Aviation-Focused Webinar Series:

Handling the Turbulence from COVID-19

Part 2
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Topics Covered

• Insolvency – US Section 1110 and Cape Town Convention Alternative A

• U.S. Tax Relief in Stimulus Plan

• U.S. Government Accountability Office (GAO) Report to Congress on FAA Aircraft Registry
Insolvency - US

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Section 1110 of the U.S. Bankruptcy Code

• The Basics (Once Filed under Chapter 11)
  • Overrides portions of Sections 362 and 365 of the Bankruptcy Code
    • Creditors in aircraft (and vessels) entitled to expedited relief (repossession) from the automatic stay – 60 days
    • **Leases and security interests** in “aircraft, aircraft engine, propeller, appliance or spare parts,” and includes books and records (log books, etc.)
    • But, only for protections from US Airlines - must hold a “an air carrier operating certificate issued pursuant to chapter 447 of title 49 for aircraft capable of carrying 10 or more individuals or 6,000 pounds or more of cargo……”
      • Distinction from Cape Town’s Alternative A (which provides same types of protections from any debtor)
Section 1110 of the U.S. Bankruptcy Code

• How does it work?
  • a lessor or secured lender may take possession of the equipment 60 days after the bankruptcy filing if breaches (including payment of past due monies) not cured (aka “Rejection”)
    • Unsecured (lessee) / Secured (secured lender) claim to extent of collateral (unsecured to extent claims exceed collateral) against the bankruptcy estate
  • 60 days may be extended by agreement of the parties
    • subject to Court approval though
  • 1110 agreements (aka “Acceptance”) are not considered an assumption of a lease by the Bankruptcy Code; non-rejectable assumption may not occur until plan confirmation
Section 1110 of the U.S. Bankruptcy Code

- Return Process
  - 1110 does not specify the conditions for surrender and return and does not require the Debtor to comply with a leases/security agreements return requirements
    - Pick-Up Aircraft (or Aircraft in Pieces) As Is
    - Claim for Not Meeting Return Requirements of Contract (may be administrative – payable in full)
  - Lessors request courts to impose return requirements
    - Courts have limited the Debtors’ conduct to “reasonableness”
    - Debtors incentivized to cooperate on return to reduce claims (estate may be fully liable for these claims)
Chapter 15 Proceeding under the Bankruptcy Code

Ancillary Proceeding in the US for Foreign Airlines Flying to US or Having Assets in US

• Debtor asks US Courts to Honor Stay against Debtor’s Assets until the Stay against Assets Lifted under Home Country Proceedings
Cape Town Insolvency
Cape Town Insolvency

Alternative A

Alternative B

“Alternative C”

Covered by Articles XI and XXX of the Aircraft Protocol
Cape Town Alternative A

- Section 1110 on Steroids
  - Alternative A was fashioned based on Section 1110 with tweaks to make it more powerful
    - Applies to any aircraft debtor, not just certificated airlines
    - Court cannot prevent or delay remedies is expressly stated
    - Court cannot alter the obligations of debtor under the contract without consent of the Creditor
  - Period of Stay Determined by a Country’s Ratification
    - Not aware of any country over 60 days
    - At least one country under 60 days (Brazil – 30 days)
Alternative B might not look that different, but . . .

3. The applicable law referred to in sub-paragraph (b) of the preceding paragraph may permit the court to require the taking of any additional step or the provision of any additional guarantee.

Discretion to the court before a creditor can take possession of its Aircraft Objects even after the stay period and defaults not cured.
What is Alternative C?

- Alternatives A & B are only applicable if a country declared them during ratification.
- If no declaration, what do you have, Alternative C – status quo
- The countries usual insolvency laws apply and in the case of the US, that means Section 1110
Recent Insolvency Under Alternative A

**Avianca Brazil (not an Avianca Airline)**
- Brazil declared Alternative A with **30** day waiting period
- December 2018 – insolvency commenced in Brazil
- January 2019 – waiting period should have ended with court no right to extend or intervene
  - US Ancillary Proceeding - Creditors requested judge in Ancillary Proceeding to release assets (argued US courts required to honor Cape Town even if Home Country Courts do not–Unsuccessful)
- April 2019 – Court ended stay and permitted repossession
- Roughly 90 days rather than 30 days and still quicker than likely expected if Alternative A did not exist
Thoughts on 1110 and Alternative A Today

Value of 1110 and Alternative A is ability to retrieve an aircraft object and relatively quickly redeploy it.

If few to no options for redeployment, maybe better kept with airline that will operate it, maintain it, insure it, store it and have risk of loss.

More than usual, all parties will need each other:

• Lenders need Lessors
• Lessors need Airlines and
• Airlines need the Lessors and Lenders
Big Moment for Cape Town

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Big Moment for Cape Town

So much of Cape Town depends on its application around the world.

Despite the US’s 50 States, our Section 1110 will (eventually) be interpreted by a single court (US Supreme Court).

Alternative A (and B) might have approximately 76 jurisdictions interpreting it in the near future.

• That’s a good thing. We need those decisions to better understand country risk.

• Tough task if all at once, creditors having to educate courts in multiple jurisdictions.
Tax

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Pending U.S. Tax Relief

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Pending U.S. Tax Relief

• Senate approval of bi-partisan economic relief package.

• Significant changes that will benefit businesses, including the aviation sector – airlines, lessors, manufacturers, etc.

  • Net Operating Loss (NOL) Carryback Relief

  • Interest Deduction Cap Relief
NOL Carryback Relief

Current law:

- Businesses cannot carryback net operating losses.

- Businesses can carry the loss forward to offset future income, subject to various limitation (i.e., can’t offset more than 80% of income).
NOL Carryback Relief

Pending Changes under Relief Package:

- Businesses can carryback losses from 2018, 2019 and 2020.
- Carryback period is 5 years.
- 80% limitation and other restrictions don’t apply.
NOL Carryback Relief

Example:

• In 2009 the domestic aviation industry lost about $8 billion.

• Assuming similar losses in 2020, US airlines would be able to carryback that loss to profitable years and get a refund of the taxes paid.

• At current tax rates, this would result in an industry-wide recovery of about $1.7 billion.
NOL Carryback Relief

Planning:

- Airlines and creditors of airlines should quantify potential tax recoveries and factor them into ongoing discussions.

- Practical Problem:

  - If a business was profitable in recent years, but will likely incur an overall loss for 2020, no refund is possible until early in 2021.

  - Solution – Congress could permit quarterly or real-time refunds. Or, the US Treasury department could authorize this unilaterally. Under either approach, refunds could be issued beginning in April.
NOL Carryback Relief

See, generally:


Double Counting Rule:

• During prior recessions, the carryback rules were expanded, but the government denied relief if the taxpayer was also the recipient of a federal bailout.

• No such restriction appears in the current proposals.
Interest Cap Relief

Current Law:

• In general, businesses cannot deduct interest expense that exceeds 30% of EBITDA.

Proposed Relief:

• Cap changed to 50% of EBITDA.

• Will largely affect highly leveraged participants – e.g., some airlines and lessors.
AVIATION

FAA Needs to Better Prevent, Detect, and Respond to Fraud and Abuse Risks in Aircraft Registration
History:

- Concern over NCTs
- Internal Investigations/Reports
- GAO Investigation

Concerns Over:

- Fraud, Abuse, Illicit or Unsafe Operations Activities, Money Laundering, Hindrance of Law-Enforcement and Safety Officials

- 15 Recommendations from GAO
Mostly Good News:

• Nothing Really New!

• “Abuse” still seems quite low.

• Majority of Recommendations are for FAA to Perform with Little Impact on Industry:
  • Modernize (including charge more than $5.00 per aircraft registration)
  • Less reliance on self-certification, Registry to Perform Some Diligence (KYC/OFAC)
 Mostly Good News (Cont.):

• A bit more personally identifiable information (PII) on owners and beneficial owners
  
  • Actual, real, physical address – no PO Box, not mail drop, not registered agent’s address (already required for owners)
  
• ISSUE OF CONCERN: Legitimate needs/reasons for Shielding of PII from General Public. No Recognition (Nor Rejection) of Confidential Submission.

• More accessibility to information on documents filed but not recorded with the FAA (trust files)

Not the scathing report on industry many expected based on prior involvement in NCT-type discussions and investigations.
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ANY QUESTIONS?
Thank You For Joining Us!

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