 304 was challenged by three of its US creditors, including BOEING and General Electric. In re Philippine Airlines is one of the first decisions under section 304 to address comity in the context of foreign corporate reorganization.

United States creditors. The United States Court eventually granted the request on October 11, 2001. [238]

In this case, Swissair Group AG and Sabena SA both filed chapter 11 section 304 ("a petition ancillary to a foreign proceeding"), seeking to prohibit collection efforts against the companies' U.S. assets during international proceedings in Europe. [239] They were successful.

6. The goal: effective extra-territoriality of US Chapter 11

Since not all nations have insolvency laws which provide for reorganization or restructuring, the ability of a foreign or US company engaged in foreign commerce to operate in Chapter 11 and to reorganize accordingly, depends upon whether an 'effective extraterritorial' effect of the US Bankruptcy Code is possible and will be awarded or not. The uncertainty that presently exists as a consequence of the above mentioned tests and conditions surely do not give US Chapter 11 a world wide automatic application if so desired by parties.

Whereas parties have traditionally tried to mitigate legal risk and uncertainties by making their dealings subject to contracts with an U.S. choice of law and/or U.S. choice of forum provisions, and where these contract provisions invoke a 'justified reliance' upon familiar substantive and procedural regimes, the above mentioned tests and conditions that have to met will not add to the use of Chapter 11 as a global reorganization tool. It is to the benefit of every commercial party to create '*terra cognita*' in their dealings with foreign commercial parties. Still it seems that in practice, however, even US parties should remain guarded in their assumptions about the protections afforded by US legal norms, particularly if their foreign counter party devolves into bankruptcy or reorganization proceedings under their own foreign law.

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[238] See, e.g., Laker Airways, Ltd. v. Sabena, Belgian World Airlines, 731 F.2d 909, 921 (D.C. Cir. 1984) (observing foreign nations have interest in governing transactions which occur within their borders).
[239] Business Bankruptcy Headlines for 10/12/2001

Namely, whereas 28 U.S.C. section 1471(e) provides: *'The bankruptcy court in which a case under title 11 is commenced shall have exclusive jurisdiction of all of the property, wherever located, of the debtor, as of the commencement of such case"*; and section 362 of the Code furthermore does not limit its scope to property of the debtor in the United States; section 541 of the Code purports to reach assets of the debtor *'wherever located and by whomever held' a* US bankruptcy court however does not have jurisdiction to enforce a judgement extra-territorially unless it has jurisdiction over the person or persons against whom it seeks to enforce its orders. As illustrated earlier this depends on certain considerations and is never a given.

Foreign courts frequently have difficulty recognizing a reorganization case under Chapter 11 of the U.S. Bankruptcy Code as an insolvency proceeding similar to one under their domestic laws. Namely, the insolvency regimes in most countries require the appointment of an administrator (similar to a case trustee in the U.S. bankruptcy system) who takes possession of the assets of the debtor and administers them for the benefit of creditors. Leaving the debtor in possession of the assets, as is typical in a Chapter 11 case in the United States, is uncommon outside the United States. Finally, a foreign court may not be willing to entertain so-called avoidance actions against its foreign creditors, even where such actions are permitted in an insolvency case under local law in that country. [240] [241]

It can be concluded that the desired extraterritorial effect of the US Code finds its limitation in the fact that it is left to recognition by law of the forum in which it is sought to be applied. This means that ultimately, the effect to be given to a U.S. bankruptcy ruling will vary from country to country. This is because of the fact that, despite the theoretically universal applicability of the definition of "property of the estate" and the reach of the automatic stay, the extraterritorial application of

[240] Ibid. 228

the US bankruptcy code can only effectively be enforced where the U.S. court's jurisdiction can be enforced, more specifically as where the U.S. court also has an explicit in personam jurisdiction over the creditor. Therefore, if a non-U.S. creditor with no interest, connection or presence in the U.S. takes, or obtains an order of a non-U.S. court allowing it to take, property owned by a U.S. debtor, the extraterritorial reach of the US bankruptcy code will not be enforceable as a practical matter. For example, this can be illustrated by the fact that every case in which section 541 and the automatic stay have been used to preserve property located outside the U.S. a US creditor or defendant was present. [242]

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[241] Avoidance rules are the rules by which pre-insolvency transactions may be avoided for the benefit of creditors, solely upon economic and temporal factors rather than culpability, including preference and fraudulent conveyance rules, for definition see also Norton Bankruptcy Law and Practice 2d at 152:66

[242] 6A Norton Bankr. L. & Prac. 2d § 152:2 (1981), Norton Bankruptcy Law and Practice 2d, William L. Norton, Jr., Current through the February 2002 Update Analysis, Part 19. Related Laws and Issues, Chapter 152; International Insolvencies I. Fundamental Principles of Cross-Border Insolvencies in the United States, under A. The U.S. Bankruptcy Code and Cross-Border Insolvencies.

CHAPTER 7
CONCLUSION: FINAL CONSIDERATIONS

Bankruptcy is in its own right a complex, multi-disciplinary legal institution. It involves a wide range of different interests, objectives and parties. Bankruptcy law has evolved from simply facilitating the organized exit of a business, to providing a means of paving the way for a company to start afresh. In this view, the reorganization plan contains the blueprint for a new business structure or organization; it codifies a new relationship between the company and its creditors, with the objective to re-launching it restructured and financially healthy. This end result, however, involves negotiations that have significant cost and time constraints.

Chapter 11 may and should be used -preferably on a "fast-track" basis- as a means to negotiate with key stakeholders over their respective contributions to the reorganization plan, or to achieve the necessary cost savings envisioned. In the event of default of an airline, interestingly, if consensual participation between creditors is absent- in the US, presently, the survival of the airline may presently be additionally helped financially by a so-called "exit financing facility" which is supported by the Air Transportation Safety Board (ATSB), accordingly, despite the absence of an airline with a loan guarantee or a so-called "Plan Sponsor". [243] Upon implementing a reorganization plan, the airline debtor may emerge from chapter 11 reorganization as a "*stronger, financially sound airline*".[244]

1. SUMMARY & FINAL CONSIDERATIONS

[243] On September 22, 2001, President Bush signed into law the Air Transportation Safety and System Stabilization Act ("Act") (Public Law 107-42). The Act establishes the Air Transportation Stabilization Board ("Board"). The Board may issue up to $10 billion in Federal credit instruments, e.g. (loan guarantees). See also: 14 CFR Chapter VI and Part 1300 Regulations for Air Carrier Guarantee Loan Program Under Section 101(a)(1) of the Air Transportation Safety and System Stabilization Act; Final Rule

[244] August 19, 2002; US AIRWAYS GROUP INC (U); adapted from "form 8-K" Item 5 under 'Other Events'

In view of the fact that the airline industry is one of the most capital intensive and international industries, airlines especially need to be facilitated in their recent struggles. The current episodes of financial distress of airlines demonstrate the importance of having effective means to achieve a rapid, efficient and equitable resolution in order for the industry to become sustainable. [245]

The challenge, however is big, and made greater by the industry's increasing global reach. Moreover, the rapid evolution of the environment in which default occurs does not coincide with the more measured evolution of existing bankruptcy law regimes. Effective and comprehensive resolution techniques are needed for in order to contain systemic risks. Increased legal certainty helps market participants form a probability distribution around the outcomes of financial transactions and to make choices based on their willingness to bear risk, which may finally facilitate the urgently needed capital infusion in the industry against a competitive rate.

As the entire airline industry grapples for restructuring, this thesis proposes that reorganization efforts coordinated by the US Chapter 11 procedure, may facilitate that an airline emerges as an efficient airline with competitive labour, fleet and operating costs. This legal forum namely recognizes that the coordinated cooperation and support of customers, employees (labour unions) as well as the lenders, lessors and vendors, are needed in order for airlines to lay the groundwork for future successes.

This thesis described that airline default involves a range of competing interests and affects many parties, including its international counterparts.[246] Consequentially, flexibility seems to be indispensable. The legal tools offered need to take this into account. The provisions of Chapter 11 recognize that no

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[245] On the capital intensivity of the airlines, see also footnote 6 in George Mason Law Review, Fall, 1999, Article "Thou canst not fly high with borrowed wings, Airline Finance and Bankruptcy Code Section 1110"

[246] 6A Norton Bankr. L. & Prac. 2d § 152:2 (1981), Norton Bankruptcy Law and Practice 2d, William L. Norton, Jr., Current through the February 2002 Update Analysis, Part 19. Related Laws and Issues, Chapter 152; International Insolvencies I. Fundamental Principles of Cross-Border Insolvencies in the United States.

'one size fits all' solution exists in the context of airline default but nevertheless offer a unique and urgently needed facilitory framework in order to tackle the complexity of the issues at hand. Reorganization is uniquely acknowledged as a separate solution under US law.

Under the US Bankruptcy Code, the Reorganization Plan includes a detailed good faith 'liquidation analysis', which ensures the abuse of Chapter 11. This analysis is a required element of the Court's Disclosure statement, which concludes that the airline' s creditors and the overall value of the company's estate would be better served if the airline completes a successful restructuring and remains an on-going enterprise of which creditors would be given stock in the company in exchange for unpaid claims.

As bad as bankruptcy is, and despite unsuccessful experiences, major airlines have also successfully emerged from Chapter 11. There are endless possibilities under Chapter 11 to reorganize and emerge, or not emerge as an entity. It allows the reorganization and restructuring of the relationship with creditors, the issuance of stock for debt, and the liquidation of assets. Chapter 11 filings are used by companies in the acquisition process to help them sell assets free and clear of liens, allowing the target to start with a clean slate. The acquiring company can also reject leases and other contractual obligations, including, in some cases, collective bargaining agreements.

This thesis therefore argues that Chapter 11 can be portrayed as a centrepiece of a strategy that is pro-active and facilitating the 'survival of the fittest'. Even non-U.S. parties may seek refuge to this Chapter 11 forum; try to enforce an automatic stay, which prohibits creditors from appropriating property of the estate. Despite the theoretically universal applicability of the definition of "property of the estate" and the reach of the automatic stay provision, extraterritorial application of US bankruptcy law can, however, not be effectively enforced unless the U.S. court also has an explicit 'in personam jurisdiction' over the creditor. Therefore, the

non-U.S. party requires an interest, connection or presence in the U.S. Unless such is achieved, the extraterritorial reach of the US bankruptcy code will not be enforceable as a practical matter.[247]

In the US, if a company can be kept alive, the primary goal would always be to work towards a reorganization plan. However, such a plan is not achievable unless a court can bind all stakeholders to the reorganization plan, including the dissenters. This is the most important prerequisite of an effective viable reorganization. Only a system that conclusively resolves all stakeholders' legal rights can produce a financial restructuring that gives existing and future parties, including financiers, investors, and employees, a sufficient guarantee of legal certainty. Without such assurances, reorganization cannot go forward. It is especially within this context that international coordination and cooperation is also warranted for. For example, interim financing, equitable protection of security interests and supervision of the company's management are only a few of the delicate functions that are difficult to carry out without cooperation between different national courts.

In the international context neither the strict theory of territoriality nor that of universality copes adequately with the divergent situations. [248] In the absence of international treaties, as an effective, efficient and intermediary solution, the use of Protocols and accordingly, the Concordat may and should be called upon.

Namely, for the benefit of the airlines, any measure or law that effectively promotes a single approach is recommended. The UNIDROIT Convention (the Aircraft Protocol, specifically) to cross-border insolvencies also recognizes this. It will therefore undoubtedly benefit the airlines in distress. In particular for the airlines, a single approach to default shall give the industry the necessary stability. Predictability will consequently reduce the legal costs of foreign investors.

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[247] Conneticut Journal of International Law, Fall 1999, 'The cross border insolvency concordat and customary international law; is it ripe yet?, David H. Culmer; also citing Professor K.H. Nadelmann

Investors will be better able to price their investments because they can better predict the outcome of a bankruptcy proceeding. Ultimately, this is the factor, the significance that cannot be discarded of.

If an universal insolvency regime seems or in practice proves too ambitious, at least guiding principles exist resulting in a reasonably predictable, fair and convenient doing international business climate, which the airline industry should avail of.

While there exist many barriers that interfere with the coordination of insolvencies, including the absence of international insolvency treaties and the multiplicity of mostly incompatible local insolvency laws, to my opinion, universalism should be advocated as the ultimate objective. Special industry focused, aviation bankruptcy law provisions may perhaps promote a gradual development into this direction, paving the way for a future, in which finally a sustainable healthy, efficient, global and equitable economy is assured.

The adoption of the EEC Insolvency Regulation, the explicit statutory authorization to US Courts as given in section 1504 to order the appointment of a foreign representative where appropriate, the proven US practice of providing assistance to foreign courts and foreign insolvency representatives, the unilateral recognition of foreign bankruptcy proceedings within the US confirmed by the adoption of Chapter 15, the UNIDROIT Convention, all show that significant steps are presently made. This gives good hopes for the future.

No one knows if globalisation will continue at its current, accelerating pace, but what we do know is that in other fields there are meaningful international legal rules adopted today that seemed far-distant ten years ago and would have been almost unimaginable ten years before that. If globalisation does proceed apace, then the pressures for a universal system for managing the financial crises of

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[248] Banking Law Journal, July/August, 2001, GLOBAL FINANCE AND TRANSNATIONAL FAILURE:

multinational companies will prove irresistible: global bankruptcy is for a global market

In the meantime, within the US, chapter 15 can be quite an effective tool for promoting the growth of a global economy by introducing a single approach.[249]

Section 1110 may potentially play an important role in the current, and in the future, Chapter 11 proceedings of major American carriers. Particularly since airlines can no longer own their entire fleet outright. Section 1110 namely forces an airline in Chapter 11 to make final, binding decisions regarding their most important assets- their aircrafts- very early in bankruptcy proceedings. With the adoption of section 1110, US Congress intends to strengthen the borrowing power of airlines engaged in fleet modernization by offering equipment financiers more security on their investment by limiting the equitable powers of the bankruptcy court to modify their rights to take possession of collateral after a default.

The international aviation community has definitely taken note to the potentialities and successes of US Chapter 11. The UNIDROIT Convention even contains a provision inspired by section 1110, making urgently needed capital available to the airlines.

COMITY AND THE BANKRUPTCY CODE, Paul L. Lee

[249] 98 Mich. L. Rev. 2276, 2282, article "A global solution to multinational default" by J.L. Westbrook, at page 2 , see also Michigan Journal of International Law, Fall 1997, A new approach to transnational insolvency; Robert K. Rasmussen and National Conference of Bankruptcy Judges American Bankruptcy Law Journal Winter, 2002

76 Am. Bankr. L.J. 1, article "Multinational Enterprises in General Default: Chapter 15, The Ali Principles, and The EU Insolvency Regulation" by Jay Lawrence Westbrook at page 7, footnote 21; A number of scholars have supported universalism, although from various perspectives. See, e.g., Kent Anderson, The Cross-Border Insolvency Paradigm: A Defense Of The Modified Universal Approach Considering The Japanese Experience, 21 U. PA. J. INT'L ECON.L. 679 (2000); Lucian Arye Bebchuk & Andrew T. Guzman, An Economic Analysis Of Transnational Bankruptcies, 42 J. L.& ECON. 775 (1999); Ronald J. Silverman, Advances In Cross-Border Insolvency Cooperation: The UNCITRAL Model Law On Cross-Border Insolvency, 6 ILSA J. INT'L & COMP. L. 265 (2000) [hereinafter Silverman]; Liza Perkins, Note, A Defense of Pure Universalism in Cross-Border Corporate Insolvencies, 32 N.Y.U. J. INT'L L. & POL. 787 (2000) [hereinafter Perkins]. See also Hannah L. Buxbaum, Rethinking International Insolvency: The Neglected Role of Choice-of-Law Rules and Theory, 36 STAN. J. INT'L L. 23, 60 (2000) (arguing for a single jurisdiction internationally following the logic of domestic practice); Lore Unt, Note, International Relations and International Insolvency Cooperation: Liberalism, Institutionalism, and Transnational Legal Dialogue, 28 Law & Policy Intnl. Bus. 1037 (1997) (arguing that the answer is cooperation among decentralized courts in liberal states).

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