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Guidance on the Scope of Airline Debtors' "Surrender and Return" Obligations Under Section 1110 of the Bankruptcy Code

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April 13, 2016 - Section 1110 of the Bankruptcy Code provides special protections to lenders and lessors that lease, finance, or conditionally sell aircraft equipment. In 2000, Congress amended section 1110 to add section 1110(c), which provides that a debtor must "immediately surrender and return" aircraft equipment to a secured party if such party is entitled to possession under section 1110(a)(1). Since Congress' passage of this provision in 2000, debtor airlines and aircraft financiers in airline bankruptcies have disputed how an airline debtor's "surrender and return" obligations should be interpreted and enforced. Aircraft financiers have argued that "surrender and return" requires the airline debtor to deliver an intact and airworthy aircraft to the location of the financier's choosing in the condition required under the underlying documents. Airline debtors have argued that "surrender and return" merely requires that the aircraft be made available to the aircraft financier at any location and in any condition.

On April 8, 2016, in the first written decision in *In re Republic Airways Holdings, Inc.*, Judge Sean Lane of the U.S. Bankruptcy Court for the Southern District of New York issued a decision providing guidance on the scope of an airline debtors' "surrender and return" obligations, holding that "[t]he court will not require the Debtors return the aircraft and related equipment in particular condition for surrender and return."^[1]

The dispute regarding the scope of Republic's "surrender and return" obligations arose as a result of Republic's motion seeking to surrender and return aircraft equipment that served as collateral under a loan agreement with Citibank because the aircraft collateral was not required for its long-term business plan. Citibank did not object to Republic's business judgment or discretion under Sections 365 or 544 of the Bankruptcy Code—the provisions that allow a debtor, respectively, to assume or reject executory contracts or unexpired leases, and to abandon the estate's burdensome property of inconsequential value and benefit after notice and a hearing.^[2] Instead, Citibank argued that the procedures under which Republic actually proposed to perform the "surrender and return" of the

aircraft collateral did not satisfy Section 1110(c) of the Code because, among other things, the engines subject to Citibank's security interest were not installed on the correct airframe and in some cases in different locations than the airframes.[3]

Faced with this objection, and noting that "there's not a lot of case law out there,"[4] Judge Lane issued a published decision interpreting the "frequently disputed" section 1110(c) of the Code.[5] Relying, in part, on a decision issued in the US Airways bankruptcy in the Eastern District of Virginia and lengthy bench decisions issued in the *Northwest Airlines* and *Delta* bankruptcies, Judge Lane rejected most of Citibank's objections.[6]

The Court refused to require the Debtors to return the aircraft with the matching Citibank engines—which would have been "akin to" forcing the Debtors to comply with the agreement's conditions for return.[7] The Court noted that bankruptcy courts have rejected similar requirements in several other airline bankruptcy cases: namely *US Airways*, *Northwest Airlines*, and *Delta Air Lines*.^[8] Courts have variously found these requirements to be counterintuitive, costly, and burdensome to debtors, their estates, and their creditors.^[9]

Judge Lane held that instead of splitting the costs for any engine replacements now, Citibank may instead file a claim for the expenses it incurs for costs associated with the surrender and return of its aircraft and engine collateral.^[10] Citibank suggested that—rather than leave the cost determination to a later date in the claims process—the parties split the costs associated with the surrender and return now.^[11] Relying on the reasonableness standard that courts use to address surrender and return of aircraft collateral, the Court held that splitting costs at this early stage is inappropriate—first, because the Court lacked sufficient information about the condition of the aircraft and engines at issue, and second, because Citibank failed to take prompt action to address the surrender and return of the aircraft at issue.^[12] The Court held, "A claim filed by Citibank—and any resulting decision on that claim—will be a more accurate reflection of the true burdens associated with the surrender and return process than a simple splitting of the costs."^[13]

This decision provides necessary guidance on the scope of an airline debtor's "surrender and return" obligations, which will help debtors make fleetplan decisions in the early days of the case, as required under section 1110 of the Bankruptcy Code and defer litigation and negotiation regarding the proper allocation of expenses to the claims reconciliation process.

Footnotes

[1]. Mem. of Decision, 8, Case No. 16-10429 (SHL) (Bankr. S.D.N.Y. Apr. 8, 2016), ECF No. 323.

[2]. *Id.* at 5.

[3]. *Id.*

[4]. See Hearing Transcript of March 22, 2016 at 83:1-7 [ECF No. 225].

[5]. *Id.* (citing *In re US Airways Grp., Inc.*, 287 B.R. 643, 645 (Bankr. E.D. Va. 2002); *In re Northwest Airlines Corp.*, Case No. 05-17930 (Bankr. S.D.N.Y. Oct. 7, 2005), Hearing Transcript of October 7, 2005 at 40:9–41:24, ECF No. 1847).

[6]. *Id.* at 8.

[7]. *Id.*

[8]. *Id.* at 8-10.

[9]. *Id.* at 9-10

[10]. *Id.* at 10-11.

[11]. *Id.* at 11-12.

[12]. *Id.* at 11.

[13]. *Id.* at 11-12.

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