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In this era of multi-national corporations and transnational business dealings, dissimilar and competing sovereign laws have and will continue to create . a commensurate increase in litigation to determine whose national laws must apply and which sovereign's public policy should carry the day. Courts are now faced with choice of law and comity concerns on a regular basis as business entities fight to ensure that the laws and protections to which they are accustomed are afforded them in the unfamiliar environs of a foreign courtroom. This Article addresses just such a battle, in which United States-based lessors and creditors fought to maintain the protections given them by the U.S. Bankruptcy Code in the face of conflicting protections provided to the lessee/debtor—a Brazilian airline—by the Brazilian Bankruptcy Code.

I. INTRODUCTION

The judicial recuperation sought by the Brazilian airline *Viação Aérea Rio Grandense* ("Varig") was largely a negative experience for the lessors and creditors involved. This judicial recuperation was the first major test case under the New Bankruptcy and Restructuring Law of Brazil (NBRL).[1] This case adversely affected lessors and creditors, most of whom were U.S.-based and were accustomed to special protections afforded them by 11 U.S.C. § 1110, which statute specifically provides greater protection to aircraft lessors and creditors in bankruptcy procedures than to other secured creditors.[2] In the United States, an aircraft creditor may use § 1110 to circumvent the automatic stay, or any other power of the court, that would prevent the creditor from repossessing the equipment (unless the debtor's obligations are performed in full and all prior defaults are cured within sixty days after the petition for relief). However, the NBRL provides no such protections in a Brazilian bankruptcy proceeding. Following the initiation of the main proceeding in Brazil, Varig Airlines immediately brought an

1. *See* Thomas Benes Felsberg et al., *Brazil: New Bankruptcy Law Ready for Signing*, INTER-AM. TRADE REP., Dec. 2004, at 2 [hereinafter Felsberg, *New Bankruptcy Law*].

2. *See* 11 U.S.C. § 1110 (2006). Of particular relevance is § 1110(a)(1):

Except as provided in paragraph (2) and subject to subsection (b), the right of a secured party with a security interest in equipment described in paragraph (3), or of a lessor or conditional vendor of such equipment, to take possession of such equipment in compliance with a security agreement, lease, or conditional sale contract, and to enforce any of its other rights or remedies, under such security agreement, lease, or conditional sale contract, to sell, lease, or otherwise retain or dispose of such equipment, is not limited or otherwise affected by any other provision of this title or by any power of the court.

See also Kenneth Basch, *Why the Varig Experience Should Not Recur*, GUIDE TO AVIATION LAWYERS, Jul. 2007, at 38.

ancillary proceeding in New York under the U.S. Bankruptcy Code, and the U.S.-based assets subject to the ancillary proceeding were conserved and administered in accordance with the NBRL. This frustrated Varig's U.S.-based creditors. The airline creditors' discontent also stemmed from the Brazilian court's handling of both pre- and post-petition debt claims arising out of the security and lease agreements. Beyond the issue of missed rent payments, issues arose regarding the failure to pay maintenance reserves, to maintain required liquidity to meet return conditions, and to maintain critical maintenance and parts logs.[3]

On June 17, 2005, Varig filed its ancillary proceeding in the Bankruptcy Court of the Southern District of New York (U.S. Court) under the former § 304 of Title 11 (the U.S. Bankruptcy Code) of the United States Code (the Code). (An ancillary proceeding does not commence a full bankruptcy case, but instead authorizes the U.S. court to administer limited proceedings in aid of a principal proceeding abroad; a foreign representative must seek injunctive or other relief, as the automatic stay is not triggered.)[4] Although the aircraft lessors and

3. Basch, *supra* note 2, at 38.

4. Petition Pursuant to 11 U.S.C. § 304 to Commence a Case Ancillary to a Foreign Proceeding 1, *In re* Petition of Vicente Cervo, as Foreign Representative of Varig, S.A., et al., No. 05-14400 (Bankr. S.D.N.Y. 2005) [hereinafter cited in footnotes as Petition Pursuant to 11 U.S.C. § 304] [hereinafter referred to in the text as *Varig*]. Section 304 of the Code read as follows:

§ 304. Cases ancillary to foreign proceedings.

(a) A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative.

(b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may

(1) enjoin the commencement or continuation of--

(A) any action against--

(i) a debtor with respect to property involved in such foreign proceeding; or

(ii) such property; or

(B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;

(2) order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or

(3) order other appropriate relief.

(c) In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with--

(1) just treatment of all holders of claims against or interests in such estate;

(2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;

(3) prevention of preferential or fraudulent dispositions of property of such estate;

(4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;

(5) comity; and

creditors urged the U.S. Court not to defer to the NBRL, the Court was not persuaded. The lessors and creditors argued that because the NBRL lacked a provision similar to § 1110,[5] which offered protection to a specific class of aircraft creditors, including secured parties, lessors, and conditional vendors (collectively "Varig financiers"), the U.S. Court should not give deference to the Brazilian proceeding.[6] The aircraft leasing and credit industry has come to expect those protections when financing aircrafts and engines; indeed, Congress retained the provisions of § 1110, indicating that the industry would simply cease financing relevant equipment if the protections were not preserved.[7] As a general matter, however, U.S. bankruptcy courts, in an ancillary proceeding, will defer to the foreign distribution scheme of the main proceeding unless it unfairly discriminates against U.S. creditors. Consequently, the New York court extended comity to the main proceeding in Brazil because it determined that U.S. policy interests and protections behind § 1110 did not override considerations that favored deference to the NBRL.[8]

This Article will compare the protections under the NBRL and § 1110, examine why the U.S. Court extended comity to the Brazilian proceeding in the *Varig* case, and review the reasons for the U.S. Court's denial of the Varig Airlines financiers' petitions for relief from the injunctive stay. This Article will do so, in part, by examining two cases decided under § 304 and the tests that the courts in those cases used to determine whether to extend or deny comity. The analysis will address the somewhat unique status of § 1110 against the other provisions within the Code: *modified universalism* and its application to the *Varig* case at

(6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

11 U.S.C. § 304 (2004), *repealed by* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 11 U.S.C. ch. 15, 119 Stat. 146 (Chapter 15 incorporated most of the principles of § 304 and still allows for ancillary proceedings to foreign bankruptcy actions.). Section 304(c) outlined six factors for the court to consider in determining whether to grant relief, one of which is comity. *Id.* A court may decline to afford comity to a foreign proceeding so long as that court is of competent jurisdiction and as long as laws and public policy of the forum are not violated. *See, e.g.*, *In re* Culmer, 25 B.R. 621 (Bankr. S.D.N.Y. 1982); *see also* Interpool, Ltd. v. Certain Freights of M/VS Venture Star, 878 F.2d 111 (3d Cir. 1989).

5. *See, e.g.*, Otto Eduardo Fonseca Lobo et al., *Varig Airlines: Flying the Friendly Skies of Brazil's New Bankruptcy Law with Help from Old § 304*, AM. BANKR. INST. J., July/Aug. 2007, at 42-43.

6. *Id*.

7. *See* Jason J. Kilborn, *Thou Canst Not Fly High with Borrowed Wings: Airline Finance and Bankruptcy Code Section 1110*, 8 GEO. MASON L. REV. 41, 51 (1999).

8. *Id.* (discussing the protections provided by § 1110 that were originally intended by Congress to encourage financiers to offer favorable credit terms to airline operators and thus promote industry growth and consumer travel and ensure airlines' ability to secure financing for replacing obsolete equipment with modern aircraft).

hand, specifically when looking at the relative merits of deferring to the Brazilian court versus protecting the Varig financiers. Additionally, this Article will argue that a bankruptcy filing in Brazil today by another Brazilian airline would still result in an unfavorable outcome to Varig financiers—in spite of (or perhaps because of) changes made to laws in both the United States and Brazil following the *Varig* decision. This Article will also speculate as to the way the case might differ under Chapter 15 of the Code and will look at what the UNIDROIT Convention on International Interests in Mobile Equipment ("Convention") and its corresponding Protocol on Matters Specific to Aircraft Equipment ("Aircraft Protocol") indicate about the international economic community's approach to handling aircraft priority in secured transactions and insolvency proceedings. Finally, this Article will reveal the way the U.S. Court in the ancillary proceeding had the opportunity to decline the extension of comity to the main proceedings by concurring with the Varig financiers' argument that the public policy exception labeled the "escape clause" of § 304 provided § 1110 protections to aircraft.[9] However, by extending comity to the foreign proceeding, the court set a precedent that will likely weaken the reliance of the Varig financiers on § 1110 in future deals with Brazilian and other foreign airlines. The analysis in this Article is not limited solely to Brazilian carriers, but may be applied elsewhere and thus found useful for any U.S.-based creditor faced with the challenge of confronting a foreign bankruptcy proceeding in a state whose bankruptcy laws do not have provisions analogous to § 1110.

II. HISTORY OF VARIG AIRLINES AND ITS BANKRUPTCY

Before filing for bankruptcy, Varig had a long history as a significant Brazilian airline. At the time of the bankruptcy filing in 2005, Varig was

9. Though § 304 was repealed under the Bankruptcy Abuse Prevention and Consumer Protection Act (the "BAPCPA") in 2005 (after the filing of the *Varig* case under § 304) and replaced by Chapter 15 of the Code, financiers today would likely have an even more difficult time attempting to convince the courts to uphold the § 1110 protections. The pre-repeal cases interpreting § 304 still matter inasmuch as the tests applied by courts pre-BAPCPA inform the current Chapter 15 comity analysis. Chapter 15 also implemented the Model Law on Cross Border Insolvency drafted by the United Nations Commission on International Trade and Law.

The *modified universalist* approach of the Model Law and its enactment in Chapter 15 expands upon the principles of comity enumerated in § 304 to make the U.S. Bankruptcy Code even more broad in its acceptance of foreign courts of law and their decisions in insolvency proceedings. However, the expansiveness and spirit of international cooperation of the new Chapter 15 on its face is tempered by several specific provisions that allow territorialism to sneak back into the frame and possibly allow financiers to succeed in their arguments.

the largest air carrier in Brazil and Latin America.[10] Having operated continuously since 1927, its eighty-year history secures Varig a place among the world's oldest airlines.[11] By the end of Varig's bankruptcy proceedings in Brazil in 2006, the Ruben Berta Foundation ("RBF"), a non-profit organization founded in 1945, had become the majority owner of Varig.[12] Though Varig has been managed and operated as a private business enterprise since its inception, the Brazilian State of Rio Grande du Sol holds a minority interest of less than one percent.[13]

Varig's principal business was and is passenger travel along domestic routes within Brazil and international routes between Brazil and the Americas, Europe, and Asia.[14] As of May 31, 2005, the airline had a fleet of 87 aircraft, carried approximately 13 million passengers per year, and employed approximately 11,456 full-time employees.[15] Varig Airlines has no significant fixed assets,[16] and each of its aircraft is operated under lease—eighty-three under operating leases and four under finance leases.[17]

Varig has long been a marquee brand in Brazil.[18] For years the Brazilian government protected Varig by limiting competition and regulating ticket prices.[19] In return, Varig compensated government officials with courtesy tickets and flew unprofitable routes to destinations the government hoped to tie into the national Brazilian economy.[20] Regulation of all air carriers in Brazil requires government approval of the acquisition of additional aircraft, opening of new routes, and changing flight frequency; the government also monitors fares that air carriers are permitted to charge on each domestic route.[21]

Varig eventually penetrated the international market. Flights to the United States began in 1955, with Varig providing approximately

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10. Petition Pursuant to 11 U.S.C. § 304, *supra* note 4, at 2.

11. *Id.*

12. *Id.*

13. *Id.*

14. An archived image of Varig's international routes map can be found at http://www.airlineroutemaps.com/Latin_America/img/Varig.jpg (last visited Oct. 30, 2009) (showing Varig's international flight routes before bankruptcy).

15. Background and Description of Varig, Varig Bankr. News, June 18, 2005, at § 00001, http://bankrupt.com/varig.txt (last visited Nov. 13, 2007).

16. Petition Pursuant to 11 U.S.C. § 304, *supra* note 4, at 6.

17. *Id.* at 4. See the discussion, *infra*, Part IV.C and notes 74–77 for commentary on why the distinction was at the time significant.

18. Geraldo Samor, *Brazil's Not-So-Favored Airline: Once a Government Darling, Varig Faces Vagaries of Competition*, WALL ST. J., Sept. 14, 2005, at A18.

19. *Id.*

20. *Id.*

21. Petition Pursuant to 11 U.S.C. § 304, *supra* note 4, at 6.

eighteen flights each week into Miami, New York, and Los Angeles.[22] In 2004, tickets sold in the U.S. accounted for roughly 5.2% (approximately US $163.9 million) of Varig's flight revenues.[23] Varig estimated that 133 employees were employed in the United States, with 51 of those working in New York at John F. Kennedy International Airport or at one of two Manhattan locations.[24]

In the mid-1990s, Brazil began to loosen its regulations of the airline industry by allowing low-price competitors into the market. *Transportes Aéreos Marília Linhas Aéreas* ("TAM") and *Gol Linhas Aéreas Inteligentes* increased their offerings to business travelers within and coming to Latin America, and slowly Varig's market share began to evaporate.[25] Other low-cost carriers, such as *Web Jet Linhas Aéreas*, entered the market as well.[26] Finally, while the Brazilian government maintained a high degree of control over Varig, Varig was still a private company; many of its foreign competitors were wholly or majority owned by their respective governments and thus had better access to greater resources and subsidies than Varig.[27]

Prior to filing for bankruptcy, Varig made several unsuccessful attempts to stabilize its finances. In 1994, and again in 1999, Varig restructured its debt by deferring payments to its creditors.[28] This alleviated immediate pressure, but caused Varig's debt burden and future cash flow requirement to grow.[29] In 2001, after Varig laid off approximately ten percent of its workers and reduced its fleet, the Brazilian government considered nationalizing the carrier temporarily.[30] In February 2003, International Lease Finance Corporation, a U.S.-based corporation, seized one of its leased Boeing 777 aircraft from Varig at the Paris Charles De Gaulle airport due to missed lease payments.[31] Then in March, GE Capital Aviation Services, another U.S. corporation, impounded a Varig Boeing 767 bound for Rio de Janeiro while on the runway at Miami International Airport for non-payment of past due

22. *Id.* at 5.
23. *Id.*
24. *Id.*
25. Samor, *supra* note 18.
26. *See* Webjet Linhas Aéreas, http://www.webjet.com.br/empresa/novosite/index.asp (last visited Nov. 1, 2007).
27. Petition Pursuant to 11 U.S.C. § 304, *supra* note 4, at 7.
28. *Id.*
29. *Id.*
30. Megan Christoph, Comment, *Airline Reorganization Under the New Bankruptcy and Restructuring Law of Brazil*, 13 L. & BUS. REV. AM. 451, 457 (2007).
31. *Creditors Release Varig's Boeing 777 Aircraft*, ALLBUSINESS.COM, Feb. 3, 2003, http://www.allbusiness.com/operations/ shipping-air-freight/448097-1.html.

leasing fees.[32]

There were two important factors contributing to Varig's financial difficulties. First, the high degree of operating leverage inherent in the airline industry and the high costs of fuel (and the subsequent inability to pass rising fuel costs onto customer fares due to Brazilian fare regulation) caused minor shifts in passenger revenues based on seasonality or competition to have a disproportionately large effect on Varig's profits.[33] Second, because Varig dedicated a large percentage of its cash flow to service its accumulated debt, and because of the devaluation of the Brazilian Real against the U.S. Dollar over the years prior to filing, Varig was intensely sensitive to any decline in revenue.[34]

On June 17, 2005—a mere eight days after the NBRL became effective[35]—Varig filed for bankruptcy under the NBRL's reorganization procedures.[36] At the time of its filing, Varig had a negative net worth of approximately US $2.5 billion, with debts amounting to approximately US $4.0 billion.[37] Varig's largest single creditor was the Brazilian state itself, which had claims of over US $3.3 billion for back taxes and Brazilian social security payments.[38]

III. HISTORY OF THE BRAZILIAN BANKRUPTCY CODE

Prior to the enactment of the NBRL in June 2005, the landscape of insolvency in Brazil was a scary place for debtors and creditors alike. Corporations considering filing bankruptcy faced potentially "harsh consequences" as a result of "ineffective and fragmented bankruptcy law that had been in place since 1945."[39] Under the old law, only merchants

32. *Varig 767-200 Impounded in Miami by Gecas*, AVIATION DAILY, Mar. 10, 2003, at 5 (pointing out also that Varig attorneys had been in negotiations with Gecas to return several on-lease aircraft out of the thirty that it had at one time).

33. Petition Pursuant to 11 U.S.C. § 304, *supra* note 4, at 8.

34. *Id.* at 7–8.

35. Felsberg, *New Bankruptcy Law*, *supra* note 1, at 2.

36. Petition Pursuant to 11 U.S.C. § 304, *supra* note 4, at 9.

37. *Id.* at 7.

38. Samor, *supra* note 18, at 2.

39. *See* Christoph, *supra* note 30, at 452; *see also* Christopher Andrew Jarvinen, *A Primer on Judicial Reorganizations and Out-of-Court Reorganizations Under Brazil's New Bankruptcy and Restructuring Law*, 2005 ANN. SURV. OF BANKR. LAW. PART II § 3, at 10 n.4 [hereinafter Jarvinen, *Primer on Reorganizations*] ("Prior to the effective date of the NBRL, the system of corporate reorganization in Brazil was governed by Decree-Law No. 7661 of June 21, 1945 (the "Prior Bankruptcy Law ") . . . . [T]he Prior Bankruptcy Law was the target of heavy criticism in Brazil because it effectively prevented companies from reorganizing, failed to provide a meaningful role for creditors in the reorganization process and provided minimal protections for secured creditors."). This Article provides an excellent and exhaustive overview in English of most of the changes made to the Brazilian Bankruptcy Code with enactment of the NBRL. For purposes of this Article, I will

were eligible for bankruptcy protection.[40]

Two of the most common types of bankruptcy available to debtors were bankruptcy liquidation (*falencia*) and debt rehabilitation (*concordata*).[41] The majority of all bankruptcy proceedings initiated in Brazil prior to enactment of the NBRL were *falencia*.[42] While the *concordata* was a proceeding similar in some regards to a reorganization proceeding, it was conducted under strict scrutiny from the Brazilian courts.[43] A court-appointed receiver (*comissário*) provided oversight, and a debtor was severely limited with the reorganization strategies that it could pursue.[44] Unlike a Chapter 11 reorganization in the United States or a Judicial Reorganization under the NBRL, a statutorily-prescribed percentage of unsecured claims were discharged with a *concordata*, while secured claimholders were not affected by any stay and were free to attempt to collect their claims.[45] Ultimately, the *concordata* was not a flexible tool for reorganizing a going concern; it failed in large part for rehabilitating businesses because of the limited discharge of unsecured debts and the inability of the debtor and creditors to negotiate directly.[46]

Furthermore, a significant impediment to secured creditors in Brazil was the priority scheme for claims. Unlike the varied protective measures built into the U.S. Bankruptcy Code, the prior bankruptcy law of Brazil placed secured claims lower in priority than two classes of claims that are conceivably almost unlimited: labor claims in first priority and tax claims in second priority; and "because those [two] claims are frequently enormous in Brazil, there are generally few assets remaining in a debtor's estate to satisfy secured claims."[47] Even compared to other Latin American countries, Brazilian creditors have very minimal protection, making credit "scarce and expensive."[48] Due to the high risk of failing to recover in bankruptcy proceedings from a

highlight only those passages that apply most directly to the crux of my argument. For good synopsis of the entire NBRL, see generally *id.* and Christopher Andrew Jarvinen et al., *Bankruptcy Reform Coming to Brazil*, AM. BANKR. INST. J., Dec. 2004–Jan. 2005, at 32 [hereinafter Jarvinen et al., *Bankruptcy Reform*].

40. *See* Christoph, *supra* note 30, at 452.

41. Jarvinen et al., *Bankruptcy Reform*, *supra* note 39, at 32.

42. *Id.*

43. *See* Christoph, *supra* note 30, at 452.

44. *See* Jarvinen, *Primer on Reorganizations*, *supra* note 39, at 11 n.9.

45. *See* Jarvinen et al., *Bankruptcy Reform*, *supra* note 39, at 68.

46. *See* Jarvinen, *Primer on Reorganizations*, *supra* note 3, at 11 n.9.

47. Jarvinen et al., *Bankruptcy Reform*, *supra* note 39, at 32.

48. Aloisio Araujo & Bruno Funchal, *Past and Future of the Bankruptcy Law in Brazil and Latin America*, 50 ESCOLA DE PÓS GRADUAÇÃO EM ECONOMIA DA FUNDAÇÃO GETULIO VARGAS [GRADUATE SCH. OF ECON., GETULIO VARGAS FOUND., ECON. WORKING PAPERS], Paper No. 599, at 48 (2005) (Braz.), *available at* http://epge.fgv.br/portal/arquivo/1922.pdf.

Brazilian corporation (and because of the losses that some lenders *have* suffered in the past due to loan defaults), Brazilian lenders still protect themselves with some of the highest lending rates in the world.[49]

IV. ENACTMENT OF THE NEW BANKRUPTCY AND RESTRUCTURING LAW OF BRAZIL

On February 9, 2005, Brazil enacted its new bankruptcy law, the New Bankruptcy and Restructuring Law (NBRL). This new law gives insolvent companies a better chance at reorganization and made drastic reforms to Brazil's existing bankruptcy laws, such as those determining claim priority. The NBRL was the first significant remodeling of Brazilian insolvency law in over sixty years.[50]

A. Judicial Reorganization and Limited Automatic Stay Under the NBRL

Chief among the new provisions of the NBRL is the creation of a new proceeding: the Judicial Reorganization (*Recuperaçáo Judicial*).[51] *Recuperaçáo Judicial* is similar to a Chapter 11 reorganization proceeding under the U.S. Bankruptcy Code: its goal is to preserve the operation and assets of a bankrupt corporation as a going concern and to impute a greater social value (in terms of employing workers, participating in the economy, paying taxes, etc.) than would be true in a liquidation proceeding.[52] In Brazil, reorganization is a recent development that reforms the financial and organizational structure of debtors to allow the rehabilitation and continuation of their business, whereas the older method merely liquidated and eliminated insolvent companies.

The NBRL's *Recuperaçáo Judicial* provision has several notable aspects that facilitate the reorganization procedure. One aspect of the reorganization provision is the institution of a limited automatic stay.[53]

49. *See* Jarvinen et al., *Bankruptcy Reform*, *supra* note 41, at 32. *See generally* Araujo & Funchal, *supra* note 48, at 47. (This Article argues that "creditors' rights are only weakly protected and financial markets are characterized by a relatively low credit volume and high interest rate." The ratio of private credit to Gross Domestic Product in Brazil is at only 35%, compared to a ratio in Organisation for Economic Co-operation and Development ("OECD") states of 102% during the period from 1997–2002.).

50. *See* Jarvinen, *Primer on Reorganizations*, *supra* note 39, at 1.

51. *See id.*

52. *See id; see also* Araujo & Funchal, *supra* note 48, at 50 (noting that creditors now have a much more active role in the proceedings than under the old *concordata* and that creditors now directly negotiate with the debtor and vote for the reorganization plan).

53. Lei. No. 11.101, 9 de fevereiro de 2005, D.O.U. de 09.02.2005, Art. 52(III) (Brazil),

Conceptually, the limited stay provides similar protections to that afforded under § 362 of the Code.[54] The stay also provides "breathing room" for the debtor to focus on developing a reorganization plan for its creditors to negotiate.[55] The stay in the context of the *Recuperaçáo Judicial* is limited in duration to a single 180 day period that is not extendable; yet when the stay expires, creditors may immediately resume collection efforts against the debtor.[56] Another key aspect of the reorganization proceeding is that the debtor has sixty days from the filing of its judicial reorganization petition to submit its reorganization plan.[57] All creditors must approve this plan; if any creditor objects to the proposal, a formal vote is held, and dissident creditors are bound, provided that the statutorily stipulated proportion of creditors in each credit class ratify.[58]

Thus, the NBRL allows insolvent Brazilian companies to attempt reorganization under a scheme that is more beneficial to them than the previous law. Features that make this new law more beneficial include the limited automatic stay in addition to providing more time to negotiate with creditors, file the reorganization plan, and obtain approval of the plan, all of which serve to fulfill the preservation objectives of the Judicial Reorganization.

B. Prioritization of Claims and Successor Liability Under the NBRL

The NBRL further provides improved benefits over the prior bankruptcy law with respect to the prioritization of claims as well as addressing the problems faced by successive purchasers of the debtor's assets.[59]

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translated in Affidavit of Sergio Bermudes, In re Petition of Vicente Cervo, as Foreign Representative of Varig, S.A., et al., No. 05-14400 (Bankr. S.D.N.Y. June 17, 2005) [hereinafter Lei. No. 11.101]; *see also* Jarvinen, *Primer on Reorganizations*, *supra* note 39, at 3.

54. 11 U.S.C. § 362 (2006).

55. Lei. No. 11.101, *supra* note 53, Art. 6; *see also* Jarvinen, *Primer on Reorganizations*, *supra* note 39, at 3.

56. Lei. No. 11.101, *supra* note 53, Art. 6, § 4; *see also* Jarvinen, *Primer on Reorganizations*, *supra* note 39, at 3.

57. Lei. No. 11.101, *supra* note 53, Art. 53. Given that Brazilian debtors have never before had this opportunity to reorganize rather than liquidate, an argument could be made that sixty days may prove to be an insufficient amount of time to meet with creditors and negotiate a plan, particularly in complex reorganizations such as the *Varig* proceeding. Certainly this would be true of most U.S. Chapter 11 reorganizations of any size (even with sufficient precedent existing to guide the debtor and creditors through the process).

58. Felsberg, *New Bankruptcy Law*, *supra* note 1, at 2. *See also* Jarvinen, *Primer on Reorganizations*, *supra* note 46, at 7. (A thorough discussion of the steps necessary to obtain approval from creditors and the court is laid out in "Procedure to Obtain Court Confirmation of a Reorganization Plan" in Jarvinen, *Primer on Reorganizations*.)

59. Prioritization of claims protects the creditor by getting the most critical work handled

The NBRL enhances prioritization for secured creditors in three ways. First, the claims of secured creditors now occupy second position in priority (after labor claims), supplanting tax claims in the order of priority.[60] Second, the amount of first priority labor claims is capped.[61] Third, the NBRL also protects creditors who choose to continue to deal with the debtor post petition, primarily by granting an administrative post-petition priority claim to post-petition lenders over other secured, pre-petition claims.[62] In the event that the reorganization is converted into a liquidation proceeding and the debtor's funds are insufficient to satisfy all creditor claims, the post-petition claims will enjoy a higher priority.[63]

Additionally, the NBRL provides protection to potential purchasers of debtor assets where the prior bankruptcy law provided none. The NBRL protects these successive purchasers from successor liability where there are claims against the original debtor.[64] In other words, purchasers can buy a debtor's assets and be protected from inheriting any liability claims made against the debtor. Under the prior bankruptcy law, no analogue to § 363 of the Bankruptcy Code existed to authorize asset transfers "free and clear" of liens and interests.[65] Thus, investors were understandably leery of purchasing assets in bankruptcy proceedings that were likely encumbered by labor and tax claims.[66] However, certain categories of claims under the NBRL are no longer subject to successor liability. Certain types of debtor assets, such as separate production units or branches of the debtor's operations, in judicial reorganization are no longer burdened by the debtor's obligations for tax claims, labor or work-related injury claims, or social security claims.[67] Thus, under the

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first; for example, by allowing claims arising from insurance contracts to have priority over other types of contracts.

60. Lei. No. 11.101, *supra* note 53, Art. 83(II).

61. *Id.*, Art. 83(I). *See* Jarvinen, *Primer on Reorganizations*, *supra* note 46, at 6. The cap is equal to Brazil's monthly minimum wage for 150 months. At current exchange rates, the amount of the cap is approximately US $31,666 per employee (31, 666 = 150 x 380 reals (monthly minimum wage) / 1.80 reals/dollar (current exchange rate as of October 2007)).

62. Lei. No. 11.101, *supra* note 53, Arts. 67, 83.

63. Jarvinen, *Primer on Reorganizations*, *supra* note 46, at 6.

64. Jarvinen et al., *Bankruptcy Reform*, *supra* note 39, at 32

65. 11 U.S.C. § 363 (2005).

66. *See* Jarvinen, *Primer on Reorganizations*, *supra* note 39, at 6; *see also* Jarvinen et al., *Bankruptcy Reform Coming to Brazil*, *supra* note 41, at 32 ("Because the actual amounts of such claims are not generally known or capable of accurate estimation at the time of a sale, investors avoid purchasing assets from debtors. Consequently, the existing bankruptcy laws preclude the development of an efficient market in Brazil for the sale of assets in bankruptcy.").

67. Lei. No. 11.101, *supra* note 53, Art. 60 ("The object of disposal shall be free of any encumbrances and the bidder shall not be encumbered with the debtor's obligations, including those related to tax."); *see also* Jarvinen, *Primer on Reorganizations*, *supra* note 39, at 6.

NBRL, creditors will have an incentive to provide financing to debtors-in-possession and will feel sufficiently protected in doing so "since the [creditors] will have a prior claim against the assets in the debtor's bankruptcy estate in relation to pre-petition debt and a greater likelihood of recoveries on their debt in the event of a liquidation."[68]

Therefore, the NBRL provides greater benefits and security to secured creditors than did the prior bankruptcy law of Brazil. The added or enhanced features of prioritization and protection from successor liability cause creditors to feel more protected from insolvent debtors while subsequent purchasers will be more likely to buy debtor assets.

C. Air Carrier Reorganization Under the NBRL

Despite the many benefits of the NBRL, it also creates some turbulence for creditors and air carriers undergoing reorganization. For example, the NBRL disadvantages creditors because aircraft leases are subject to Article 49 of the NBRL, which provides that leased assets cannot be repossessed if essential to the economic activity of a company in recovery.[69]

Additionally, the NBRL creates disadvantages for aircraft carriers by prohibiting some from reorganizing and requiring specific procedures for others. Article 198 of the NBRL prevents companies not allowed to file bankruptcy under the *concordata* of the old law from choosing reorganization.[70] However, fortunately for some aircraft carriers, under Article 199 of the NBRL, corporations identified in Article 187 of the Brazilian Aeronautical Code of December 19, 1986, are not subject to the restrictions found in Article 198 and thus *may* file a *Recuperaçáo Judicial* petition.[71] Furthermore, although the identified airlines may file,

68. *New Brazil Bankruptcy Law Likely to Improve Recovery Prospects for Creditors, But Challenges Remain*, STANDARD & POOR'S RATINGS DIRECT, Jul. 5, 2005, at 2 [hereinafter *Challenges Remain*], *available at* http://www.securitization.net/pdf/sp/ BrazilianLaw_5Jul05.pdf.

69. Lei. No. 11.101, *supra* note 53, Art. 49, § 3 ("In the event of the creditor who is a fiduciary owner of chattels and real estate properties, or mercantile lessor, owner or prominent seller of property whose respective contracts contain irrevocable or irretrievability clauses, including estate institutions or owner in a sale contract with domain reserve, its credit shall not be submitted to the effects of judicial recovery, prevailing the rights to property over the things or contractual conditions, observing the respective legislation, *not allowing, however*, during the suspension period referred to in §4 of Section 6 of this Law, *the sale or removal of the establishment of the debtor of goods essential for its corporate activity*." (emphasis added)).

70. Lei. No. 11.101, *supra* note 53, Art. 198 ("The debtors prohibited to request reorganization in bankruptcy under the terms of the specific legislation in effect on the day of publication of this Law are prohibited to request a judicial or extrajudicial recovery under the terms of this Law."); *see also* Lobo et al., *supra* note 5, at 42.

71. Lei. No. 7.565, 19 de decembero de 1986, Art. 187, D.O.U. de 20.12.1986. (Brazil), ("Those companies who have as their constituent acts the purpose of pursuing air services of any

the NBRL requires an analysis of the debtor's obligations to determine which ones are subject to reorganization proceedings.[72] It also requires an analysis of which equipment must be preserved by the debtor as necessary to maintain the going concern.[73]

Another disadvantage of the NBRL formerly existed in a loophole regarding aviation finance contracts. Article 199, which addresses finance provisions including finance contracts applied only to finance leases (as opposed to finance *and* operating leases).[74] Article 199 of the NBRL identifies finance leases of aircraft as being outside of the judicial recovery proceedings, so that the nondebtor party to the lease could pursue collection on its collateral notwithstanding the stay provisions of the NBRL.[75] Furthermore, these provisions completely prohibited Brazilian airlines from rescheduling any obligations arising from aircraft and equipment *leases*, essentially removing any stay period at all for finance leases.[76] The Brazilian Congress closed this loophole in November 2005 by applying Article 199 to both finance and operating leases.[77]

Despite the closure of this loophole, there is still tension between Articles 199 and 49 of the NBRL. Article 199 indicates that there is no stay at all for aircraft and aircraft engine leases, while Article 49 indicates that equipment necessary to maintain a going concern is not to be repossessed.[78] Thus, airlines may file for judicial reorganization

nature or aeronautical infrastructure cannot petition for *concordata*."). Prior to the NBRL's enactment, Brazil seemed disinclined to allow recovery proceedings for a commercial air carrier under the rationale that the safety of the general public was at stake; that is, aircraft maintenance and safety was too great of a public concern to allow to be affected by the financial instability of a company in reorganization. *See* Lobo et al., *supra* note 5, at 42. Presumably, it was preferable for an airline to be liquidated and sold off rather than allowed to continue on with possibly suspect safety and maintenance oversight. *See also, Challenges Remain, supra* note 68, at 6 ("Under the old bankruptcy regime, airline insolvencies were governed by the federal Aeronautical Code and were supervised by a trustee appointed by a federal regulator. The airlines sought to have their insolvencies governed by the New Bankruptcy Code….").

72. Lei. No. 11.101, *supra* note 53, Art. 51(III).

73. *Id.* Art. 66.

74. *Id.* Art. 199 ("In the judicial recovery and the bankruptcy of corporations mentioned in the heading of this section, the exercise of the rights resulting from the finance leasing contracts of aircrafts or their parts will not be suspended in any hypothesis.").

75. *See id.* Immediately after Varig's filing, Brazil amended this section to provide that lease agreements (including aircraft lease agreements) are not subject to the judicial recovery, according to the first part of § 3 of Art. 49 of the NBRL. However, air carriers' leases would presumably still be protected under the second portion of § 3, prohibiting the repossession of goods "essential for . . . corporate activity." *Id.*, Art. 49, § 3; *see* Lobo et al., *supra* note 5, at 72.

76. Lei. No. 11.101, *supra* note 53, Art. 199.

77. Basch, *supra* note 2, at 39.

78. *See id.* ("Article 199 completely prohibits Brazilian airlines from rescheduling any obligations arising from aircraft and aircraft engine leases. In other words, the stay provided by Article 199 is zero days. A Brazilian airline in judicial reorganization is allowed to reschedule its

under the NBRL (an improvement from the prior bankruptcy law, which prevented them from proceeding under a *concordata*), but both finance and operating leases are outside the scope of the stay *unless* Article 49 is determined to apply and the leases are necessary for the corporation to continue as a going concern.[79] It is difficult to imagine that this would not be the case for an airline. Thus, for cases in the U.S. courts, no relief akin to § 1110 is apparent for aircraft creditors if comity is granted to Brazilian or similar foreign law.

Therefore, even though the enactment of the NBRL undoubtedly expanded the flexibility of debtors and creditors seeking to pursue reorganization and created more options for the judiciary to facilitate the maximization of value of insolvent companies,[80] the relative newness of the statute (and its literal newness at the time of the Varig filing), means there is much to be seen as to its shortcomings. One noted deficiency of the NBRL, which is discussed further below, is its lack of reference to cross-border insolvency proceedings—a deficiency especially germane to this discussion and a growing concern in light of the ongoing globalization of commerce.[81]

V. AIRCRAFT EQUIPMENT AND VESSELS UNDER 11 U.S.C. § 1110

In the United States, Congress has long afforded special protection to financiers of certain equipment such as aircraft, aircraft engines, propellers, appliances, and spare parts.[82] Congressional development of

non-lease debt only. The original language of Article 199, which remains applicable in the Varig case, contained language that the judiciary intended to limit the scope of the Article to finance leases only. Future judicial recuperation would be processed under the new language, however, which closes that loophole. Now all aircraft and aircraft engine leases, regardless of whether they are finance or operating leases, are protected by Article 199 and should be excluded from judicial recuperation restructuring."). *But*.");*but cf.* Lobo et al., *supra* note 5, at 72 ("Nevertheless, as with any other type of lease, the aircraft lease agreements are still subject to the rule of the first part of § 3 of Art. 49 of the NBRL, providing that any assets that are leased cannot be repossessed from the debtor if it is essential to the economic activity of the company in judicial recovery.").

79. *See* Lobo et al., *supra* note 5, at 72.

80. See Araujo & Funchal, *supra* note 48, for an in-depth discussion of the anticipated favorable effects of the NBRL on the Brazilian credit market and overall economic efficiency.

81. Jarvinen, *Primer on Reorganizations*, *supra* note 46, at 9. *See also* Thomas Benes Felsberg et al., *Brazil Overhauls Restructuring Regime*, 25 INT'L FIN. L. REV., Jan. 2006, at 40, 44 (2006) ("In 1997 UNCITRAL promulgated a Model Law on Cross-Border Insolvency and several countries, including most recently the U.S. in 2005 with the new Chapter 15, have incorporated the Model Law in their domestic insolvency laws. But the new Brazilian law does not do so, and this failure to incorporate the Model Law will maintain the uncertainty and unpredictability that existed under the old law with respect to multi-jurisdictional insolvencies that include a Brazilian component, including the process by which Brazilian courts will determine whether to grant recognition to, or otherwise cooperate with, foreign insolvency proceedings.").

82. *See, e.g.*, *In re* Ionosphere Clubs, Inc., 123 B.R. 166 (S.D.N.Y. 1991) (holding that a

§1110 continued to provide greater protection to aircraft financiers. As far back as 1957, Congress was concerned with the fact that airlines were facing "serious financing problems resulting from the need to replace obsolete equipment with modern aircraft."[83] Due in part to the great capital expense of operating a large fleet of high-maintenance aircraft and to the extremely high price of purchasing even one modern airliner,[84] most air carriers—even large ones—are incapable of owning their fleets outright.[85] As a result, air carriers are forced to enter into complex financial arrangements with both financial institutions and aircraft manufacturers.[86] In these agreements airlines are, perhaps, predisposed to acquiesce to the demands of Financiers for more substantial protections for their investments when considering the statutory protections.[87] Today, aircraft financiers continue to argue that they are unwilling, or at least unlikely, to provide financing for new or unproven airlines absent the protections offered their investments under § 1110 (or at least that the terms they would offer would border on the usurious).[88]

Prior to the enactment of § 1110 (the modern version of the law), the old § 116(5) of the U.S. Bankruptcy Act (Bankruptcy Act) made reorganization proceedings completely inoperative insofar as they affected title and the right of aircraft creditors to repossess.[89] Since § 116(5) required debtors to obtain aircraft financiers' consent to retain

creditor with a purchase money security interest could take possession of property such as aircraft pursuant to § 1110 despite the automatic bankruptcy stay). The Federal Aviation Act of 1958, 49 U.S.C.A. § 40102, defines the types of equipment that are subject to protection.

83. H.R. REP. NO. 85-944 (1957), *reprinted in* 1957 U.S.C.C.A.N. (71 Stat. 716) 1926, 1926. *See also* Ripple, *infra* note 85, at 290 ("Most commentators agree that Congress hoped to strengthen the borrowing power of airlines engaged in fleet modernization by offering equipment financiers more security on their investment by limiting the equitable powers of the bankruptcy court to modify their rights to take possession of collateral after a default.").

84. A Boeing 767-200 of the type repossessed by Gecas from Varig in 2003, for example, currently costs between US $124.5 million and US $135.5 million. *See* Boeing Commercial Airplane Prices, http://www.boeing.com/commercial/prices (last visited Oct. 14, 2007).

85. *See* Gregory P. Ripple, Note, *Special Protection in the Air[line Industry]: The Historical Development of Section 1110 of the Bankruptcy Code*, 78 NOTRE DAME L. REV. 281, at 281–82, n.4 ("The difficulty these costs impose on start-up airlines is evidenced in the circumstances surrounding the beginnings of JetBlue Airways. In 1999 the airline launched with $ 130 million in capital investment, the largest capital buildup in the history of the American airline industry. This amount would have been sufficient to buy outright only one of the airline's twenty-three Airbus A320s.").

86. *Id.* at 282.

87. Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 MICH. L. REV. 47, 48 ("It has, of course, long been assumed that certain narrow provisions of the 1978 Act reflect the influence of interest groups—for example, the section that gives special protection to security and lease interests in aircraft.").

88. *See, e.g.*, Ripple, *supra* note 85, at 282.

89. *See* H.R. REP. NO. 85-944 (1957), *supra* note 83, at 1927.

equipment in which the debtor was in default during insolvency proceedings, § 116(5) essentially gave financiers "the absolute veto power over a reorganization."[90] Additionally, the Bankruptcy Act did not give a debtor any grace period in which to determine if it would cure defaults and continue under a pre-petition agreement or if it would surrender its equipment to the creditor.[91]

When Congress enacted § 1110 in 1977, it narrowed the class of creditors and, rather than perpetuating the aircraft creditors' veto power, crafted § 1110 such that a debtor may remain in possession of aircraft and aircraft equipment so long as it cures any defaults and reaffirms its obligations under any pre-petition security agreements or financing arrangements.[92] Section 1110 sets out three prerequisites limiting when a creditor may receive the protection of its provisions: the protection only applies to a specific type of equipment, a specific type of transaction, and a licensed debtor. As such, the § 1110 protection is available to only a particularly narrow class of creditors.[93] Additionally, this narrow class of creditors must make a written demand for possession before the trustee surrenders the collateral.[94] Lastly, § 1110 states that the rights of a financier are not "limited or otherwise affected by any other provision of this *title* or by any *power of the court*."[95] The "title" referred to is Title 11 of the United States Code (the Bankruptcy Code); "power of the court" is defined in § 105 of the Code as the court's ability to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[96] This new language allowed debtors to no

90. *See* S. REP. NO. 95-989, at 116–17 (1978), *reprinted in* 1978 U.S.C.C.A.N. (92 Stat. 2549) 5787, 5903.

91. 4 WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW AND PRACTICE § 81:1 (William L. Norton III ed., 2d ed. 2007).

92. *See* Margaret Sheneman & Cecily A. Dumas, *Equipment Leasing and the Bankruptcy Code*, *in* 1 EQUIPMENT LEASING – LEVERAGED LEASING § 7-1, 7-98 (Ian Shrank & Arnold G. Gough eds., 4th ed. 2002). It is important to note, however, that § 1110 "merely provide[s] an exception to the automatic stay and collateral use provisions of sections 362 and 363; [it] does not insulate the transportation equipment financier from the other provisions of the Bankruptcy Code." *Id.* at 7-107.

93. 11 U.S.C. § 1110(a) (2004).

94. 11 U.S.C. § 1110(c)(1).

95. 11 U.S.C. § 1110(a)(1) (emphasis added).

96. 11 U.S.C. § 105(a) (2009). *See also* United Airlines, Inc. v. U.S. Bank N.A., 406 F.3d 918, 922 (7th Cir. 2005) ("This takes aircraft out of the automatic stay, see 11 U.S.C. § 362, and entitles secured lenders and financing lessors to repossess their collateral. There are only two exceptions. Section 1110(b), which we have mentioned, says that the creditor or lessor may agree to allow the debtor to continue using the equipment. This is how [the debtor] has retained the aircraft so far. Section 1110(a)(2), the other exception, gives the debtor 60 days after the bankruptcy begins to come current on its payments and provides that, if the debtor thereafter makes all payments called for by the contracts, it may retain the airplanes. [The debtor] is not paying the full amount required by these leases, so § 1110(a)(2) does not assist it.").

longer worry about possible repossession by creditors, effectively ending the creditors' veto power of reorganization.

Although § 1110 eliminated financiers' veto power of reorganization by greatly narrowing their right to repossess, § 1110 still provided a way for financiers to repossess but only under very strict standards. Section 1110 provides certain financiers with the right to repossess certain aircraft and equipment under the terms of their pre-petition agreements with two exceptions: if within sixty days of the commencement of the relief proceedings, the debtor either: (1) "agrees to perform all obligations of the debtor under [the] security agreement" and cure all pre- and post-petition defaults; or (2) agrees, with the secured party or lessor whose right to possess is protected, to extend the sixty-day period specified.[97] If the debtor fails to agree to perform or to negotiate an extension, the automatic stay of § 362 does not apply and the financier may recover its collateral to the extent governed by the pre-petition financing arrangement.[98]

Thus, §1110 is somewhat unusual in the scheme of the Code in that it takes the "adequate protection" concept of §§ 362 and 363 further than usual. Whereas the Code ordinarily provides for payments or other forms of compensation that are minimally sufficient to maintain the value of the creditor's claim relative to its collateral, § 1110 "basically rewrites the concept of 'adequate protection' in the context of qualifying aircraft equipment . . . to provide the secured creditor [or] lessor with precisely what it bargained for: compliance with the terms of any relevant . . . agreement . . . , or return of the property."[99] The legislative history for the enactment of § 1110 expressly clarifies this:

[t]he major differences for transportation equipment security interests is that the proposed section defines more precisely what constitutes adequate protection. It is the payments and duties of the debtor called for under the security agreement. In the case of a lease, the protection is the same afforded other lessors, but the trustee is required to make a decision within 60 days of the order of relief.[100]

97. 11 U.S.C. § 1110(a)–(b) (2006); *see also* Sheneman & Dumas, *supra* note 92, at, 7-106 ("As a practical matter, the value of the financier's or lessor's right to repossess the equipment depends on the market for resale or re-lease of the equipment at the time the debtor's sixty-day period has expired. For example, the financier may prefer to have the debtor operate the aircraft during a Chapter 11 case under a month-to-month rent stipulation, rather than have the aircraft sit idle at the end of the runway after repossession.").

98. 11 U.S.C. § 1110(c)(1).

99. 7-1110 COLLIER ON BANKRUPTCY, *Relationship Between § 1110 and Other Provisions of the Code*, ¶ 1110.05 (15th ed. 2007).

100. H.R. REP. NO. 95-595, at 239–40 (1977).

Moreover, any post-petition default must be cured within thirty days.[101] The transaction from which the default flows must be an equipment security interest, a conditional sale, or a lease to qualify for the protections, and the pre-petition security or lease agreement must give the financier the right to repossess.[102]

Therefore, while limited in scope and applicability, § 1110 is a potent section within the Code.[103] This is exemplified by Congressional treatment of § 1110, as "Congress obviously knew what it was doing when it gave special protection to aircraft financiers. In each of the amendments in 1978, 1994, and 2000, respectively, Congress broadened the scope and applicability of § 1110."[104] Any lease or security interest in aircraft falls under the aegis of § 1110—Congressional 1994 amendments specifically clarified the issues created by the debtor challenges based on the previous § 1110 language in the Pan Am and Continental insolvency proceedings of the early 1990s where it was unclear whether creditors' actions to recover aircraft and equipment leased in sale-leaseback transactions were exempted from the automatic stay of the operation of § 1110.[105] The 1994 amendments also clarified that the rights of a § 1110 creditor are not intended to be limited by the effects of a § 1129 "cramdown" in the reorganization process.[106] Section 1129 normally requires that all creditors have their interests met by either accepting the reorganization plan or receiving their fair share; however, the confirmation requirements of § 1129 do not apply with the 1994 amendments to § 1110.[107] Lastly, after the initial sixty-day stay period under § 1110 expires, any subsequent breach of the lease or loan terms gives the secured party an immediate and unqualified right to retake possession and control.[108]

101. 11 U.S.C. § 1110(a)(2)(B)(ii)(I) (2004).

102. 11 U.S.C. § 1110(a)(1).

103. Kilborn, *supra* note 7, at 46 ("Given the significant value of transportation equipment to a carrier's estate—either in operating the carrier's business or in producing proceeds from assignment of the carrier's rights under an unexpired lease—debtors have a powerful incentive to fulfill these conditions.").

104. Vanguard Airlines, Inc. v. Int'l Aero Components, Inc. (*In re* Vanguard Airlines, Inc.), 295 B.R. 908, 919 (Bankr. W.D. Mo. 2003).

105. *In re* Pan Am Corp., 929 F.2d 109 (2d Cir. 1991); *In re* Continental Airlines, Inc., 932 F.2d 282 (3d Cir. 1991).

106. *See* 11 U.S.C. § 1129 (2006); *see also* Ripple, *supra* note 85, at 296.

107. Bankruptcy Reform Act of 1994, Pub. L. 103-394, § 201, 108 Stat. 4106, 4119 (1994).

108. *See* Ripple, *supra* note 85, at 296.

VI. BACKGROUND OF CROSS-BORDER INSOLVENCIES UNDER THE U.S. CODE

Varig commenced its bankruptcy proceedings in the United States under former § 304 of the Code, a code that has had a major effect on the landscape of international insolvencies, albeit a sometimes unpredictable effect.[109] The now repealed § 304 authorized the initiation of a U.S. case ancillary to an existing foreign proceeding commenced by the filing of a petition by a foreign representative of the debtor.[110] The ancillary proceeding was meant to prevent a duplicative effort by the U.S. Bankruptcy Court in cases where main proceedings have already been filed in another country, and it aimed to be a "more efficient and less costly alternative" to initiating a full bankruptcy case.[111] Although ancillary proceedings did not automatically trigger stay protections, nor did they automatically grant the petitioner powers of avoidance or create an estate,[112] § 304 was intended to protect a foreign debtor's assets in the United States by preventing "the piecemeal distribution of assets in the United States by means of legal proceedings initiated in domestic courts by local creditors."[113]

Stay requests could be made in the ancillary proceeding, but were analyzed on a discretionary basis by the bankruptcy judge using the guidance provided by § 304. The court, *at its discretion*, had the ability to enjoin the commencement or continuation of any action or the enforcement of a judgment against the debtor concerning property involved in the proceeding, order turnover of such property to the foreign representative, or order any relief it deems proper.[114]

Section 304 outlines six factors for the court to consider when determining whether to grant a foreign representative's petition for relief:

(1) just treatment of all holders of claims against or interests in

109. Petition Pursuant to 11 U.S.C. § 304, *supra* note 4, at 1. Act of Nov. 6, 1978, P.L. 95-598, Title 1, § 101, 92 Stat. 2560, *repealed by* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, P.L. 109-8, Title VIII, § 802(d)(3), 119 Stat 146. Section 304 was good law at the time of the filing of the ancillary proceeding in the Bankruptcy Court of the Southern District of New York. Chapter 15 (Ancillary and Cross-Border Proceedings) of 11 U.S.C. § 1501 et seq. did not go into effect until October of 2005 with the enactment of the BAPCPA, so the *Varig* case was conducted under the provisions of § 304.

110. 11 U.S.C. § 304(a).

111. Cunard S.S. Co. v. Salen Reefer Servs. A.B., 773 F. 2d 452, 456 (2d Cir. 1985). *See generally* Joseph Samet, *Multinational Insolvencies*, *in* EMERGING ISSUES IN WORKOUTS & BANKRUPTCIES 2005 at 337 (2005) (program to Practicing Law Institute's 2005 workshop on workouts and bankruptcies; provides a background on proceedings initiated under § 304).

112. *See* Samet, *supra* note 111, at 337.

113. *In re* Koreag, Controle et Revision S.A., 961 F. 2d 341, 348 (2d Cir. 1991).

114. 11 U.S.C. § 304(b) (repealed 2005).

such estate;

(2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;

(3) prevention of preferential or fraudulent dispositions of property of such estate;

(4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;

(5) comity; and

(6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.[115]

Naturally, conflicts arise between debtors and creditors—as they did in the Varig ancillary proceeding—when a foreign debtor requests injunctive relief under § 304 and the creditor protests, arguing that it should not have to sacrifice remedies available to it under the U.S. Code simply because a foreign proceeding is underway elsewhere.[116] In these cases, the U.S. Bankruptcy Court must decide which of the above § 304(c) factors are applicable and the weight to give each of them when determining whether to defer to the jurisprudence of the foreign proceedings and grant the relief requested by the foreign representative.[117]

Comity is given great deference[118] by a U.S. bankruptcy court in considering whether to defer to the foreign jurisdiction, and comity will be accorded so long as the foreign court is of competent jurisdiction and

115. 11 U.S.C. § 304(c) (repealed 2005).

116. *See* Samet, *supra* note 111, at 345. For examples of courts applying the § 304 factors to the facts of the cases at hand, see *In re* Parmalat Secs. Litig., 472 F. Supp. 2d 582 (S.D.N.Y. 2007) and *In re* Petition of Davis, 191 B.R. 577 (Bankr. S.D.N.Y. 1996).

117. *See, e.g.*, *In re* Rubin, 160 B.R. 269, 283 (Bankr. S.D.N.Y. 1993) (enjoining all actions by creditors against the debtor's property in the United States and holding that as long as "as the laws of the foreign jurisdiction are not repugnant to our own, there is a distinct judicial preference for deferring to the foreign tribunal litigation respecting the validity or the amount of the claims against the foreign debtor"). *But cf. In re* Hourani, 180 B.R. 58 (Bankr. S.D.N.Y. 1995) (denying a foreign representative's § 304 petition on grounds that the foreign liquidation proceedings lacked minimum safeguards for creditors when it did not distinguish between secured and unsecured creditors in prioritization of claims); Treco v. Bank of New York, 240 F. 3d 148 (2d Cir. 2001) (declining to extend comity to Bahamian courts, reasoning that comity did not hold greater weight than the other factors of § 304(c) and that the Bahamian bankruptcy laws did not substantially accord with the priority given secured claims in the United States).

118. BALLENTINE'S LAW DICTIONARY (3d ed. 1969) ("Literally, courtesy or civility, to which the law adds some refinements in defining the term for the purposes of conflicts of laws and international law: Neither a matter of absolute obligation on the one hand nor a mere courtesy and good will on the other, but the recognition which one nation or state allows within its territory to the legislative, executive, or judicial acts of another nation or state, having due regard both to international duty and convenience and to the rights of its own citizens or of other persons who are under the protection of its laws.").

the laws and public policy of the home forum are not violated.[119] Comity is not, however, to take automatic precedence over the other factors of § 304(c), but rather should be considered in light of all of the factors that Congress provided.[120]

Numerous commentators have examined the circumstances under which courts should either defer to foreign proceedings or decline to grant comity in favor of public policy arguments.[121] Section 304(c)(2) is commonly cited as the source of the "escape clause" reasoning that courts use to abjure foreign law and apply local law instead. The escape clause is a public policy exception that "provides that if application of the law chosen by the relevant conflicts rule would violate the public policy of the forum state, the court can choose to apply forum law instead."[122] However, courts have not been consistent in their determinations of what constitutes a public policy violation significant enough to warrant not extending comity.[123] While no fixed rule exists, predictability is necessary to reach uniform results and thus allow for more stability in cross-border financing.[124]

Also significant to the concept of comity analysis is the extent to which a foreign proceeding might discriminate against a U.S. creditor. For instance, when a court grants a petition for a protective stay as part of the initiation of an ancillary proceeding under § 304 of the Code—which would ordinarily be circumvented by a financier under the protections of § 1110—the financiers are arguably discriminated against in the sense that they are left in a significantly worse position than they would be under a U.S. main proceeding. However, New York courts in particular are inclined to defer to the foreign proceeding, so convincing

119. *See In re* Culmer, 25 B.R 621, 628 (Bankr. S.D.N.Y. 1982) (granting petition of foreign representative on grounds that no prejudice to creditors was shown by foreign proceedings and reasoning that their primary consideration was "whether the relief petitioners seek will afford equality of distribution of the available assets")

120. *See, e.g.*, *In re* Caldas, 274 B.R. 583 (Bankr. S.D.N.Y. 2002) (reasoning that comity, considered in conjunction with the other § 304(c) factors, was not at odds with granting deference to the foreign proceedings); *In re* Application of Papeleras Reunidas, S.A., 92 B.R. 584 (Bankr. E.D.N.Y. 1988) (holding that comity should not be accorded when Spanish law prejudiced American creditors under the other factors of § 304).

121. *See, e.g.*, Hannah L. Buxbaum, *Rethinking International Insolvency: The Neglected Role of Choice-of-Law Rules and Theory*, 36 STAN. J. INT'L L. 23 (2000); Sandeep Gopalan, *Transnational Commercial Law: The Way Forward*, 18 AM. U. INT'L L. REV. 803 (2003).

122. *See* Buxbaum, *supra* note 121 at 40.

123. *See, e.g.*, *In re* Toga Mfg., 28 B.R. 165, 168 (Bankr. E.D. Mich. 1983) (refusing to defer to a foreign proceeding in which a local creditor was recognized as holding a secured claim under U.S. law but would be an "ordinary" (unsecured) creditor under foreign law); Overseas Inns v. United States, 911 F.2d 1146 (5th Cir. 1990) (stating that foreign law would have implicated public policy, unrelated to bankruptcy, favoring payment of income taxes).

124. Buxbaum, *supra* note 121, at 55.

them of discrimination will likely require showing proof of a "transaction which is inherently vicious, wicked or immoral, and shocking to the prevailing moral sense."[125]

VII. THE PETITION OF VARIG AIRLINES COMMENCE A CASE UNDER 11 U.S.C. § 304

The § 304 proceedings in the *Varig* case provide significant insight into the handling of such international insolvency cases under U.S. law. On June 17, 2005 (the Filing Date), Vicente Cervo, the foreign representative of Varig, filed a petition in the Bankruptcy Court of the Southern District of New York (the "U.S. Court") to commence a case ancillary to a foreign main proceeding in Brazil under the auspices of § 304 of the Code, Case No. 05-14400 (RDD).[126] The petition coincided with the filing of applications by Varig for the commencement of judicial reorganization proceedings (the "Foreign Proceeding") in the Commercial Bankruptcy and Reorganization Court in Rio de Janeiro (the Brazilian Court) pursuant to the NBRL.[127]

Varig sought the U.S. Court's protection principally to enjoin aircraft and engine lessors and the financiers from repossessing the equipment; at the time of filing, pre-petition claims by Varig's creditors were in the tens of millions of dollars on past-due rent and maintenance reserves.[128] Varig intended to extend the protective orders of the Brazilian Court to make them enforceable in the United States against property and creditors subject to U.S. jurisdiction.[129] Thus, the petition sought to "obtain the assistance of [the] Court in protecting the property of Varig for the benefit of all its creditors."[130] It further asserted that as part of the

125. Intercontinental Hotels Corp. v. Golden, 203 N.E.2d 210, 212 (N.Y. 1964) ("[F]oreign-based rights should be enforced unless the judicial enforcement of such a [right] would be the approval of a transaction which is inherently vicious, wicked or immoral, and shocking to the prevailing moral sense.").

126. Petition Pursuant to 11 U.S.C. § 304, *supra* note 4, at 1.

127. *Id.* at 9. Judge Alexander dos Santos Macedo of the Commercial Bankruptcy and Reorganization Court issued an interim order (a *medida liminar*) in compliance with the NBRL on the Filing Date. The interim order—similar to a temporary restraining order in the United States—specifically restrains aircraft creditors from seizing or interfering with Varig's use of equipment essential to its operations. *See* Lobo et al., *supra* note 5, at 43.

128. *See* Lobo et al., *supra* note 5, at 42; Basch, *supra* note 2, at 38 ("Another significant portion of Varig's pre-filing debt with lessors arose from prior rescheduling plans that Varig had negotiated for repayment of unpaid rent over time.").

129. Lobo et al., *supra* note 5, at 72 ("This was particularly critical in Varig's case, because nearly all of the aircraft creditors were located in the United States and could have repossessed their equipment at any of the three U.S. airports where Varig landed.").

130. Petition Pursuant to 11 U.S.C. § 304, *supra* note 4, at 1.

judicial reorganization under the NBRL, the debtor is permitted to remain in control of its business and properties and is protected by a stay from the attempts of most creditors to enforce claims against the debtor.[131] Through its foreign representative, Varig outlined the shell of a reorganization plan and claimed that the stay of proceedings, if granted, would provide the "breathing space" necessary for it to complete its restructuring and rework its balance sheet.[132]

Varig argued that its anticipated reorganization plan would provide for the fair treatment of creditors, result in a creditor-approved restructuring of the debtor capital structure, and create a financially stable reorganized airline.[133] A stated goal of the petition was to reduce the costs of litigation by funneling all claims through the Brazilian Court for adjudication, and accordingly, the foreign representative requested injunctive relief to enable Varig to devote its resources to reorganizing rather than litigating in the United States.[134] The petition specifically referenced five of the factors set forth in § 304(c), and, without elaborating further, claimed that the grant of relief by the U.S. Court would satisfy each of the factors by contributing "to an economical and expeditious administration of the foreign estates."[135] On 17 June 2005, the U.S. Court entered a temporary restraining order, granting Varig's requested relief pending further consideration of the parties' arguments and briefs.[136]

Varig's creditors in the United States immediately countered with objections to the temporary restraining order entered by the U.S. Court.[137] Financiers accustomed to the protections afforded to them by § 1110 of the Code petitioned for relief from the stay and the right to have

131. *Id.* at 9.

132. *Id.* at 11.

133. *Id.*

134. *Id.* at 12.

135. *Id.*

136. Temporary Restraining Order, *In re* Petition of Vicente Cervo, as Foreign Representative of Varig, S.A., et al., No. 05-14400 (Bankr. S.D.N.Y. 2005).

137. *See, e.g.*, Objection of the Boeing Company to Temporary Restraining Order, *In re* Petition of Vicente Cervo, as Foreign Representative of Varig, S.A., et al., No. 05-14400 (Bankr. S.D.N.Y. 2005) (arguing, *inter alia*, that the filing of the § 304 proceeding was premature and thus invalid, as Varig had not fulfilled all of the filing requirements in Brazil, nor had it had its foreign representative approved by the Brazilian Court. It further argued that Article 199 of the NBRL does not suspend the rights resulting from mercantile leases of aircraft and so it should be permitted to pursue its rights of repossession.); Objection of International Lease Finance Corporation to Further Continuation of Temporary Restraining Order at 9, *In re* Petition of Vicente Cervo, as Foreign Representative of Varig, S.A., et al., No. 05-14400 (Bankr. S.D.N.Y. 2005) (arguing that § 304(a) is inapplicable as no foreign proceeding is pending due to filing failures; arguing also that the debtors wrongly characterize the aircraft leases as not being "mercantile" leases and that the operating leases should not be subject to a stay under the foreign proceedings.).

any faults cured or to repossess their aircraft or equipment.[138] The lack of an analogous provision to § 1110 in the NBRL (Article 199 notwithstanding) led the creditors to argue that the U.S. Court should not recognize the Brazilian proceedings because the NBRL did not protect claimholders in the same manner to which they were accustomed under the Code.[139]

The Varig's financiers made three basic arguments in their briefs to the U.S. Court. The first, primarily procedural, was that Varig had not met the burden of properly filing the assorted paperwork required by the NBRL for a proceeding to commence; if no foreign proceeding was properly initiated, then necessarily no ancillary proceeding could follow.[140] The second argument centered around § 1110 and the protections afforded therein.[141] The third argument revolved around the way in which both the Brazilian Court and the U.S. Court handled pre- and post-filing debt obligations.[142]

While undoubtedly a matter of great importance to all parties involved, ultimately the issues regarding the proper filing of the suit were resolved in the Brazilian courts and the case proceeded apace in both Brazil and New York. This Article focuses not on this procedural line of protest from the creditors, but rather the substantive argument of the financiers centered on the perceived inequities of applying Brazilian law, and the way that would affect the rights available to the creditors regarding their collateral. Varig's foreign representative relied heavily on the argument that § 304 of the Code authorized the U.S. Court to grant relief in the form of continuation of the initial preliminary injunction. In particular, it pointed to the flexibility afforded courts to "broadly mold appropriate relief in near blank check fashion."[143] This conflict of opinion formed the main argument between the parties regarding the aircraft collateral and was the crux of the case.

138. *See* Lobo et al., *supra* note 5, at 43.

139. *Id.*; s*ee, e.g.*, Objection of the Boeing Company to Temporary Restraining Order, *supra* note 136.

140. *See, e.g.*, briefs cited *supra* note 13.

141. *See, e.g.*, Objection of U.S. Bank National Association, U.S. Bank Trust National Association and Wells Fargo Bank, N.A., as Trustees, to the Temporary Restraining Order or Preliminary Injunction at 7, *In re* Petition of Vicente Cervo, as Foreign Representative of Varig, S.A., et al., No. 05-14400 (Bankr. S.D.N.Y. 2005) (arguing that no power of the court may affect the rights of creditors protected under § 1110). *See* Lobo et al., *supra* note 5, at 43.

142. *See* Basch, *supra* note 2, at 38 (noting that when post-filing defaults on debt should give the creditor the right to possess, Brazilian courts found ways to prevent them from doing so in order to protect Varig as a going concern).

143. Memorandum of Law in Support of Continuation of Preliminary Injunction, *In re* Petition of Vicente Cervo, as Foreign Representative of Varig, S.A., et al., No. 05-14400 (Bankr. S.D.N.Y. 2005) (citing *In re* Culmer, 25 B.R. 621, 624 (Bankr. S.D.N.Y. 1992)).

In an attempt to satisfy both parties, instead of extending the protections of § 1110 to the aircraft financiers as they had petitioned, the U.S. Court crafted a "contingency return plan" that purported to approximate some of the protections of § 1110.[144] Varig was required to prepare a schedule that showed the location of each asset and granted a priority claim for any damages incurred as a result of missing parts or maintenance documents. The U.S. Court directed Varig to seek to have the contingency return plan, including the grant of priority claim, approved by the Brazilian Court. The Brazilian Court approved the plan, but the plan did not provide the relief that the financiers were seeking; namely, it neither required the debtor to come current on arrearages and default terms incurred pre-petition, nor granted creditors the option of repossessing after the prescribed cure period.[145]

VIII. OUTCOME ANALYSIS

The *Varig* Court, in extending comity to the debtor's application, determined that the foreign main proceeding sufficiently protected creditor interests and that U.S. public policy considerations were not infringed. Comity, while an important (indeed, perhaps the *most* important) factor of the six § 304 factors, does not trump all others, and the U.S. Court in Varig considered each of the factors, especially "protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding."[146]

A. Section 304 and Modified Universalism

Section 304, propagated as an embracing of "modified universality" by Congress in the 1978 Bankruptcy Reform Act, purports to assist the foreign representative undertaking a foreign proceeding while still preserving the discretion of the local court to protect the interests of local creditors.[147] However, because of the broad flexibility given to the court (indeed, the very flexibility that the foreign representative espoused in its motion to continue the preliminary injunction), the actual application of

144. Preliminary Injunction Order, *In re* Petition of Vicente Cervo, as Foreign Representative of Varig, S.A., et al., No. 05-14400 (Bankr. S.D.N.Y. 2005).

145. *See* Lobo et al., *supra* note 5, at 72.

146. 11 U.S.C. § 304(c)(2) (2004). In cases where U.S. courts ultimately did not defer to the law of the primary proceeding state, this section was most commonly cited as the basis for the decision. *See, e.g.*, Interpool, Ltd. v. Certain Freights, 102 B.R. 373 (D. N.J. 1988); *In re* Toga Mfg.., Ltd., 28 B.R. 165 (Bankr. E.D. Mich. 1983).

147. Buxbaum, *supra* note 121, at 29.

the law in ancillary proceedings in the United States has been somewhat unsystematic.[148] This of course has the potential to lead to unpredictable outcomes, which in the world of finance—especially aircraft finance—is a dangerous thing.[149]

Modified universalism is a philosophy of international insolvency jurisprudence that tempers a purely universal approach (advocating using the law of only a single forum in adjudicating insolvency proceedings) with an acknowledgement that in certain circumstances a local proceeding and local forum rules may need to be applied.[150] The U.S. system is a modified universalist approach, recognizing the need to acknowledge foreign debtor proceedings in foreign courts (per § 304 and now Chapter 15 of the Code) while maintaining a territorialist option for protecting local creditors from unfairness or prejudice in those proceedings (per § 304(c)(2)).[151] Section 304 does not provide a bright-line rule for judges regarding the way to apply the decision-making process when evaluating the protections afforded local creditors versus the deference to grant to the foreign proceeding.[152] Each case in a § 304 ancillary proceeding involves the application of the law by the presiding judge on an ad-hoc basis.

Although courts are overwhelmingly likely to defer to the foreign proceedings, courts in the United States nonetheless will use public policy exceptions—the above mentioned "escape clauses"—to ensure fair results in the local forum when the foreign law would render an injustice.[153] As Hannah Buxbaum says:

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148. *Id.* at 30.

149. *Id.* ("Although the fair resolution of any individual case is of course desirable, unpredictability of outcome is not. This is especially true in international bankruptcy, where uncertainty as to the possible consequences of a debtor's bankruptcy renders creditor planning difficult and cross-border lending unduly risky.").

150. *See id.* at 27.

151. *See id.*; *see also* John A. E. Pottow, *Procedural Incrementalism: A Model for International Bankruptcy*, 45 VA. J. INT'L L. 935, 951 (2005) ("A critical problem that universalism faces . . . stems from the ongoing allure of territorialism to sovereignty-conscious states. Many states will be happy to apply their own bankruptcy laws broadly to the resolution of an international dispute, but few want to cede their sovereignty over the same dispute when they are deemed to be in the ancillary position.").

152. In a purely universal or purely territorial insolvency system, the choice for a judge would be clear: in universal proceedings, the law of the foreign forum prevails; in territorial systems, the local forum law governs. *See* Buxbaum, *supra* note 121, at 31–32.

153. *See* Buxbaum, *supra* note 121, at 46; *see also* Pottow, *supra* note 151, at 952 (pointing out that the challenge to pure universalism is getting courts to accept outcome differences; that is, "the commitment of rationally selfish states - which generally prefer to see their own substantive bankruptcy laws govern - to cede sovereignty when another state has been chosen to control an international bankruptcy dispute, even though such a concession may produce a different substantive outcome to the bankruptcy for the deferring state's participants"). This reluctance to cede sovereignty manifests itself in multilateral or modified universal systems that allow public policy exceptions

> In a sense, public policy is merely the flip side of comity: Where comity is viewed as a reason to accept a choice leading to the application of the laws of another nation, public policy is viewed as a reason to refuse that choice, preferring instead to apply the laws of one's own.[154]

While Congress explicitly embodied the public policy escape clause into the Reform Act of 1994 with the language of § 304, the lack of system-wide predictability creates problems in the arenas of international financing and transaction costs.[155] In order to establish general predictability for parties, "only if the application of a particular foreign law contravenes a public policy of the United States should a court refuse to effectuate the choice of law resulting from the selection of jurisdiction."[156] As discussed below, the § 1110 provisions are those that the financiers argued should be preserved as public policy exceptions during cross-border insolvency proceedings.

B. Cases Addressing Comity Considerations

Cases in which U.S. courts have declined to defer to foreign main proceedings under § 304 and principles of comity acknowledge the primacy of comity and international cooperation as factors, but are careful to point out that the other tests of § 304(c) must be given due consideration in order to prevent § 304(c) from being "effectively eliminated from the statute, violating '[the court's] duty to give effect, if possible, to every clause and word of a statute'."[157] Courts generally recognize that the priority, preference, or automatic stay rules of a foreign main proceeding need not be identical to those of the Code, as demanding pure equivalence would be akin to reverting to territorialism

when needed to protect local creditors.

154. *See* Buxbaum, *supra* note 121, at 46.

155. *See id.* at 48 ("[A]ny court considering which law to apply to a particular case should reach the same result, and that result should be predictable. These advantages are particularly relevant to the resolution of international bankruptcy proceedings. If domestic creditors know that a local action (whether a local bankruptcy proceeding or an action to attach a debtor's assets) will be subordinated to the bankruptcy proceeding initiated in the debtor's home jurisdiction, they will be less likely to initiate such actions, thereby increasing the likelihood that the estate will remain intact. In addition, if creditors are aware in advance of the jurisdiction to which any future bankruptcy proceeding concerning the debtor will be assigned, they will be able to enter into their financing arrangements with an appreciation of the likely results of debtor insolvency.").

156. *Id.* at 58.

157. In re Treco, 230 F.3d 148, 157 (2d Cir. 2001) (quoting United States v. Gitten, 231 F.3d 77, 80 (2d Cir. 2000)).

and would offend the spirit of international cooperation. However, the factors of § 304(c) (or of the current § 1507) are not to be thrown aside in a blind rush to confer comity on an ancillary proceeding. Courts must "consider differences between American . . . rules and those applicable to the foreign proceeding in determining whether affording comity will be repugnant to American public policies," and then "consider the effect of the difference in the law on the creditor in light of the particular facts presented."[158]

i. In re Maxwell Communication Corp.

The court in *In re Maxwell Communication Corp.* looks beyond the statutory factors for comity extension and considers broader public policy implications including the impact on the parties and forums involved. In fact, the case is one of the most important modern cross-border insolvency cases to address a wide range of dueling foreign law considerations using principles of comity analysis.[159] After the controversial death of Robert Maxwell, a prominent publisher and businessman whose many business interests were headquartered in London but whose assets were largely located in the U.S., a Chapter 11 proceeding was brought in the U.S. simultaneously with an administration in the United Kingdom.[160]

The *Maxwell* court addressed the primary considerations of comity in determining that it should defer to the courts and England law on a question of avoidance of pre-petition transactions.[161] The court began by establishing that "[w]hen construing a statute, the doctrine of international comity is best understood as a guide where the issues to be resolved are entangled in international relations."[162] It then argued that "international comity" is a "canon of construction [that] might shorten the reach of a statute."[163] In *Maxwell*, the court was concerned that the U.S. system should not take precedence if it appeared clear that English law should apply based on concern for the international system as a whole functioning properly. In other words, the court reasoned that unless Congress legislates specifically against it, the doctrine of comity may properly be used to analyze any statute in proceedings with foreign

158. *Id.* at 158–59.
159. *In re* Maxwell Commc'n Corp., 93 F.3d 1036 (2d Cir. 1996).
160. *Id.*; *see also* Jay Lawrence Westbrook, *The Lessons of Maxwell Communication*, 64 FORDHAM L. REV. 2531, 2534 (1996).
161. *In re* Maxwell Commc'n Corp., 93 F.3d 1036.
162. *Id.* at 1047.
163. *Id.*

ties. In particular, the court stated:

Comity is especially important in the context of the Bankruptcy Code for two reasons. First, deference to foreign insolvency proceedings will, in many cases, facilitate "equitable, orderly, and systematic" distribution of the debtor's assets . . . . Second, Congress explicitly recognized the importance of the principles of international comity in transnational insolvency situations when it revised the bankruptcy laws.[164]

Having determined that a true conflict exists between U.S. and English law (namely, English avoidance law requires a pre-petition transfer to have been made with intent to benefit the creditor, whereas § 547 of the Code has no such requirement), the court went on to argue that under the facts, English law had primacy to the dispute and thus should apply. Looking at the location of the debt, overdraft facilities, and other credit transactions, as well as choice of forum clauses in the agreements between the debtor and creditors, the court believed that the interests of the U.S. forum were not compelling enough to warrant applying § 547 preference avoidance.[165] "The principal policies underlying the Code's avoidance provisions are equal distribution to creditors and preserving the value of the estate through the discouragement of aggressive pre-petition tactics causing dismemberment of the debtor," the court reasoned; and as the English court effectuated those same policies with its laws, the court deferred to the English primacy of interest.[166]

The court concluded by reasoning that in addition to the strong jurisdictional interests of the English forum, the spirit of international cooperation "argues decidedly against the risk of derailing that cooperation by the selfish application of our law to circumstances touching more directly upon the interests of another forum."[167] In *Maxwell*, therefore, the test for extension of comity was based less on the specific factors enumerated in § 304(c) and more on the balance of interests involved for each party and each forum country.

It is important to note, however, the extent to which the court applied a balancing test when choosing the applicable law to use. While in *Maxwell*, the U.S. contacts were deemed so insignificant as to preclude the application of U.S. law, the court analyzed the U.S. and English law and determined that a true conflict does exist between the competing

164. *Id.* at 1048.
165. *Id.* at 1051–52.
166. *Id.* at 1052.
167. *Id.* at 1053.

insolvency procedures, thus compelling the use of comity principles.[168] In the instant case, the court determined that the U.K. contacts to the case had primacy over the U.S. contacts,[169] and in fact, the court characterized the linkage to U.S. interests as "not particularly weighty" and stated that the "negative effects [of not applying the Code] are insubstantial."[170] Lawrence Westbrook speculates that had the U.S. interests been greater, the choice of law analysis would have been more closely addressed:

If, for example, the record in Maxwell had shown that the banks had forced the company to make payments by liquidating important United States operations, thereby putting United States creditors, employees, and communities at risk, then interests to which the preference laws are relevant would have been implicated.[171]

The implication for the Varig creditors, perhaps, is that had they been able to demonstrate a greater connection to the United States, the court may have been more inclined to apply U.S. law.

ii. In re Treco

In *In re Treco*, U.S. interests were weighed more heavily and the case establishes that perhaps the protection of U.S. creditors is valued higher than comity interests. Unlike in *Maxwell*, the court in *Treco* analyzed the § 304(c) factors in detail when considering a turnover request in a Bahamian main proceeding and a U.S. ancillary proceeding.[172] At issue was the priority of the secured claim of a U.S. creditor.[173] Under Bahamian insolvency law, the secured claim was subordinated to administrative expenses arising from the proceeding, whereas under the Code, a secured creditor's interest is not relegated to a lower priority than most administrative claims, and thus can usually

168. *Id.* at 1049.

169. *Id.* at 1051 ("England has a much closer connection to these disputes than does the United States. The debtor and most of its creditors—not only the beneficiaries of the pre-petition transfers—are British. Maxwell was incorporated under the laws of England, largely controlled by British nationals, governed by a British board of directors, and managed in London by British executives . . . . These same factors, particularly the fact that most of Maxwell's debt was incurred in England, show that England has the strongest connection to the present litigation.").

170. *Id.* at 1052.

171. Westbrook, *supra* note 160, at 2537 ("[I]t must be conceded that the result is essentially a case-by-case choice-of-law analysis. That approach pays the price of unpredictability to avoid the harmful consequences of a mechanical territorial rule.").

172. *In re* Treco, 240 F.3d 148 (2d Cir. 2001).

173. *Id*. at 161. Note that for the purposes of its reasoning and arguments concerning secured claims, the court assumed that BNY's claim was in fact secured. They ultimately remanded this case for the lower court to decide that important point. *Id.*

count on receiving the full value of its collateral.[174] While the debtor's estate argued that comity was the primary factor to be considered under § 304(c), the court reasoned that the Code calls for a fact-specific inquiry in light of all of the circumstances.[175] While "comity is the ultimate consideration in determining whether to provide relief under § 304 . . . [t]he statute plainly provides that the other factors may form the basis for denying relief, and thus denying comity, in some cases."[176] In addressing the facts of the case, the court recognized that "[i]t is implicit in the concept that deference should be withheld where appropriate to avoid the violation of the laws, public policies, or rights of the citizens of the United States."[177]

The court then dismissed the first three factors of § 304(c) as presenting no obstacle to the granting of comity to the Bahamian proceedings: "[t]here being no reason to doubt that the insolvency proceeding in the Bahamas will be fair, impartial, procedurally sound, and free from fraud, there is no question that comity would be extended and the turnover order issued if our scrutiny of Bahamian bankruptcy law were limited to these considerations."[178] However, § 304(c)(4) indicates a Congressional decision to require courts to look beyond mere considerations of fairness and prejudice and to consider the specific effects of applying foreign insolvency law to a U.S. creditor, specifically in assessing the distribution of proceeds of an estate relative to how the Code would prescribe the distribution.

Because the court found from the facts that the administrative expenses of the estate were so large as to deplete the estate completely and deprive the secured creditor of the value of its claim, the distribution of proceeds "in the Bahamian proceedings would thus *not* be 'substantially in accordance with the order prescribed by' United States law."[179] The court's "observation that security interests enjoy constitutional protection supports [its] conclusion that United States law affords strong protection to secured creditors and treats those protections very seriously, a conclusion that, in turn, amplifies the significance of the difference in the way secured claims are treated under Bahamian law."[180] In the end, comity to the Bahamian court was held to be less important

174. *Id.* at 155.
175. *Id.* at 156.
176. *Id.* at 156–57.
177. *Id.* at 157.
178. *Id.* at 158.
179. *Id.* at 159 (*citing* § 304(c)(4)).
180. *Id.* at 160.

than the secured interest of the U.S. creditor, as the U.S. court found the Bahamian procedures too prejudicial to U.S. creditors' interests.

C. Public Policy and § 1110

For a court to decline to grant comity, the decision more properly is evaluated in terms of national interests than solely on the rights of any particular domestic creditor.[181] To be consistent with the goals of comity and modified universalism, the "trigger" for application of local law—here, § 1110—should be the actual violation of public policy.

Secured creditors have protections built into the Code that are derived from the Fifth Amendment of the U.S. Constitution.

The theory that the fifth amendment places substantive limits on the ability of the government to restrain secured creditors' rights in reorganization has crystallized into the following proposition: any impairment of the liquidation value of a secured creditor's collateral attributable to the exercise of powers conferred on the reorganization court by bankruptcy legislation is, in the absence of just compensation, a violation of the takings clause of the fifth amendment.[182]

Clearly, protecting secured creditors is of high importance from a public policy standpoint.

i. The public value of aircraft creditor priority

The United States has a legitimate interest in protecting secured creditors in the airline industry. Expanding on the prior discussion of the Congressional intention behind the enactment and continued refinement of the protections given by § 1110, courts might reasonably deduce that there is a high public value in giving "super-priority" to aircraft creditors in insolvency proceedings. The plain language of § 1110 indicates how preemptive the clause is relative to the rest of the Code:

> [T]he right of a secured party with a security interest in equipment . . . to take possession of such equipment, . . . and to enforce any of its rights and remedies . . . *is not limited or otherwise affected by any other provision of this title or by any power of the court*.[183]

181. Buxbaum, *supra* note 11, at 68.

182. James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 977 (1983).

183. 11 U.S.C. § 1110(a)(1) (2006) (emphasis added).

The Section trumps all comers in the Code; it is evidence of the importance placed on aircraft financiers rights' by Congress that the protections of § 1110 are not to be abridged by any other section of the Code. That, in and of itself, is an argument for handling its protections as instruments of public policy. In *United Airlines, Inc. v. U.S. Bank N.A.*, the court even went so far as to say that the phrase "any power of the court" was not limited purely to the bankruptcy court.

The final clause of § 1110(a)(1) prevents bankruptcy judges from using *any* source of law, including antitrust, as the basis of an injunction against repossession. United protests this understanding, observing that "power of the court" is the caption of the Code's § 105 . . . and contending that the language "any power of the court" thus must refer back to § 105. Yet that would drain all meaning from the phrase "any power of the court" in § 1110(a)(1), for the preceding language already blocks reliance on any other part of the Bankruptcy Code. Unless it is to be empty, the phrase "any power of the court" must deal with sources of law outside the Bankruptcy Code. It is not as if "power of the court" were a phrase limited to bankruptcy practice. It is generic language, logically read to mean exactly what it says: "*any* power of the court."[184]

Thus, under the plain language of the statute, Varig's creditors have the right to take possession of the collateral pursuant to their agreements with Varig, and those rights are not limited or otherwise affected by any other provision of the Code, or by any power of the court. Under the Seventh Circuit's theory, then, no external legal theory usurps the ability of the financiers to repossess under § 1110. The court in *In re Vanguard* elaborated further on this clause:

The legislative history of § 1110 provides further support demonstrating that the statute means what it says. Prior to the 2000 amendments, § 1110(a)(1) provided that the underlying agreement was "not affected by section 362, 363, or 1129, or by any power of the court to enjoin the taking of possession False" In 2000, Congress changed the wording of the statute, expressly deleting the limiting references to §§ 362, 363, and 1129 in favor of the all-inclusive language, "any other provision of this title." Thus, any argument for *expressio unius est exclusio alterius* that existed prior to 2000—i.e., that [a section] was not limited by § 1110 because [that section] was not specifically mentioned—certainly cannot prevail after the amendments. Indeed, under the rules of statutory construction, the more specific provisions in

184. United Airlines, Inc. v. U.S. Bank N.A., 406 F.3d 918, 924 (7th Cir. 2005) (emphasis in the original).

§ 1110—which concerns the relationship between a specific chapter, a specific class of creditors, and specific collateral—should take precedence over the more general provisions in [any other section].[185]

In other words, the legislative history of § 1110 reveals that its enactment was primarily motivated by public policy concerns.

ii. Collateral value and financing predictability

The question, then, is how the provisions of § 1110 further a legitimate public policy. Legal protection for collateralized securities has a direct effect on the availability of external financing options for airlines in developing and established financial markets.[186] As discussed, the airline industry depends heavily on outside investments to raise capital. Any legal reforms that encourage lending or secured financing increases liquidity, which adds value—the gains from which will in some part be passed back to the borrower.[187] Within the airline industry, practically all lenders require some sort of security to back a loan or lease contract, usually in the form of taking collateral in the underlying aviation asset.[188] Technologically advanced, expensive, rapidly depreciating and highly-mobile assets such as aircraft and aircraft engines have value as collateral largely to the degree that a financier can repossess them quickly and with minimal legal uncertainty upon debtor default, and then sell or re-lease the collateral.[189] The financing principles underlying the lender's ability to extend asset-backed financing are that a financier:

(1) should be able to determine and assure itself that its proprietary interest in a financed or leased asset is superior to all potential competing claims against that asset; (2) upon default, will be able to promptly realize the value of the asset and/or redeploy that asset for purposes of generating proceeds/revenues to be applied against amounts owed; and (3) will not have their rights described in (1) and (2) above qualified or modified in the context of bankruptcy or insolvency.[190]

In the United States, § 1110 guarantees to financiers that those

185. *In re* Vanguard, 295 B.R. at 916–17 (*citing* Pub. L. 106-181, Title VII § 744(b)).

186. Anthony Saunders et al., *The Economic Implications of International Secured Transactions Law Reform: A Case Study*, 20 U. PA. J. INT'L ECON. L. 309, 313. *See also* Kilborn, *supra* note 7, at 65–66 ("A reduction in section 1110 protections may advance general bankruptcy principles, but the gain to a relatively limited number of transportation debtors pales in comparison to the cost of sacrificing the substantial advantages of strong section 1110 protections for developing airlines.").

187. Saunders et al., *supra* note 186, at 313.

188. *See id.* at 315.

189. *See id.* at 317.

190. *See id.* at 316.

financing principles will be met in the event that default occurs. Saunders et al. argues that the § 1110 protections are significant in regards to the cost of external asset-backed financing "because the major international credit rating agencies will give a rating enhancement of up to two notches to debt issues so protected."[191] The lower credit and liquidity risks provided by § 1110 protection result in lowered spreads over the risk-free interest rate offered by lenders.[192] Arguably, then, § 1110 has a tangible effect on asset-backed financing within the airline industry that extends beyond the immediate benefits to the secured creditor in an insolvency proceeding; the external markets themselves reflect the security and predictability provided to lenders.[193] This predictability manifests itself favorably for the debtor as well, as premiums demanded by investors are lowered and capital is thus more readily available. The legal system, by enforcing § 1110, plays a substantial role in helping predictability remain constant when default occurs and a lender seeks to speedily repossess and enforce contractual rights.

D. Chapter 15 and Its Effect on the Case If Filed Today

Examining the *Varig* case from the perspective of the new Chapter 15 requirements for cross-border proceedings requires an analysis of the new test for extending or declining to extend comity to a foreign main proceeding. Debtors, creditors, and courts must determine whether the new language of the Code will lead to different outcomes for § 1110 creditors than what occurred under § 304 of the old Code.

Section 1506 specifically provides that "nothing in this chapter prevents the court from refusing to take an action governed by this

191. *See id.* at 323.

192. See *id.* at 331–33 for a discussion of the effects on Standard & Poor's index of airline stocks when the U.S. Bankruptcy Reform Act of October 22, 1994, was enacted. "[T]he Standard & Poor's index of airline stocks rose 3.43% in the week before the Reform Act's passage and 6.3% in the week following, resulting in a two-week return of 9.73% in the period immediately surrounding the Act's passage. By comparison, the Standard & Poor's 500 index fell 0.9% in the week prior to the Act's passage and rose only 1.95% in the week following, resulting in a two-week return of 1.05%."

193. *See* Kilborn, *supra* note 7, at 43 ("In light of recent experience, the balance of burdens appears to favor encouraging financing of the entire airline industry rather than avoiding the disruption of individual bankruptcy proceedings."). *See also* United Airlines, Inc. v. U.S. Bank N.A., 406 F.3d 918, 924 (7th Cir. 2005) ("Section 1110(a)(1) gives the trustees a right to the return of aircraft unless United pays the full rental or the lessors agree to accept a lower price. Those conditions are not satisfied, so the bankruptcy judge must dissolve the injunction and allow the lessors to repossess their collateral . . . The statute gives them that entitlement, treating aircraft different from other assets. A credible threat to repossess the aircraft changes the terms on which post-bankruptcy bargains can be struck; it is exactly this prospect that makes credit available on better terms when air carriers shop for financing in the first place. United obtained the sort of terms that were available from creditors secure in their ability to repossess the collateral; it must live with those terms now, just as it must pay the current market price for jet fuel.").

chapter if the action would be manifestly contrary to the public policy of the United States." However, the Committee Report for the new Act specifically states that "the word 'manifestly' in international usage restricts the public policy exception to the most fundamental policies of the United States." Thus, the bar is set high for convincing a court to sidestep a request for comity.[194] Traditional parochial interests in sovereign power in the face of foreign main proceedings are preserved by removing the language of Chapter 15 comity considerations from the realm of "shall" to "may."[195] That being said, the primary effect of Chapter 15's enactment was to move "comity" from the six § 304(c) factors and to make it instead an overarching, primary consideration.[196] That is to say, Congress has made it explicitly clear that comity is in fact a more influential factor for courts to consider when approaching foreign main proceedings and requests for ancillary help.[197] The case law that has accrued under § 304 is still valid to the extent that courts use it to assess comity in the face of the other factors to be considered. Thus, the reasoning and strategies gleaned from previous cases still generally hold true.

E. Harmonization with International Financing Principles

A further step in the analysis of the importance of § 1110 and the protection of airline creditors to U.S. public policy is to examine the way other states handle the same issue. The United States is not alone in creating protections for financiers in the aviation arena. The International Institute for the Unification of Private Law ("UNIDROIT") Convention on International Interests in Mobile Equipment as modified by the

194. H.R. Rep. No. 109-31, pt. 1 (1995).

195. 11 U.S.C. § 1507(a) (2005) ("[T]he court, if recognition is granted, *may* provide additional assistance to a foreign representative under this title.") (emphasis added).

196. 11 U.S.C. § 1507(b) (2005) states: In determining whether to provide additional assistance under this title or under other laws of the United States, the court shall consider whether such additional assistance, consistent with the principles of comity, will reasonably assure--

(1) just treatment of all holders of claims against or interests in the debtor's property;

(2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;

(3) prevention of preferential or fraudulent dispositions of property of the debtor;

(4) distribution of proceeds of the debtor's property substantially in accordance with the order prescribed by this title; and

(5) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

197. *See* H.R. Rep. No. 109-31, pt. 1 (2005) ("Although the case law construing section 304 makes it clear that comity is the central consideration, its physical placement as one of six factors in subsection (c) of section 304 is misleading, since those factors are essentially elements of the grounds for granting comity. Therefore, in subsection (2) of this section, comity is raised to the introductory language to make it clear that it is the central concept to be addressed.").

Aircraft Equipment Protocol thereto ("Convention/Aircraft Protocol") was formulated and adopted in November 2001, at a diplomatic conference in Cape Town, South Africa. Fifty-three of the sixty-eight attending states at the convention signed the final act; forty-one have signed the Convention/Aircraft Protocol.[198] The United States ratified the Convention and Protocol on October 28, 2004.[199] Brazil, however, was not a party to the Convention and has not ratified the measures.

The scope of the Convention is not as broad as § 1110, only applying "when, at the time of the conclusion of the agreement creating or providing for the international interest, the debtor is situated in a Contracting State."[200] The Convention thus does not apply to the particular facts of *Varig*, but the weight of the international movement toward harmonization of aircraft financing protection swings the pendulum toward the U.S. courts' application of § 1110 protections by use of the public policy exception escape clause in § 304.

The Convention addressed many of the same concerns of international aircraft financiers that § 1110 of the Code addressed for U.S. lenders regarding asset-backed financing: the ability to determine superior priority to all potential competing claims; the ability to realize the value of the collateral promptly upon default; and the knowledge that the first two rights will not be qualified or modified in a bankruptcy or insolvency proceeding.[201] Countries that adopt the international insolvency rule of the Convention/Aircraft Protocol choose to embrace asset-backed financing principles; "in particular, the international insolvency rule will assist in internationalizing the types of financing benefits and alternatives available to U.S. airlines under Section 1110."[202] The advantages of stabilizing financing for aviation assets and the predictability provided within those markets by a consistent application of the protections described in the Convention/Aircraft

198. International Institute for the Unification of Private Law (UNIDROIT), *Convention on International Interests in Mobile Equipment*, Nov. 16, 2001, http://www.unidroit.org/english/conventions/mobile-equipment/mobile-equipment.pdf; *see also* UNIDROIT, *Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment,* Nov. 16, 2001, http://www.unidroit.org/english/conventions/mobile-equipment/aircraftprotocol.pdf.

199. *See* UNIDROIT, *Status of the Convention on International Interests in Mobile Equipment*, http://www.unidroit.org/english/implement/i-2001-convention.pdf (last visited Nov. 13, 2007); *see also* UNIDROIT, *Status of the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment*, Nov. 16, 2001, http://www.unidroit.org/english/implement/i-2001-aircraftprotocol.pdf (last visited Nov. 13, 2007).

200. UNIDROIT, *Convention on International Interests in Mobile Equipment*, *supra* note 199, at Art. 3(1).

201. Saunders et al., *supra* note 186, at 324.

202. *Id.* at 327.

Protocol would contribute to micro- and macroeconomic benefits in capital and transaction costs for all parties involved. "International commerce demands international law,"[203] and as more cross-border transactions are conducted, more standardized cross-border legal remedies are being sought. Thus, it is vital that U.S. courts recognize the public policy implications of § 1110 when determining whether to grant comity in international bankruptcy proceedings.

IX. CONCLUSION

The unique protections of § 1110 present a compelling case to deny grant comity to foreign main insolvency proceedings that do not provide similar protections. U.S. courts might use the public policy "escape clauses," permitted by the doctrine of modified universalism, to enforce the provisions of § 1110 that protect creditors. In order to convince the court to deny comity, financiers approaching a Chapter 15 ancillary proceeding need to emphasize (1) the extent to which their interests would be impaired relative to the Code if a foreign insolvency law is applied and (2) present a strong case that the center of interests for the specific transactions leading to the § 1110 protections are mainly in the United States and not the foreign forum. In sum, it is not a foregone conclusion that a § 1110 financier will not receive the protections it seeks, but in order to prevail, creditors must emphasize the particular equities that would allow a court to apply the public policy tests and decline to extend comity.

In future cross-border insolvency proceedings, U.S. courts may be inclined to modify the foreign proceedings as necessary to make available the § 1110 protections and therefore reassure an aviation financing community that seeks predictability in lending and speedy enforcement of rights in debtor default situations. Such an outcome will stem from the international economic community's progress in standardizing the collateral protections of mobile aircraft equipment and the tangible financial market benefits that accrue when the collateral is specially protected.

203. Gopalan, *supra* at 121, at 849.