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## Aircraft Lessors Entitled to Adequate Protection During the § 1110 60-Day Period

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This article is a response to the article published in the April 2009 *ABI Journal* asking whether aircraft lessors are entitled to adequate protection in the 60-day period provided under § 1110(a)(2) of the Bankruptcy Code, during which time such lessors are subject to the automatic stay. In that article, authors **Paul Avron** and **Jordi Guso** voiced their agreement with an unreported bench decision in the *Gemini Cargo Logistics* chapter 11 bankruptcy case<sup>1</sup> that denied an aircraft lessor's motion for adequate protection during the 60-day period. Avron and Guso contend, based on (1) "applicable case law that relies on the legislative history of § 1110," and (2) the effect of § 365(d)(5) of the Bankruptcy Code,<sup>2</sup> that this decision is correct. Contrary to this interpretation of § 1110, however, the plain text of the Bankruptcy Code, the relevant legislative history, a leading treatise and case law all support the contrary conclusion—that aircraft lessors are indeed entitled to adequate protection under § 363(e) during the 60-day period.

When interpreting a statute, one must begin with the text of the statute itself. Any right of an aircraft lessor to adequate protection must be found in the Bankruptcy Code, in the interplay among §§ 361, 362, 363, 365 and 1110. Section

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Accordingly, by its plain terms, § 363(e) expressly grants to a lessor under "any unexpired lease of personal property"—which would include a lease of aircraft—the right to seek adequate protection "at any time," to the

exclusion of the leased property being the subject of a stay-relief order under § 362.

The terms of § 1110 do not change this conclusion. Section 1110 subjects a leased aircraft to the automatic stay during the 60-day period, upon the

361 provides that "[w]hen adequate protection is required under" § 362 or 363, it may be provided in the manner prescribed in § 361(1)-(3). Section 362(a) provides for the automatic stay, protecting a debtor from actions against it or its property, while § 362(d) authorizes an entity to request relief from the automatic stay.

## Feature



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Section 363(e) permits an entity with an interest in property to request adequate protection of that interest when the debtor is using the property in its bankruptcy case. Section 363(e) provides that "at any time, on request of an entity that has an interest in property used...or proposed to be used...by the trustee, the court, with or without a hearing, shall prohibit or condition such use...as is necessary to provide adequate protection of such interest."<sup>3</sup> Section 363(e) concludes by stating that it "also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362)."<sup>4</sup>

expiration of which, if the debtor-lessee fails either to (1) make the agreement and cure provided under § 1110(a)(2), or (2) enter into an extension agreement with the lessor under § 1110(b), the automatic stay is lifted and the lessor can repossess the aircraft. Nothing in § 1110 purports, either explicitly or implicitly, to affect an aircraft lessor's rights under § 363(e) during the 60-day period. Reading § 1110 together with § 363(e), it therefore follows that an aircraft lessor may request adequate protection for the debtor's use of the aircraft during the 60-day period, when the automatic stay applies.

This statutory scheme is clear on its face, and is supported by at least one court decision. In *In re UAL Corp.*,<sup>5</sup> the court stated that a bank with a security interest in an aircraft being used by the debtor could have had a claim for adequate protection because,

<sup>1</sup> Transcript of July 15, 2008, Hearing at 32-37, *In re Gemini Cargo Logistics Inc.*, Case No. 08-18173-BKC-AJC (Bankr. S.D. Fla.) (Jointly Administered) [Docket No. 204] [hereinafter "Tr."]. Avron and Guso represented the debtor in this proceeding. *Id.* at 2.

<sup>2</sup> 11 U.S.C. § 365(d)(5).

<sup>3</sup> *Id.* § 363(e) (emphasis added).

<sup>4</sup> *Id.* (emphasis added).

<sup>5</sup> 2005 WL 3118411 (Bankr. N.D. Ill. 2005).

“[f]or the first 60 days of bankruptcy administration, the automatic stay prevented the Bank from repossessing the aircraft, and it is not clear that [the debtor] made any payment during that time for the use of the aircraft.”<sup>6</sup>

Legislative history also supports the conclusion that an aircraft lessor may request adequate protection during the 60-day period. Section 1110 represents a compromise between competing purposes. The predecessor to § 1110, § 116(5) of the Bankruptcy Act of 1898,<sup>7</sup> was enacted in 1957<sup>8</sup> to ensure the availability of affordable financing to the airline industry.<sup>9</sup> Under § 116(5), aircraft lessors were entitled to repossess their leased aircraft immediately upon the commencement of a case under Chapter X of the Act.<sup>10</sup> Although this certainty of outcome enabled aircraft lessors to extend more favorable lease terms to aircraft lessees, it also meant granting to aircraft lessors what was, in effect, veto power over a Chapter X reorganization in which the debtor depended on leased aircraft to operate its business.

When crafting § 1110, Congress sought to balance the enhanced protection for aircraft lessors with the goal of providing the debtor with time to assess its options and thereby have a chance to reorganize.<sup>11</sup> Section 1110 accomplishes this result by giving the debtor the protection of the automatic stay during the 60-day period, thereby providing the debtor 60 days of “breathing room” in which to decide whether to comply with the requirements of § 1110(a)(2) and thus keep the automatic stay in effect beyond the 60-day period.

Congress’s intention in drafting § 1110 in this manner was to “remove... the absolute veto power over a reorganization that lessors...ha[d] under [§ 116(5) of the Act], while entitling them to protection of their investment.”<sup>12</sup> It would be inconsistent with that expressed intention to conclude that § 1110 precludes aircraft lessors from seeking to “protect their investment” by requesting adequate protection under § 363(e) during the 60-day period. As stated by a leading bankruptcy treatise,

“a...lessor...need not wait until the expiration of the [60-day period] to seek appropriate relief under section 363(e) if necessary to protect its interest.”<sup>13</sup>

Avron and Guso assert that the bankruptcy court in *Gemini Cargo Logistics* “found further support for [its] holding in § 365(d)(5) of the Bankruptcy Code,” which provides, in pertinent part, that “[t]he trustee shall timely perform all of the obligations of the debtor...first arising from or after 60 days after the order for relief in a case under chapter 11 of [the Bankruptcy Code] under an unexpired lease of personal property... until such lease is assumed or rejected... unless the court, after notice and a hearing and based on the equities of the case, orders otherwise with respect to the obligations or timely performance thereof.”<sup>14</sup> In agreeing with the argument of the debtor’s counsel that “Section 1110 gives the debtor a free ride for 60 days,”<sup>15</sup> the bankruptcy court said that § 365(d)(5) “seems to support [that] argument, and it would appear that since there is only a 60-day window that’s open here, that it’s...reasonable to assume that the argument is sound, that this was a trade-off, no automatic stay in exchange for a free ride for 60 days... So that gives possible further support to the free ride argument.”<sup>16</sup>

The bankruptcy court’s interpretation fails to differentiate between the distinct concepts of adequate protection and timely performance of contractual obligations. Section 363(e) grants a lessor the basic right of adequate protection from diminution in the value of its property resulting from the debtor’s use of the property while the lessor is prevented from repossessing it.<sup>17</sup> Section 365(d)(5), meanwhile, grants a lessor the more-expansive right to timely performance of lease obligations from and after the 60th day, until the lease is assumed or rejected, unless the court orders otherwise. The fact that, under § 365(d)(5), a lessor is presumed to be entitled to the benefit of its contractual bargain from and after the 60th day does not mean that the lessor is not entitled to be protected under § 363(e) from diminution in the value of its property before the 60th day. The

availability of greater protection on and after the 60th day does not mean that a lessor is unable to seek lesser protection, or indeed is entitled to no protection, before the 60th day.

The bankruptcy court’s interpretation also overlooks the origin of, and the relationship between, §§ 365(d)(5) and 363(e). In its original form, the provision that is currently in § 365(d)(5) was proposed as an amendment to § 365(d)(3).<sup>18</sup> It would have given lessors of personal property the same rights and protections in chapter 11 cases that § 365(d)(3) gave to lessors of nonresidential real property in all cases, that is, the right to timely performance of all lease obligations arising from and after the date of the order for relief, with no “equities of the case” exception.<sup>19</sup>

Although the proposed amendment had its supporters,<sup>20</sup> it also generated considerable opposition.<sup>21</sup> A particularly ardent objector, the National Bankruptcy Conference, described the proposed amendment as “one of the worst bankruptcy amendments proposed since 1978,”<sup>22</sup> and detailed<sup>23</sup> what it described as “the potentially dreadful effects of this proposal in the business context.”<sup>24</sup> The National Bankruptcy Conference did state that it “would favor, instead, clarification of § 363 to assure lessors of adequate protection for assets deteriorating in value.”<sup>25</sup>

The 1994 amendments to the Bankruptcy Code reflected a compromise on this issue by: (1) enacting what are now the § 365(d)(5) protections for personal property lessors in chapter 11 cases, which are considerably weaker than those granted to lessors of nonresidential real property in § 365(d)(3), and (2) enacting the last sentence of § 363(e), which expressly states that the adequate-protection requirement of § 363(e) “applies to property that is subject to any unexpired lease of personal property.” Indeed, these two amendments were in the same section of the law that enacted the 1994 amendments.<sup>26</sup> In addition, the legislative history of the 1994

<sup>6</sup> *Id.* at \*5.

<sup>7</sup> 11 U.S.C. § 516(5) (repealed 1979).

<sup>8</sup> Pub. L. No. 85-297, 71 Stat. 617 (1957).

<sup>9</sup> *See In re Airlift Int'l Inc.*, 761 F.2d 1503, 1507 (11th Cir. 1985) (citing H.R. Rep. No. 95-595, at 238-39 (1977) [hereinafter “1977 House Report”]); H.R. Rep. No. 85-944, at 2 (1957); S. Rep. No. 85-703, at 2 (1957).

<sup>10</sup> *See In re Continental Airlines*, 932 F.2d 282, 289 (3d Cir. 1991); 1977 House Report at 238-39 (“absolute right to repossession”); H.R. Rep. No. 85-944, at 2 (1957); S. Rep. No. 85-1032, at 2, 3-4 (1957).

<sup>11</sup> *See* 1977 House Report at 239.

<sup>12</sup> *Id.* at 405; accord S. Rep. No. 95-989, at 117 (1978) (same).

<sup>13</sup> 7 *Collier on Bankruptcy* ¶ 1110.05[5][1][d], at 1110-35 (15th ed. rev. 2009).

<sup>14</sup> 11 U.S.C. § 365(d)(5). This provision was originally enacted as § 365(d)(10) of the Bankruptcy Code, *see* Pub. L. No. 103-394, § 219(b), 108 Stat. 4128-29 (1994), then later redesignated as § 365(d)(5), *see* Pub. L. No. 109-8, § 328(a)(3), 119 Stat. 100 (2005).

<sup>15</sup> *Tr.* at 33; *see id.* at 37 (“I believe that the argument that there was a 60 day, if you want to call it, free ride created by Section 1110, then that’s my determination....”).

<sup>16</sup> *Id.* at 35.

<sup>17</sup> *See In re UAL*, 2005 WL 3118411, at \*5.

<sup>18</sup> 11 U.S.C. § 365(d)(3).

<sup>19</sup> *See* S. 540, 103d Cong., § 204 (reported Oct. 28, 1993), *discussed in* S. Rep. No. 103-168, at 46 (1993).

<sup>20</sup> *See* Bankruptcy Reform: Hearing Before the Subcomm. on Economic and Commercial Law of the House Judiciary Comm., 93d Cong. 195, 209, 379-82, 447, 449-61, 482-83 (1994).

<sup>21</sup> *See id.* at 44-45, 47, 71, 101-12, 145-46, 343.

<sup>22</sup> *Id.* at 47.

<sup>23</sup> *See id.* at 101-12.

<sup>24</sup> *Id.* at 44.

<sup>25</sup> *Id.* at 71; *see id.* at 237 (testimony of Kenneth Klee) (“We do not disagree that when a trustee or a debtor in possession uses somebody else’s property, that if it is a depreciating asset the estate ought to have to pay for it. That is not the issue.”).

<sup>26</sup> *See* Pub. L. No. 103-394, § 219(b)-(c), 108 Stat. 4128-29 (1994).

amendments states that the purpose of § 365(d)(5) was to give the debtor 60 days of “breathing room...to make an informed decision,” but immediately goes on to note in the next sentence that “[s]ection 363(e) [wa]s also [being] amended to clarify that the lessor’s interest is subject to ‘adequate protection.’”<sup>27</sup> Although § 365(d)(5), like § 1110, gives debtors 60 days of “breathing room,” the availability of such “breathing room” does not mean that the debtor is exempt from the requirement to provide adequate protection under § 363(e) during that period. Indeed, if § 365(d)(5) was intended to be the only form of adequate protection available to a lessor of personal property, there would have been no reason for Congress to enact at the same time, in the same section of the same legislation, the last sentence of § 363(e).

Given this history, and the interrelationship of §§ 365(d)(5) and 363(e), it is hard to see how one could read § 365(d)(5) as somehow limiting the rights of an aircraft lessor under § 363(e). Instead, the proper reading of these provisions is that § 363(e) complements § 365(d)(5). Section 363(e) should be read as similarly complementing § 1110 by giving an aircraft lessor an express right to adequate protection during the 60-day period. Avron and Guso also rely on three cases interpreting § 1110 as supporting their contention—*Kiwi Airlines*,<sup>28</sup> *Airlift International* and *Western Pacific Airlines*<sup>29</sup>—each of which is distinguishable.

*Kiwi Airlines* discussed the interplay between §§ 1110 and 365, and emphasized that § 1110 applies the stay for only 60 days, after which time the debtor must perform its lease obligations in return for stay protection.<sup>30</sup> Avron and Guso also focus on the court’s language referencing the lessee’s ability to enter into a § 1110 stipulation with the lessor.<sup>31</sup> Neither the lessor’s right to repossess the aircraft after the 60-day period nor the lessee’s ability to enter into a stipulation during or after<sup>32</sup> the 60-day period, has any impact on the lessor’s right to adequate protection during the 60-day period.

*Airlift International* examined the nature and effect of a § 1110 stipulation, and compared it with

an actual assumption of the lease under § 365.<sup>33</sup> Avron and Guso rely on language describing the 60-day period as an opportunity for a debtor to “contemplate the wisdom of meeting the terms of § 1110” and giving the debtor “the opportunity to reassess his situation in light of bankruptcy and to choose whether to enter into a § 1110 agreement as if he were entering into a new contract.”<sup>34</sup> In context, this language is relevant to whether a stipulation can give rise to an administrative claim in a bankruptcy case, and not to whether a lessor has a right to adequate protection for the use of its property absent such a stipulation. This language also illustrates that, as noted above, the 60-day periods provided under §§ 365(d)(5) and 1110 serve similar purposes.

*Western Pacific* addressed the relationship between §§ 365 and 1110 in connection with a post-60-day period default. The court held that § 365 governed the remedy for such a default (on this point, the decision was later overruled by amendments to § 1110),<sup>35</sup> but also stated that lessors “would be entitled to the benefit of their bargain under § 365 and, as always, would be entitled under § 363(e) immediately to seek relief from the stay if the value of their collateral was being compromised.”<sup>36</sup> Nothing in the decision suggests that aircraft lessors lack the right to request adequate protection.

The intent of § 363(e) of the Bankruptcy Code is to provide a lessor of personal property, including an aircraft lessor, with adequate protection for the use of its property. The purpose of § 1110 is to provide more, not less, protection to aircraft lessors to ensure that airlines have access to affordable financing. Denying aircraft lessors the right to request adequate protection during the 60-day period would contravene that purpose and, as discussed, would be inconsistent with both the text of the Bankruptcy Code and congressional intent. ■

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<sup>27</sup> H.R. Rep. No. 103-835, at 50 (1994); accord 140 Cong. Rec. H10,764, H10,769 (daily ed. Oct. 4, 1994) (statement of Rep. Brooks) (same).

<sup>28</sup> *In re Kiwi Airlines Inc.*, 344 F.3d 311 (3d Cir. 2003).

<sup>29</sup> *In re Western Pacific Airlines Inc.*, 221 B.R. 1 (D. Colo. 1998).

<sup>30</sup> 344 F.3d at 319-21.

<sup>31</sup> See *id.* at 320.

<sup>32</sup> *In Kiwi*, the stipulation was entered into “[f]ollowing the expiration of the 60-day period.” *Id.*

<sup>33</sup> See 761 F.2d at 1508-13.

<sup>34</sup> *Id.* at 1509.

<sup>35</sup> See *In re UAL Corp.*, 299 B.R. 509, 516-17 (Bankr. N.D. Ill. 2003).

<sup>36</sup> 221 B.R. at 11.