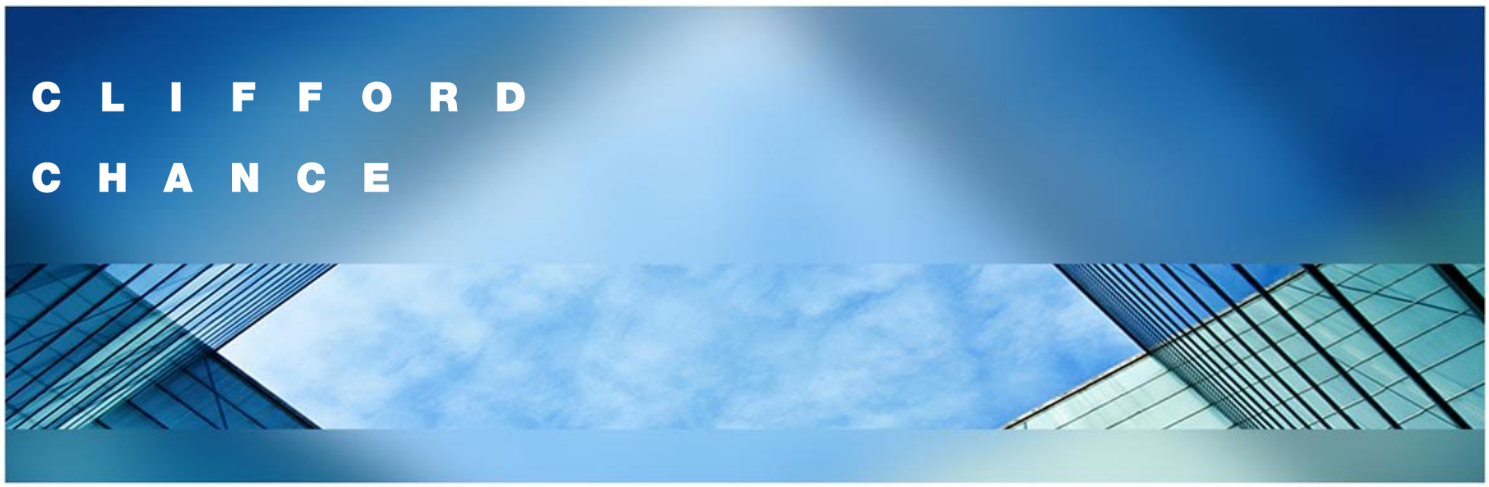


# US BANKRUPTCY COURT ISSUES RULING RELATING TO CAPE TOWN CONVENTION

Since its adoption in the US, practitioners and commentators have questioned whether and how a US court would apply the Cape Town Convention in a Chapter 11 case of a non-US airline. The significant number of non-US airlines that have commenced Chapter 11 cases since the onset of the COVID-19 pandemic has intensified that discussion. Although it stops short of definitively answering the question, a recent decision from the Southern District of New York suggests that Alternative A of the Cape Town Convention should be enforceable in a US bankruptcy case so long as the debtor's primary insolvency jurisdiction has made the necessary declaration to give international effect to Alternative A.

## THE LEGAL LANDSCAPE

Ratified by the US, the European Union and more than 80 other states, the Cape Town Convention and the related Aircraft Protocol (the "CTC")[1] establishes an international legal regime for the financing and leasing of certain aircraft and aircraft engines, including the creation, recognition and priority registration of international interests in such equipment.

A US certificated air carrier that commences a Chapter 11 case is subject to Section 1110 of the Bankruptcy Code, which generally requires that the carrier either cures all defaults and agrees to perform all of its obligations under its aircraft financing and leasing arrangements or returns any applicable aircraft equipment to the relevant creditor within the first 60 days of the Chapter 11 case. Section 1110 operates as a limitation on the Bankruptcy Code's automatic stay, which generally prohibits creditors from enforcing their rights absent relief from the bankruptcy court. Section 1110 is viewed as significantly more favorable to aircraft creditors than the Bankruptcy Code's default rules for secured financings or

1 The CTC consists of the Convention on International Interests in Mobile Equipment (the "Cape Town Convention") and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (the "Aircraft Protocol").

personal property leases, which apply to debtors (like non-US airlines) who lack the required US air operating certificate.

Outside the US, the CTC allows contracting states to establish procedures for aircraft creditors to exercise certain remedies in an insolvency scenario. Each contracting state may adopt one of two alternatives: Alternative A, which requires debtors to cure defaults and agree to perform their future obligations or to return aircraft to the relevant creditor upon the expiration of a specified waiting period (modeled on Section 1110 of the Bankruptcy Code); or Alternative B, which gives the insolvency court discretion in whether and when to permit enforcement. If a contracting state has made the required declaration giving international effect to its decision, then all other contracting states are required to enforce the alternative adopted by that contracting state in any insolvency proceeding concerning a debtor whose center of main interests is located in that state. This is intended to discourage insolvency forum-shopping: a debtor located in a state that has adopted Alternative A should not be able to evade its requirements by commencing proceedings in a state that has not made an equivalent declaration.

It is not uncommon in non-US airline bankruptcy cases where application of the CTC may be at issue for debtors to request that their aircraft creditors agree to extend the CTC waiting period and allow the debtors to continue to use the aircraft provided that the parties reserve their right to address CTC applicability in the future. However, the issue has not been litigated to a decision until SAS.

## THE COURT'S DECISION IN SAS

Scandinavian Airlines (known as "SAS") is a European airline headquartered in Sweden. Sweden is a party to the CTC and has adopted Alternative A but has *not* made the declaration required to give international effect to that election. Rather, Sweden has adopted Alternative A only for purpose of its domestic law. Because SAS is not a US certificated air carrier, it is also not subject to Section 1110 of the Bankruptcy Code. While the US is a party to the CTC, it has not adopted Alternative A primarily because it already has Section 1110.

SAS and certain of its affiliates commenced Chapter 11 proceedings in 2022. At the time SAS's Chapter 11 case was filed, the company leased two aircraft from CAVIC Aviation Leasing. During the case, SAS and CAVIC negotiated an agreement allowing SAS to use the aircraft during the case and extending the applicable waiting period under the CTC, all while reserving the parties' rights to argue over whether the CTC applied. Before the expiration of the extended waiting period, SAS rejected the leases and returned the aircraft to CAVIC. CAVIC then filed claims in the bankruptcy case seeking administrative expense claims (i.e., claims that would be paid in full) for lease rent during the Chapter 11 case and for SAS's failure to comply with the lease return conditions, arguing that the CTC applied and compelled SAS to pay these amounts in full.

On July 22, 2024, Judge Michael E. Wiles of the Bankruptcy Court for the Southern District of New York issued an opinion disagreeing with CAVIC and disallowing its requested administrative expense claims for two key reasons.[2]

[2] *In re SAS AB*, Case No. 22-10925 (Bankr. S.D.N.Y. July 22, 2024) (MEW). The opinion is available at: https://www.nysb.uscourts.gov/sites/default/files/opinions/312818_2877_opinion.pdf.

*First*, because Sweden had not made the declaration required by the CTC, the court held that its adoption of Alternative A had only domestic effect and was not applicable in the US. *Second*, even if Sweden's election applied internationally, Alternative A requires only that a debtor make full payments (or return the aircraft) *at the end* of the relevant waiting period; here, the parties agreed to extend the waiting period and SAS rejected the leases before the waiting period expired. Since Alternative A does not specify the priority given to claims that arise during the waiting period, the court held that this is governed by domestic law, i.e., the US Bankruptcy Code.

## SOME KEY TAKEAWAYS

Although CAVIC was not successful in seeking administrative expense claims in this case, the court's decision may be read to suggest that the CTC *would* apply in a Chapter 11 case where the debtor's primary insolvency jurisdiction had made the required declaration. This would be consistent with the conclusion reached by the independent expert opinion commissioned by the Aviation Working Group ("AWG"), a nonprofit group comprised of major aviation manufacturers, leasing companies and financial institutions dedicated to advancing international aviation financing and leasing. That opinion concluded that the CTC is self-executing and that US bankruptcy courts are therefore "obligated to apply . . . Alternative A in conformity with the declaration of the debtor's primary insolvency jurisdiction."[3]

Importantly, the court was unpersuaded by CAVIC's argument that Sweden and other EU member states are precluded by EU law from making the required declaration, reasoning that such countries can instead provide a "notification" in lieu of the declaration. In future cases it will therefore be critical not only to understand the status of CTC adoption and the insolvency election made in a debtor's primary insolvency jurisdiction, but also the status of that country's declaration (or notification in lieu of it) in order to determine how the CTC may interact with the Bankruptcy Code. Assuming a debtor's primary insolvency jurisdiction has made the requisite declaration to allow for international effect, SAS provides persuasive authority that the CTC should apply to allow an aircraft creditor to enforce the CTC against a non-US debtor.

[3] The opinion is available at: https://awg.aero/wp-content/uploads/2024/05/Expert-Opinion-concerning-the-application-of-CTC-under-Ch.11-involving-a-non-US-debtor-May-2024.pdf

## AUTHORS

**Michelle McGreal**
Partner
New York
T +1 212 878 8378
E michelle.mcgreal
@cliffordchance.com

**Robert Johnson**
Associate
New York
T +1 212 878 8004
E robert.johnson
@cliffordchance.com

## FURTHER CONTACTS: RESTRUCTURING

**Doug Deutsch**
Partner
New York
T +1 212 878 4935
E douglas.deutsch
@cliffordchance.com

**Brian Lohan**
Partner
New York
T +1 212 878 3187
E brian.lohan
@cliffordchance.com

**Maja Zerjal Fink**
Partner
New York
T +1 212 878 3188
E maja.zerjalfink
@cliffordchance.com

**Sarah Campbell**
Counsel
New York
T +1 212 878 3427
E sarah.campbell
@cliffordchance.com



www.cliffordchance.com

Clifford Chance, Two Manhattan West, 375 9th Avenue, New York, NY 10001, USA



Clifford Chance US LLP

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# FURTHER CONTACTS: ASSET FINANCE

**Paul Carrington**
Partner
London
T +44 207006 8124
E paul.carrington
@cliffordchance.com

**Fergus Evans**
Partner
Singapore
T +65 6506 2786
E fergus.evans
@cliffordchance.com

**Richard Evans**
Partner
London
T +44 207006 2248
E richard.evans
@cliffordchance.com

**Paul Greenwell**
Partner
Hong Kong
T +852 2825 8857
E paul.greenwell
@cliffordchance.com

**Oliver Hipperson**
Partner
London
T +44 207006 4767
E oliver.hipperson
@cliffordchance.com

**Ranbir Hunjan**
Partner
London
T +44 207006 2612
E ranbir.hunjan
@cliffordchance.com

**Patrick O'Reilly**
Partner
New York
T +1 212 878 8103
E patrick.oreilly
@cliffordchance.com

**Zarrar Sehgal**
Partner
New York
T +1 212 878 3409
E zarrar.sehgal
@cliffordchance.com

**Emily Wicker**
Partner
New York
T +1 212 878 4917
E emily.wicker
@cliffordchance.com