

COELUM

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Lessons from Mexicana and Applied Solutions,
A summary.

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Important Procedural Reform
to the Commerce Code.

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COELUM Pronunciation: 'che-l&m, is Latin for airspace or sky. The Romans began questioning the rights they had in the space above the land they owned and to how high above did that right extended to. Ad coelum et ad inferos, they discussed, meaning that their right of property would extend as high up to the heavens and down to hell.

FEBRUARY NEWS on
Mexican Aviation P. 09-10

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Lessons from Mexicana and Applied Solutions,

A summary.

by Carlos Sierra.

Without trying to write a post-mortem of Mexicana in this brief space, I believe that it is timely to write a few lines about the circumstances that have surrounded what has become in fact a test case for several aspects, all of which are useful to show just how far has respect for the rights of creditors really come to be under Mexico's legal's system, how such right is perceived nowadays before the eyes of the judges involved, how effectively the rights of creditors can or cannot be enforced in this country, in fact-in real time, and -last but not least- in relation to whether the Cape Town Convention and its Protocol have proven to be useful or not.

In spite of the demise of several other airlines of all kinds and sizes within the smaller spectrum of the airline business in Mexico; it is for the first time in many years that a major and respected international air carrier has gone bankrupt in this country since Aeronaves de México, predecessor to Aerovías de Mexico, went under in 1988.

The Mexicana case not only signaled the demise of the world's third oldest air carrier, but it also allowed the opportunity to test several novel legal recourses, it provided the chance to test the concurso mercantil system and its applicable law, and it created the right setting to try the effectiveness of Cape Town while clearly exposing the major shortcomings of the declarations that Mexico adopted at its inception.

Timeline of events.

- **July 29. Meeting with Secretary of Communications and Transport, assurance of assistance to lessors.**
- **August 2. Filing of Mexicana Airlines for concurso mercantil in Mexico / simultaneous filing under Chapter 15 US bankruptcy law.**
- **August 3. Mexicana Airlines granted TRO in Chapter 15 proceedings.**
- **August 5. Admission of concurso application by the 11th District Civil Court in Mexico City and ordering of injunctions subject to prior notice, appointment of visitor (examiner).**
- **August 21. Transfer of shares from Grupo Posadas to Tenedora K.**
- **August 28. Suspension of operations.**
- **September 7. Issuance of concurso resolution, appointment of Javier Christlieb as new administrator for Mexicana Airlines, appointment of conciliator.**

Mexicana Airlines

Click / Link

- **September 7 to date:**
- **Execution of settlement agreements for the return of the aircraft with approval of the conciliator. These agreements always involved:**
 - **the waiver of rights by the creditor and**
 - **the compromise to vote at the creditors meeting**
- **April 2: End of the initial 185 days conciliation period of the concurso mercantil.**
- **September/October:**
- **Issuance of orders by various civil courts in enforcement of the transaction agreements ordering the airlines to return the aircraft within five days.**
- **Enforcement of judgments and recovery of aircraft with the intervention of the special forces of the Federal Police.**
- **June 10: End of the initial 185 days conciliation period of the concurso mercantil.**

The enforcement of remedies.

Considering the circumstances the matter also showed how a mixture of all legal remedies available always needs to come together with the commercial needs and interests of the creditor based principally on the age, number, condition and characteristics of the aircraft involved, etc, so as to create the most suitable set of actions on a case-by-case basis to effectively recover possession, to protect the asset from harm or detention and ,in some cases, to even maintain the ability that the same could be returned to a revived version of Mexicana.

All lessors were interested in protecting their aircraft but the priority to recover the aircraft rather than settling in another form was depending of factors such as:

- Number of aircraft
- Aircraft type
- Value
- Marketability
- Vintage

Certain lessors required to repossess immediately while others were more interested in waiting to analyze further developments.

In the end, the recovery of the aircraft was achieved in record time using various remedies and recourses that varied in each case. Above all, our firm was material –and successful- in the recovery of sixty eight aircraft within a stretch of only four months. For this, we applied as many strategies as nearly aircraft we had to recover for our clients and we coped with all sorts of changing factors and events, not one single story can be said to have been the same in each case.

In evaluating and enforcing the remedies at hand, we proceeded, when we counted with such instrument, to enforce the transaction agreements that were signed before the Center of Alternative Justice of Mexico City¹. The transaction agreement resulted to be a magnificent enforcement instrument under which we obtained nearly immediate orders that once delivered on each of the airlines² obliged them to return the aircraft immediately. In certain circumstances, we were able to reach settlements under such enforcement proceedings which resulted in the aircraft returns. In other cases, the aircraft were repossessed from Mexicana Airlines in the United States and Canada through enforcement of rights before local courts and, in others, settlements were able to be reached in respect to the aircraft in possession of Mexicana Airlines when the Ministry of Communications and Transport was able to remove the obstructive administration of Tenedora K and appoint a different administrator for the main airline³. In respect to the aircraft that were on lease with the two regional subsidiaries Click and Link, which remained under control of Tenedora K the enforcement of the obtained transaction agreement court orders had to be taken to the extreme to nearly recover the aircraft with the assistance of the Federal Police. In all of these instances, but particularly on the last one, in which the cooperation of lessee was totally absent, the availability of the transaction agreement proved to be of tremendous assistance to be able to enforce, even with use of police force, when it failed to cause the airline to relinquish the aircraft voluntarily.

The different remedies that we had to apply were achieved in different forms which I have divided in groups:

Group 1: Settlement agreements that resulted from the repossession of aircraft conducted in the US and Canada resulting in the carve-out made by Mexicana of such aircraft from the TRO issued by the NY court and by Canadian proceedings. The aircraft recovered in this form were recovered between 5 days prior to concurso filing and less than 15 days from the date of filing of the concurso application. Waiver and release was granted between the parties **(4 aircraft)**.

Group 2: Initial settlement agreements before the competent civil courts in Mexico were successfully reached when enforcement of Transaction Agreements was ordered by such courts. The aircraft recovered in this form were recovered within less than 15 days from the date of filing of the concurso application. Waiver and release was granted between the parties **(12 aircraft)**.

Group 3: Settlement agreements reached with approval of concurso conciliator under commitment of lessor to vote, subject to certain qualifications, favorably in the restructure process. Waiver and release was granted between the parties **(27 aircraft)**.

1.- Several transaction agreements signed before the Center of Alternative Justice of the Superior Tribunal of Justice of Mexico City, were obtained at the time when the airline procured a major restructuring of its defaulted obligations with lessors mainly during the second and third quarters of 2009. These transaction agreements constitute firm and final judgments that can be enforced without further court proceedings within a very short time.

2.- At the time when it ceased operation on August 28, 2010 the Mexicana group was conformed by three separate Airlines: Compañía Mexicana de Aviación, S.A. de C.V. (Mexicana Airlines), Aerovías Caribe, S.A. de C.V. (Click) and Mexicana Inter, S.A. de C.V. (Link).

3.- The change of administration to remove Tenedora K from the control of the Airlines that resulted from its acquisition of all shares from the former group of shareholders lead by Grupo Posadas, was able to be achieved when the court issued the resolution by which the concurso mercantile proceedings were formally initiated (September 6, 2010 for Mexicana Airlines and November 17, 2010 for Click and Link).

Group 4: Aircraft to be recovered by enforcement of judicial proceedings resultant from transaction agreements with the use of public force issued by the applicable courts. In these cases the pressure created resulted in the final release of the aircraft by Lessee **(25 aircraft)**.

Group 5: Aircraft to be recovered through the separatory action within the number of days specified under contract if Cape Town Convention is applicable, or within the timeframe to be allowed by the court (approximately 120 days from filing). No aircraft have been recovered in this form at this time although this approach could still be used potentially for possibly two aircraft).

The Cape Town Convention.

In respect to the Cape Town Convention, we can say that nearly no cases were discussed and none were resolved within the scope of its terms. Several reasons play a role in why this was not possible but clearly the most important aspect to highlight is that it became clear to lessors and creditors, but most importantly to the government itself, that the Convention is completely toothless until the right set of declarations can be adopted by Mexico.

As Mexico adopted Alternative B under Article XI of the Protocol, the options available for creditors under the concurso mercantil became limited and excessively long considering the following aspects that Alternative B and the Law of Insolvency Proceedings with which it is fully consistent provide:

- **Alternative B:**
 - Assumption of effectiveness of the lease.
 - Assumption of involvement of assets as part of the bankruptcy estate.
 - Requirement for court decision to resolve the contractual relationship and to order the return of the aircraft.

Had Mexico adopted Alternative A, as all ratifying countries have done, the following would have applied:

- **Alternative A:**
 - Assumption of aircraft not to be part of the insolvency proceedings.
 - Designated time period for cure of default or return of the aircraft.

The use of other remedies, including the use of transaction agreements would not have been strictly necessary if creditors have been able to trust that the aircraft were going to be returned only after the lapse of a predefined short period upon filing of Mexicana for insolvency.

The absence of such certainty cause all lessors to be forced to terminate the leases in advance to procure the recovery of aircraft outside of the concurso proceedings and to avoid being subject to terms within the concurso for the final determination and termination of the lease that could have easily stretched for more that 120 days.

To prevent the need to petition for the separation of the aircraft under the insolvency proceedings and to become subject to the timeframes referred above, it was important to take steps to extract the leases and the aircraft from the insolvency proceedings. The principal discussion for that matter was to be in respect to the effectiveness of the lease throughout the proceedings described above and in respect to whether the injunctions ordered by the judge in Mexico were applicable to the lessors and other creditors. The NY court hearing the Chapter 15 application issued a TRO which became effective against the enforcement of rights of creditors in the US following the injunctions ordered by the Mexico City court. As mentioned above, we were able to sustain, rather successfully, that the earlier termination of the leases was cause for the aircraft involved to be excluded from the concurso proceedings and from the bankruptcy estate.

Conclusions.

The remedies and timeframes associated to the recovery of aircraft from Mexicana has been largely dependant from the remedies available under the lease, of the availability of transaction agreements, which have proven to be enormously effective and of the ability to conduct the enforcement of the remedies outside of insolvency proceedings. The applicability of the Cape Town Convention in has been useful to an extent in spite of its current limitations.

The insolvency proceedings in course have not assisted in expediting the recovery of aircraft for which only the ability of the lessors to recover the aircraft by other means has been effective depending of the remedies available in each case.

The Cape Town Convention has been in effect in Mexico since November 1, 2007. The role of the Cape Town Convention in these insolvency proceedings however would have certainly be more relevant if the right declarations were made.

Important Procedural Reform to the Commerce Code.

by *Antonio Vázquez*

On January 27th 2011 an important reform to the Commerce Code was published and will become effective within the next months. The reform is related to different kind of legal procedures in commercial matters, which are enlisted below:

1. - Creation of oral trials in commercial matters.
2. - Empowerment of Commercial Courts to impose means of enforcement.
3. - Participation of the Courts on specific matters related to arbitration.
4. - Creation of special procedures related to (i) several matters of arbitration and (ii) legal invalidity of arbitration awards and commercial transactions.

“The reform is related to different kind of legal procedures in commercial matters, which are enlisted below...

... 4. - Creation of special procedures related to (i) several matters of arbitration and (ii) legal invalidity of arbitration awards and commercial transactions.”

Below we will make a brief explanation of each of the matters involved in this important reform:

1.- Creation of oral trials.- These kind of procedures will be applicable to minor commercial disputes which involve amounts in dispute no higher than \$220,533.48 Mexican pesos (around US\$18,000.00 American Dollars). The reform includes all the rules applicable to these new procedures: Procedural terms, hearings, evidences, etc. This is an important introduction to the oral proceedings system because, as you know, our commercial and civil proceedings derived from the Latin tradition which historically has functioned essentially on a written basis. However, in the last few years, Mexico has been adopting the oral procedures to other kinds of cases, as for example criminal matters. We also have experienced some kind of oral administrative procedures, for example in Insurance and financial claims or consumer protection procedures, but this is the first time that the oral procedures will be applicable also to judicial procedures in commercial matters. This reform will be effective on January 28th 2012.

2.- Empowerment to Commercial Courts to impose means of enforcement.- The specific addition in the Commerce Code to give ability to the Courts to impose means of enforcement in case that the parties involved in the commercial disputes do not comply with the judicial orders or resolutions. Before this reform, all the means of enforcement that the Courts applied were regulated in the Federal Code of Civil Procedures. These include fines, use of public force, arrests and the right of the Court to ask for criminal investigation if it considers that the disobedient act may require a criminal charge. This reform is effective from January 28th, 2011.

3. - Participation of the Courts on specific matters related to Arbitration.- According to the reform, if a party requests a court, before which an action is brought in a matter that is subject of an arbitration agreement, that the controversy be referred to arbitration, the court shall suspend the proceedings until the arbitral tribunal has ruled on its own jurisdiction.

The motion to refer the parties to arbitration shall be made no later than the first statement on the merits of the dispute (generally, the answer to the claim).

The parties' referral to arbitration will be denied only if:

1. There is a final resolution indicating that the arbitration agreement is null, or
2. The ineffectiveness of the arbitration agreement is not in accordance with very strict criteria.

In order to expedite the proceedings there will be no ordinary recourse available to challenge the resolution on the referral of the parties to arbitration.

With this amendment, the proceeding to refer the parties to arbitration is now fully in line with the formula that has been used in most countries that have adopted the UNCITRAL Model Law (among them Mexico).

4.-The creation of special proceedings related to several matters of arbitration and legal invalidity of arbitration awards and commercial transactions.- A new proceeding, called "special proceeding on commercial transactions and arbitration" was created in order to deal with certain matters related to arbitration proceedings. Among such matters are:

- enforcement and recognition of an arbitration award,
- annulment of an arbitration award,
- enforcement of interim measures ordered by the arbitration tribunal,
- challenge of arbitrators,

- competence of the arbitration tribunal, when it is determined in a resolution other than the award on the merits and,
- granting of interim measures either before or during the arbitration proceedings.

On the foregoing, the enforcement and annulment of an arbitration award and the enforcement of interim measures ordered by the arbitration tribunal deserve special recognition.

“If the special procedure stated in the reform is applicable to the commercial transactions, this procedure will create an additional defense for an affected party.”

It is particularly important to emphasize that this special proceeding is applicable also to the annulment of “commercial transactions”. However, the reform does not include a specific definition of commercial transaction. In that sense, we should apply the general legal definition stated in the Federal Civil Code.

If the special procedure stated in the reform is applicable to the commercial transactions, this procedure will create an additional defense for an affected party. Let´s see if the intention of the legislator is the one described above.

ASUR seeks to expand its operations in Brazil.

Southeast Airport Group (ASUR) is interested in the international airport in the Brazilian city of Natal which will host some matches during the World Cup. ASUR said that they are interested in participating in the privatization of the airport terminals in Brazil, home of the 2014 World Cup and 2016 Olympics. Brazil has been criticized for its infrastructure, from roads with insufficient capacity, to crowded airports. The Director of Finance of ASUR commented that the airport should be ready by the first quarter of 2014. *Excelsior. 02/February/11.*

Oversupply will be generated.

The director of the Cancun Airport said that building an international airport in the Riviera Maya will create an excess supply of airport services in the region since the Cancun terminal has a capacity of 30 million passengers per year and in 2010 moved just 12.4 million.

El Economista. 02/February/11.

Click's liquidation scheme has been rejected.

Click Mexicana pilots rejected the proposed settlement of PC Capital in the insolvency process. Workers say the PC's proposal was rejected for being contrary to law, because it does not recognize accrued salaries. Also it was proposed to settle the owed amounts in three payments, when just one payment in cash would be according to bankruptcy law, but not under the collective agreement as announced. The second payment would be for a similar amount in seven years, but with interest and the other payments made in company shares.

El Economista. 04/February/11.

Canaero is looking for new regulation to boost the aviation industry.

The aviation industry requires an appropriate and institutional legal framework that allows growth of the airlines by eliminating monopolies such as ASA has exercised with fuel, and the issue of airport groups "that have a regional monopoly". The president of the Air Transport National Association (Canaero) recognized that this is major challenge. To lower its costs, the airline industry requires more investment, clear rules, and fair competition.

El Universal. 11/February/11.

In this month extract was prepared by Jessi Saba, Vera Garcia and Samantha Garnica.

Mexicana's operations in the US have been ratified.

Mexicana confirmed that the Federal Aviation Administration (FAA) has ratified the operations of Mexicana for both flights and airports. This ratification was given during the demonstration flight to San Antonio, Texas in which both Mexican and American authorities participated. With this authorization, as soon as Mexicana restarts operations, they are going to be able to fly to both US and national destinations. *Excélsior. 16/February/11.*

Opportunities for Mexicana and Aviacsa.

Both Mexicana and Aviacsa plan to restart operations as of March, looking forward to fly about 100 thousand passengers for spring break. Both airlines are looking forward to this high season, promoting low rates that will incentivize people to travel with them. As for Mexicana, the comeback is planned with seven A320 aircraft traveling to both national and international destinations. As for Aviacsa, the comeback is planned with 3 B737 aircraft flying only to national destinations. *Reforma. 22/February/11.*

Take off 93% from Mexicana's debt!

Gerardo Badin, conciliator in the bankruptcy process, advised that Mexicana will pay only 7 percent of the debt that they have with the airport groups. Airports refused to grant any discount to the Nuevo Grupo Aeronautico on the debts of Airport Use Fee. *Reforma. 25/February/11.*

Loans to Mexicana - regardless of insolvency.

The Exterior Commerce National Bank gave a loan to Mexicana of 900 million pesos in 2009 when the Federation Superior Audit had discarded Mexicana as a credit subject. The Federal government, which rejected the notion that this credit was indeed a rescue for the airline, argued that the loan was a product of the AH1N1 virus that debilitated the airlines that year. This is now being investigated by the Ministry of Communications and Transportation. *Reforma. 28/February/11.*

TG Group will insist on Mexicana's rescue.

Due to delays and failure of PC Capital, the TG Group decided to approach the federal authorities in order to review their business plan with Tenedora K to acquire the Mexicana Airlines. *El Universal. 28/February/11.*

In this month extract was prepared by Jessi Saba, Vera Garcia and Samantha Garnica.

Carlos Sierra

Attorney at law by the 'Universidad Nacional Autónoma de México' (UNAM), has coursed post-graduate studies in civil and commercial law at the 'Escuela Libre de Derecho', international law courses imparted by Duke University and the 'Universite Libre de Bruxelles', aviation contracts law at IATA and LLM studies in Air and Space Law at Leiden University in the Netherlands. After being in-house counsel for Mexicana Airlines, he has been in private practice for fourteen years advising lessors and financiers in transactional work related to the leasing and finance of aircraft and the enforcement of their rights during default, liquidation and bankruptcy proceedings. Mr. Sierra has written several articles related to aircraft finance and leasing, the Cape Town Convention and Protocol, repossession of aircraft, aviation law and Mexican commercial law and is currently a member of the Legal Advisory Panel of the Aviation Working Group. e-mail: csierra@asyv.com

Antonio Vázquez

Attorney at Law: Admitted to practice law in 1991. Mr. Vázquez of Mexican nationality obtained his law degree at the Universidad Nacional Autónoma de México (UNAM). Mr. Vázquez attended post-graduate studies in Civil Law, Corporate Law, "Amparo" Financial and Procedural Law, Civil and Commercial matters. Mr. Vázquez has been Professor of "Amparo" in UNAM and Lecturer at various universities throughout Latin America. Currently Mr. Vázquez is member of the International Bar Association. Authorized as a private mediator in civil and commercial matters recognized by the Center of Alternative Justice of the Federal District and the Superior Tribunal of Justice of the Federal District since January 2010. LANGUAGES: Spanish and English. PRACTICE AREAS: Arbitration, Civil Law, Civil Litigation, Amparo, Corporate Law and Foreign Investment. e-mail: avazquez@asyv.com

ABOGADOS SIERRA Y VAZQUEZ

Prol. Reforma No. 1190 25th Floor
Santa Fe México D.F. 05349
t. (52.55) 52.92.78.14
f. (52.55) 52.92.78.06
www.asyv.com / www.asyv.aero
mail@asyv.com

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