

# COELUM.

*Insolvency of Airlines. A few reflections on Chapter 11 filing.*  
by Carlos Sierra



## JUNE NEWS on Mexican Aviation

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.

**sierra** 25

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## Insolvency of Airlines. *A few reflections on Chapter 11 filing.*

*by Carlos Sierra.*

In the context of the ongoing COVID-19 pandemic airlines from around the world are experiencing the worst economic crisis in the history of aviation. Revenues have dropped to nearly zero as the future of air travel is being redefined for many years to come. Nothing that was taken for granted for so many decades will continue to be the same and no aviation stakeholder, not only including airlines but also airline suppliers, airports, third party services, lessors, OEMs, financiers, bond holders and countless others, however large successful or strong have been severely damaged at least, if not completely obliterated at worst, all at the sword of this economic and, most importantly, humanitarian crisis of monumental, unprecedented and still unpredictable proportions.

In this context several air carriers have attempted to restructure their financial obligations by any possible means. In Latin America, Avianca followed by LATAM and now by AeroMexico have commenced reorganization proceedings interestingly selecting the laws of the United States and particularly Chapter 11 of the US Bankruptcy Code<sup>1</sup> to govern such proceedings, as well as the courts of the state of New York as competent venue for such purpose.

Selecting the jurisdiction of the courts of NY is not a natural process for a company that is not originally domiciled or doing business in the United States. In spite of this, when a company has creditors or assets located in the United States, however minimal, apparently is not unusual for the courts of the United States and particularly of the state of New York to accept jurisdiction and agree to conduct the proceedings considering the United States as the Company's center of main interests (COMI).

When a company has operations and more particularly debt and creditors located in various jurisdictions, only

one of the insolvency proceedings that the company could apply for, generally the proceeding available in its own country of domicile, shall be considered as the principal insolvency jurisdiction (PIJ) or main proceeding, while any proceedings followed in other jurisdictions or countries would be considered ancillary to the principal proceeding which is the one that will govern the restructuring and the protective actions against creditors to allow the company to achieve its restructure.

Ancillary proceedings imply that the judge that is hearing the principal proceedings at the PIJ, and the law of such jurisdiction would be ruling the insolvency process, while the judges in charge of any ancillary proceedings would be obliged to apply the law governing the principal proceedings and to apply in their country the resolutions that for such purpose shall be issued by the court that is hearing the principal proceedings.

This, in many countries (Colombia, Chile and México included) is done through the application of what is known as the "Model Law on Cross Border Insolvency" (circa 1997) (Model Law) created under the auspice of the United Nations Commission on International Trade Law (UNCITRAL)<sup>2</sup>. México, for example, adopted the Model Law under Title Twelfth of the Law of Insolvency Proceedings (circa 2000) (Ley de Concursos Mercantiles)<sup>3</sup>.

Considering this, it can be assumed that if a US company, for instance, would initiate principal proceedings in the state of New York, a judge in Mexico, also for instance, would proceed to initiate an ancillary proceeding that would be subordinate to the former by applying the terms of the adopted Model Law and following the resolutions of the principal judge.

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1.- <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics>

2.- [https://uncitral.un.org/en/texts/insolvency/modellaw/cross-border\\_insolvency](https://uncitral.un.org/en/texts/insolvency/modellaw/cross-border_insolvency)

3.- [http://www.diputados.gob.mx/LeyesBiblio/pdf/29\\_220120.pdf](http://www.diputados.gob.mx/LeyesBiblio/pdf/29_220120.pdf)

In the case of Avianca, LATAM or now of AeroMexico, the difference is that none of these companies have their COMI in the United States, and while this does not result relevant for the judge in NY, that with minimum requirements considers that the COMI of a foreign company can be considered to be in the United States, this could be otherwise relevant for a local judge (e.g. a Mexican judge), since, as commented above, it could be argued that, in principle and in accordance with applicable provisions of local insolvency law in the majority of states, a company that has its COMI in Mexico should initiate, and consider as principal proceedings, the insolvency proceedings available in such jurisdiction in accordance, in this case, with Mexican law<sup>4</sup>.

***“The motivations of a filing under Chapter 11 of the US Bankruptcy Law could possibly be found in the perception that the protection of a NY court against foreign creditors would allow the applicant company to benefit from the reorganization prerogatives associated with Chapter 11, which could be perceived to be more expeditious or efficient than such of local concurso mercantil proceeding.”***

As a matter of fact then, for a company deciding to initiate a principal insolvency proceeding in a country different than such of the place of its principal seat of business, is not a simple proposition at all considering that not only the local court would need to admit that

the local proceedings be ancillary to the COMI determined to be in a foreign jurisdiction (e.g. NY); but furthermore, independently of whether that would be accepted as such by the Mexican judge, any local creditor, particularly creditors with preferential rights such as tax authorities and labor unions, could challenge or simply refuse to submit to these proceedings arguing that the NY court is not competent to determine the COMI in this case or even to refuse to abide by its orders arguing that the principal insolvency jurisdiction (PIJ) shall be Mexico in this case and that the resolutions of the NY court are contrary to Mexican law and public policy.

Under this scenario and considering that the courts in NY are willing to admit a filing made for proceedings and will likely determine COMI to be in New York. There are two possibilities:

1. First, and in spite of what has been explained above, to attempt to initiate an ancillary proceeding in Mexico which would have to be subordinate to the principal proceeding in NY; or
2. To not initiate any ancillary proceeding in Mexico and to attempt to reach a separate -perhaps non judicial- agreement with its local creditors.

The motivations of a filing under Chapter 11 of the US Bankruptcy Law could possibly be found in the perception that the protection of a NY court against foreign creditors would allow the applicant company to benefit from the reorganization prerogatives associated with Chapter 11, which could be perceived to be more expeditious or efficient than such of local *concurso mercantil* proceeding.

It is difficult to determine however what could motivate a Mexican company to file for principal proceedings in

4.- Law of Insolvency Proceedings (12 May 2000); article 4 para. III and article 279 paras. II; III; and VI: “Article 4, For the purposes of this law it shall be understood as: ... III. Domicile, the social domicile and in case of irreality (thereof), the place where the principal administration of the company shall be held. ...”; Article 279. For the purposes of this Title: ... II. For Principal Foreign Proceeding it shall be understood the Foreign Proceeding that is followed in the State where the Company shall have the center of its principal interests; III. For Ancillary Foreign Proceeding it shall be understood a Foreign Proceeding, that is followed in a State where the Company shall have an Establishment of as described in paragraph VI of this article; ...; VI. For Establishment it shall be understood any place of operations in which the Company shall exercise in non-transitory form an economic activity with human means, goods or services.”

NY when the exposure to certain Mexican creditors, and even potentially to non-US creditors would eventually need to be separately considered and controlled. The benefits of a US Chapter 11 proceeding available to foreign air carriers, is not the same that is available to carriers of the United States and the successful restructure of its obligations under Chapter 11 could be found to be more complex and difficult to achieve than under, say, Section 1110 of the US Bankruptcy Code<sup>5</sup>, which would only apply to US carriers.

***“Consideration of potential sanctions imposed by the NY court and on whether such could be applicable to assets or interests in the United States of each particular creditor should be taken into account as well as commercial considerations that could affect such creditor’s future relationship with the company shall it come out successfully of the Chapter 11 restructure in the future.”***

Another aspect to consider is the applicability of the Convention on International Mobile Interests<sup>6</sup> (the Cape Town Convention) to the insolvency proceedings in course. Mexico for that matter is the only state in the world that has adopted Alternative B of article XI of the Protocol to the Cape Town Convention on Matters Specific to Aircraft Equipment<sup>7</sup> in the event of insolvency. In that regard, attention should be given to the fact that the NY court within the principal proceedings should apply Alternative B in such case as such is the version of the Cape Town Convention that was adopted by

Mexico and not necessarily ancillary proceedings should be based under the Model Law in such case.

Of course we shall consider that each individual non US creditor could freely determine whether it consensually and voluntarily wishes to subordinate to the resolutions adopted by the NY court, being important to make clear that, in principal, it would not necessarily be obliged to this and remains at liberty to attempt the enforcement of its rights without abiding by the resolutions of the NY judge until an ancillary proceeding judge would have jurisdiction over such creditor.

Consideration of potential sanctions imposed by the NY court and on whether such could be applicable to assets or interests in the United States of each particular creditor should be taken into account as well as commercial considerations that could affect such creditor’s future relationship with the company shall it come out successfully of the Chapter 11 restructure in the future.

In summary, filing for Chapter 11 in the United States presents a challenging proposition to resolve the financial difficulties of a Mexican air carrier and the successful restructuring of its obligations. No precedent exists to determine how the Mexican courts and certain Mexican, and perhaps other non-US, creditors will react to the resolutions of a non-Mexican court.

As we mentioned at the commencement of this article, every mold has been broken under these pandemic plagued times. History and precedent will be made with this case whichever the outcome. This will be a very interesting proceeding.

5-<https://www.usbankruptcycode.org/chapter-11-reorganization/subchapter-i-officers-and-administration/section-1110-aircraft-equipment-and-vessels/>

6- <https://www.unidroit.org/instruments/security-interests/cape-town-convention>

7- [https://www.unidroit.org/index.php?option=com\\_content&view=article&id=454](https://www.unidroit.org/index.php?option=com_content&view=article&id=454)

### **The reason why Trump considers Mexico to be 'essential'.**

Early in May, the President of the United States, Donald Trump, was determined to launch his plan to reactivate industrial sectors. Some industries were considered essential in the neighboring northern country, but not in Mexico. The main industrial leaders asked the Mexican government to classify some sectors (including automotive, aeronautical, and electrical) as essential to standardize the operation with the United States and to fulfill the role of highly specialized suppliers. Failure to do so would result in the risk of losing an important place in the value chain of production of goods; however, the biggest risk is that Trump will use this episode as a political tool. [www.forbes.com.mx/economia-esta-es-la-razon-por-la-que-trump-considera-esencial-a-mexico/](http://www.forbes.com.mx/economia-esta-es-la-razon-por-la-que-trump-considera-esencial-a-mexico/) June 01, 2020.

### **After COVID-19, Mexican aviation will be recovered by the end of 2021: AFAC.**

The coronavirus pandemic caused a sharp drop in passenger demand in the Mexican Aviation Industry, reducing it by approximately 92%. It is estimated that due to recovery strategies planned, along with market dynamics, Mexican Aviation recovery will be of 60 % by December 2020. As part of the reactivation of the industry, a circular will be issued establishing that the new health protocols in airports will remain, including the use of masks and social distancing, along with new measures that will require users to take a questionnaire on aspects of their health prior to their trip. [www.milenio.com/negocios/covid-19-aviacion-mexicana-recuperara-finales-2021-afac](http://www.milenio.com/negocios/covid-19-aviacion-mexicana-recuperara-finales-2021-afac) June 04, 2020.

### **What flying will look like after the Coronavirus Crisis?**

In an effort to get their planes back in the air due to Covid-19 pandemic and in order to reassure passengers that, it is safe to fly again; airlines are having to rethink how they provide their inflight service. For instance, pre-boarding temperature checks on passengers will likely become a routine for flying as well as physical distancing indicators around airports, protective screens at check-in desks and immigration counters. [www.forbes.com/sites/dominicdudley/2020/06/05/what-flying-will-be-like-after-coronavirus/#4e9a86d574b8](http://www.forbes.com/sites/dominicdudley/2020/06/05/what-flying-will-be-like-after-coronavirus/#4e9a86d574b8) June 05, 2020.

### **Mexican Air Industry to be recovered by 2024: CANAERO.**

The National Chamber of Air Transportation (Cámara Nacional de Aerotransportes, CANAERO) estimates that the recovery of Mexico's air industry will take approximately four years due to the pandemic experienced by COVID-19. According to CANAERO's records, Mexico has lost about nearly \$6.4 billion and over 85% of the national fleet remains on grounded with a 90% drop in the operations. <https://a21.com.mx/aerolineas/2020/06/05/industria-mexicana-se-recuperara-para-2024-canaero> June 05, 2020.

### **SCT proposes to cancel the construction of Terminal 3 of the (AICM) due to the coronavirus pandemic and the construction of the (NAIM).**

Due to the COVID-19 pandemic and the low number of tourists arriving to the Mexico's City International Airport (AICM), as well as the inauguration of the New International Airport in Santa Lucia (NAIM) in 2022, which will have an initial capacity for 20 million passengers, the Secretariat of Communications and Transportation (Secretaría de Comunicaciones y Transportes, SCT) has considered to cancel the construction of the third terminal to be built in the AICM as it would no longer be necessary. [www.economista.com.mx/empresas/SCT-propone-cancelar-la-construccion-de-la-Terminal-3-del-AICM-debido-al-coronavirus-y-el-NAIM-en-Santa-Lucia-20200606-0001.html](http://www.economista.com.mx/empresas/SCT-propone-cancelar-la-construccion-de-la-Terminal-3-del-AICM-debido-al-coronavirus-y-el-NAIM-en-Santa-Lucia-20200606-0001.html) June 06, 2020.

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### **Coronavirus continues to hit the AICM; passenger traffic fell 93.7% in May.**

The COVID pandemic has been very harsh with one of the most important airports in Latin America, Mexico's City International Airport (AICM), presenting an annual drop of 93.7% on the flow of passengers with regard to the figures shown during the month of May, 2019. Last year's records shown a traffic of passengers of 4 million 347 thousand passengers and this year of barely almost 276 thousand people. [www.milenio.com/negocios/aicm-golpeado-coronavirus-trafico-pasajeros-cayo-93](http://www.milenio.com/negocios/aicm-golpeado-coronavirus-trafico-pasajeros-cayo-93) June 15, 2020.

### **Should Airlines Standardize Pre-flight Testing for COVID-19?**

Airlines around the world are slowly starting to operate more flights as regulators in different regions of the world begin to relax the travel restrictions and introduce new guidelines. However, must operators need a standardized approach to pre-flight Covid-19 testing to make the process more efficient and help restore confidence in passengers that they can safely fly during the pandemic? As travelers are starting to fill airport lounges and aircraft cabins, the industry is still trying to figure out the best method for testing passengers prior to getting onboard. [www.aviationtoday.com/2020/06/16/airlines-standardize-pre-flight-testing-covid-19/](http://www.aviationtoday.com/2020/06/16/airlines-standardize-pre-flight-testing-covid-19/) June 16, 2020.

### **Progress in the construction of "Felipe Angeles International Airport".**

On June 22, 2020, a video was published by the Secretariat of National Defense (SEDENA) with an update on the progress of Santa Lucia's New International Airport, keeping in mind that the current Mexican Government, led by President Lopez Obrador, decided to cancel the new airport of Mexico City in Texcoco to start with the construction of a new commercial airport within the military airbase of Santa Lucia. [www.gob.mx/aifa/videos/avance-en-la-construccion-del-aeropuerto-internacional-felipe-angeles-22-jun-2020](http://www.gob.mx/aifa/videos/avance-en-la-construccion-del-aeropuerto-internacional-felipe-angeles-22-jun-2020) June 22, 2020.

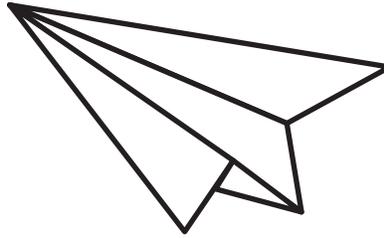
### **IATA requests States to bear the cost of COVID testing.**

The International Air Transport Association (IATA) has requested to the Latin American countries, to bear the cost of testing possible cases of covid-19 in air terminals in the region. The right after Sergio Allard stated it would be possible that the test could be included in the price ticket of the passenger. Nevertheless, it will be fundamental to justify the reasonableness of the cost and to ensure it will not affect the demand on countries who are still facing the recovery phase. [www.a21.com.mx/aeronautica/2020/06/25/pide-iata-que-estados-asuman-el-coste-de-pruebas-covid](http://www.a21.com.mx/aeronautica/2020/06/25/pide-iata-que-estados-asuman-el-coste-de-pruebas-covid) June 26, 2020.

### **Mexican airlines will lose about USD 8.13 billion on COVID, IATA revises.**

The advance of the COVID-19 pandemic, which maintains restrictions on the aviation industry in several countries and the slow recovery in others, has caused airlines in Mexico to add a loss of USD \$8.13 billion in income, which will mean a drop of 57% compared to last year, as stated by the vice president of the International Air Transport Association (IATA) for the Americas, Peter Cerdá. As for Mexico, this situation remains aggravated due to the lack of financial aid from the Federal Government, which includes at least tax incentives and flexibility in the payment of services. [www.eleconomista.com.mx/empresas/Aerolineas-mexicanas-perderan-US8130-millones-por-el-Covid-ajusta-IATA-20200626-0012.html](http://www.eleconomista.com.mx/empresas/Aerolineas-mexicanas-perderan-US8130-millones-por-el-Covid-ajusta-IATA-20200626-0012.html) June 26, 2020.

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