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Caveat Lessor


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I. Introduction

The Viação Aérea Rio Grandense (“Varig”) airline judicial recuperação in Brazil was the first major test case under the New Bankruptcy and Restructuring Law of Brazil (“the NBRL”), ratified in February of 2005 and going into effect on June 9, 2005.1 The experience was largely negative for aircraft and engine lessors and creditors, most of whom were United States-based and accustomed to special protections afforded them by 11 U.S.C. § 1110, which specifically provides greater protection to aircraft owners in bankruptcy procedures than other secured creditors enjoy.2 In the United States, an aircraft creditor may use § 1110 to circumvent the automatic stay or any injunctive power of the court to enjoin taking of possession of certain equipment unless the debtor’s obligations are performed in full and all prior defaults are cured within 60 days after the order for relief. No such protections are available in a Brazilian bankruptcy proceeding. When the main proceeding was initiated in Brazil, and an ancillary proceeding was then simultaneously brought in New York under the U.S. Bankruptcy Code, the U.S.-based assets that were subject to the ancillary proceeding were conserved and administered in accordance with the NBRL.

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   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.
Varig’s creditors’ discontent stemmed from the Brazilian court’s handling of claims for both pre- and post-petition debt claims arising out of the security and lease agreements (beyond just missed rent payments, issues existed with failure to a) pay maintenance reserves, b) maintain required liquidity to meet return conditions, and c) maintain critical maintenance and parts logs).  

Varig filed an ancillary proceeding under the former § 304 of Title 11 (the Bankruptcy Code) of the U.S. Code (“the Code”) in the Bankruptcy Court of the Southern District of New York on June 17, 2005, the same day that its main petition was filed in Brazil (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).  

§ 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;
had no corollary to § 1110 at the time Varig filed, the specific class of aircraft creditors referred to in § 1110 (secured parties, lessors, and conditional vendors, hereinafter referred to as the “Financiers”) argued that the U.S. court should not recognize the judicial recovery in Brazil because the NBRL did not afford these creditors the special position they hold under U.S. law.

As a general matter, however, the foreign distribution scheme of the main proceeding is followed in an ancillary proceeding unless it unfairly discriminates against U.S. creditors. The New York court in the Varig case extended comity to the foreign main proceeding because it determined that the U.S. policy interests behind § 1110 did not override the considerations that favored abiding by the NBRL’s provisions.

The protections provided by § 1110 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 that airlines were able to secure financing for replacing obsolete equipment with modern aircraft. The industry has come to expect those protections when

(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.


Section 304(c) outlined six factors for the court to consider when 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/V S Venture Star, 878 F.2d 111 (3d Cir. 1989).


6 Id.

financing aircrafts and engines; indeed, Congress indicated in retaining the provisions that the
industry claimed it would simply cease financing relevant equipment if the protections were not
preserved.\(^8\)

By comparing NBRL and § 1110 protections to one another, this paper will examine why
the U.S. court extended comity to the Brazilian main proceeding and review the reasons why the
aircraft Financiers’ petitions for relief from the injunctive stay were denied in the ancillary
proceeding. This paper will argue that a filing for bankruptcy by another Brazilian airline today
would—in spite of (or perhaps because of) changes made to laws in both the United States and in
Brazil after the Varig decision—still result in an outcome unfavorable to Financiers. As is
demonstrated in detail below, with respect to the Varig case, the Court in the ancillary
proceeding in New York had the opportunity to decline to extend comity to the foreign main
proceedings had it concurred with the arguments advanced by the Financiers that the public
policy exception “escape clause” in § 304 should provide § 1110 protections to aircraft
Financiers; in extending comity to the foreign proceeding instead, a precedent was set that will
likely weaken the Financiers’ reliance on § 1110 in future deals with Brazilian and other foreign
airlines.

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-change cases
interpreting § 304 still matter inasmuch as the tests applied by courts prior to the BAPCPA
inform the Chapter 15 comity analysis of current cases. Chapter 15 implemented the Model Law

\(^8\) Id. at 51.
on Cross Border Insolvency drafted by the United Nations Commission on International Trade and Law. The ‘modified universalism’ approach of the Model Law and its enactment in Chapter 15 expands upon the principles of comity enumerated in § 304 to make the 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.

This note will examine two cases decided under § 304 and the tests that the courts in those cases used in extending or denying 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 hand, specifically when looking at the relative merits of deferring to the Brazilian court versus protecting the Financiers. Finally, using the foregoing, the note will speculate as to how the case might differ, if at all, under Chapter 15 of the code, and look at what the UNIDROIT Convention on International Interests in Mobile Equipment and its corresponding Protocol on Matters Specific to Aircraft Equipment (“Convention/Aircraft Protocol”) indicates about the international economic community’s approach to handling aircraft priority in secured transactions and insolvency proceedings.

The Varig ancillary proceeding is presented here as an example of how aircraft Financiers might be thwarted in their efforts to take advantage of § 1110 protection for their assets. The analysis is not limited solely to Brazilian carriers, however; this analysis may be

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9 11 U.S.C. § 1501(a) (2005) (“The purpose of this chapter is to incorporate the Model Law on Cross-Border Insolvency so as to provide effective mechanisms for dealing with cases of cross-border insolvency . . . .”); U.N. Comm. on Int'l Trade Law [UNCITRAL], MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT, 36 I.L.M. 1386 (1997).
useful for any U.S. based creditor that is faced with the challenge of confronting a foreign main proceeding that does not have analogous provisions to § 1110.

II. History of Varig and its Bankruptcy

At the time of the bankruptcy filing in 2005, Varig was the largest air carrier in Brazil and Latin America.\(^\text{10}\) Having operated continuously since 1927, its 80-year history secures it among the world’s oldest airlines.\(^\text{11}\) Up to the conclusion of the bankruptcy proceedings in Brazil in 2006, Varig was majority-owned by the Ruben Berta Foundation ("RBF"), a non-profit foundation constituted in 1945 “to provide health, financial, social, and recreational benefits” to company employees; RBF controls Varig through a holding company, FRB-Par Investments.\(^\text{12}\) Varig has been managed and operated as a private business enterprise since inception, though the Brazilian State of Rio Grande du Sol holds a minority interest of less than 1%.\(^\text{13}\)

Varig’s principle business was and is passenger travel on domestic routes within Brazil and international routes between Brazil and North and South America, Europe, and Asia.\(^\text{14}\) As of May 31, 2005, the airline had a fleet of 87 aircraft, carried approximately 13 million passengers a year, and employed approximately 11,456 full-time employees.\(^\text{15}\) Varig has no significant fixed

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\(^\text{10}\) Petition Pursuant to 11 U.S.C. § 304, \textit{supra} note 6, at 2.
\(^\text{11}\) \textit{Id}.
\(^\text{12}\) \textit{Id}.
\(^\text{13}\) \textit{Id}.
assets,\textsuperscript{16} and each of the aircraft is operated under lease – 83 under operating leases and 4 under finance leases.\textsuperscript{17}

Varig has long been a marquee brand in Brazil.\textsuperscript{18} For years, it was protected by the Brazilian government, which limited competition and regulated prices.\textsuperscript{19} In return, Varig compensated government officials with courtesy tickets and flew unprofitable routes to destinations the government hoped to tie into the national economy.\textsuperscript{20} Regulation of air carriers in Brazil across the board requires government approval of the acquisition of additional aircraft, opening of new routes, and changes in flight frequency; the government also monitors fares that air carriers are permitted to charge on each domestic route.\textsuperscript{21}

Flights to the United States began in 1955, with Varig providing approximately 18 flights each week into Miami, New York, and Los Angeles.\textsuperscript{22} In 2004, tickets sold in the U.S. accounted for roughly 5.20\% (approximately US $163.9 million) of Varig flight revenues.\textsuperscript{23} Varig estimated that 133 employees were employed in the United States, with 51 of those working in New York State at John F. Kennedy International Airport or one of two Manhattan locations.\textsuperscript{24}

In the mid-1990s, Brazil began to loosen its hold on regulation of the airline industry by allowing low-price competitors into the market. TAM Linhas Aéreas and Gol Linhas Aéreas Inteligentes increased their offerings to business travelers within and coming to Latin America,

\textsuperscript{16} Petition Pursuant to 11 U.S.C. § 304, \textit{supra} note 6, at 6.
\textsuperscript{17} \textit{Id.} at 4. \textit{See} discussion \textit{infra} Part IV.C and notes 69-73 for commentary on why the distinction was at the time significant.
\textsuperscript{19} \textit{Id.}
\textsuperscript{20} \textit{Id.}
\textsuperscript{21} Petition Pursuant to 11 U.S.C. § 304, \textit{supra} note 6, at 6.
\textsuperscript{22} \textit{Id.} at 5.
\textsuperscript{23} \textit{Id.}
\textsuperscript{24} \textit{Id.}
and slowly Varig’s market share began to evaporate.\textsuperscript{25} Other low-cost carriers such as WebJet Linhas Aéreas have entered the region as well.\textsuperscript{26} Finally, while Brazil maintained a high degree of control over Varig, Varig was still a private operation, whereas many of its foreign competitors were wholly or majority owned by their respective governments and thus able to access greater resources and subsidies than could Varig.\textsuperscript{27}

Additionally, in 1994, and again in 1999, Varig restructured its debt by deferring it, alleviating immediate pressure by causing its debt burden and cash flow requirement to grow.\textsuperscript{28} In 2001, Varig laid off approximately 10\% of its workers and reduced its fleet, and the Brazilian government briefly considered nationalizing the carrier.\textsuperscript{29} In February 2003, International Lease Finance Corporation, a U.S.-based corporation, seized one of its leased Boeing 777 aircraft from Varig at Paris’ Charles De Gaulle airport due to missed lease payments.\textsuperscript{30} That March, GE Capital Aviation Services, another U.S. corporation, impounded—for non-payment of past due leasing fees—a Varig Boeing 767 bound for Rio de Janeiro while it was on the runway at Miami International Airport.\textsuperscript{31}

At the time of the filing on June 17, 2005, of the main and ancillary proceedings in Brazil and United States respectively, Varig’s negative net worth was approximately US $2.5 billion, with balance sheet debt of approximately US $2.0 billion and off-balance sheet debt at

\textsuperscript{25} Samor, \textit{supra} note 18.
\textsuperscript{27} Petition Pursuant to 11 U.S.C. § 304, \textit{supra} note 6, at 7.
\textsuperscript{28} \textit{Id.}
\textsuperscript{29} Megan Christoph, Comment, \textit{Airline Reorganization Under the New Bankruptcy and Restructuring Law of Brazil}, 13 L. & BUS. REV. AM. 451, 457 (2007).
\textsuperscript{31} Varig 767-200 Impounded in Miami by Gecas, \textit{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 30 that it had at one time).
approximately US $2.0 billion. Varig’s largest single creditor was Brazil itself, which had claims on the larger part of US $3.3 billion for back taxes and Brazilian social security payments.

Given the high degree of operating leverage inherent to the airline industry and the high costs of fuel (and subsequent inability to pass rising fuel costs onto customer fares due to Brazilian fare regulation), minor shifts in passenger revenues based on seasonality or competition have a disproportionately large effect in decreasing profits. Additionally, 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 dollar over the years prior to filing, Varig was intensely sensitive to any decline in revenue. On June 17, 2005—a mere eight days after the NBRL became effective—Varig filed for bankruptcy under the NBRL’s new reorganization procedures.

III. Prior History of 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 for bankruptcy faced potentially “harsh consequences” going through “ineffective and fragmented bankruptcy law that had been in place since 1945.” Under the old law, only merchants were eligible for

\[\text{\textsuperscript{32}}\text{Petition Pursuant to 11 U.S.C. § 304, } \text{supra note 6, at 7.}\]
\[\text{\textsuperscript{33}}\text{Samor, supra note 18, at 2.}\]
\[\text{\textsuperscript{34}}\text{Petition Pursuant to 11 U.S.C. § 304, supra note 6, at 8.}\]
\[\text{\textsuperscript{35}}\text{Id. at 7, 8.}\]
\[\text{\textsuperscript{36}}\text{Felsberg, New Bankruptcy Law, supra note 1, at 2.}\]
\[\text{\textsuperscript{37}}\text{Petition Pursuant to 11 U.S.C. § 304, supra note 6, at 9.}\]
\[\text{\textsuperscript{38}}\text{See Christoph, supra note 29, 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 PT 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}
bankruptcy protection.\textsuperscript{39} Two of the most common types of proceedings available to debtors declaring bankruptcy were bankruptcy liquidation (\textit{falencia}) and debt rehabilitation (\textit{preventive concordata}).\textsuperscript{40} The majority of all bankruptcy proceedings initiated in Brazil prior to enactment of the NBRL were bankruptcy liquidations, or \textit{falencia}.$^{41}$

While the \textit{concordata} was a proceeding similar in some regards to a reorganization proceeding, it was conducted under strict scrutiny from the Brazilian courts.$^{42}$ The oversight was provided by a court-appointed receiver (\textit{comissário}), and a debtor was severely limited regarding the options for reorganization strategies that it could pursue.$^{43}$ Unlike a Chapter 11 reorganization in the U.S. courts or a Judicial Reorganization under the NBRL, a statutorily-prescribed percentage of unsecured claims were discharged with a \textit{concordata}, while secured claimholders were not affected by any stay and were free to attempt to collect their claims.$^{44}$ Ultimately, the \textit{concordata} was not a flexible tool for reorganizing a going concern; it largely failed for rehabilitating businesses because of the limited discharge of unsecured debts and the inability of the debtor and its creditors to negotiate directly.$^{45}$

One of the most significant impediments to secured creditor recovery in Brazil was the priority scheme for claims. Unlike the varied protective measures built into the U.S. Bankruptcy

\textsuperscript{39} See Christoph, supra note 29, at 452.
\textsuperscript{40} 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].
\textsuperscript{41} Id.
\textsuperscript{42} See Christoph, supra note 29, at 452.
\textsuperscript{43} See Jarvinen, Primer on Reorganizations, supra note 38, at 11 n.9.
\textsuperscript{44} See Jarvinen et al., Bankruptcy Reform, supra note 40, at 68.
\textsuperscript{45} See Jarvinen, Primer on Reorganizations, supra note 38, at 11 n.9.
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: “because those claims are frequently enormous in Brazil, there are generally few assets remaining in a debtor's estate to satisfy secured claims.”46 Even compared to other Latin American countries, Brazilian creditors have very minimal protection, making credit “scarce and expensive.”47 Because the risk of failing to recover in bankruptcy proceedings from a Brazilian corporation (and because of the losses that some lenders have suffered in the past due to loan defaults), lenders and Brazilian banks protected (and still protect) themselves with some of the highest lending rates in the world.48

IV. Enactment of the New Bankruptcy and Restructuring Law of Brazil

The enactment of the NBRL on February 9, 2005, was the first significant remodeling of Brazilian insolvency law in over 60 years.49 Chief among the new provisions of the NBRL is the creation of two new proceedings, a Judicial Reorganization (Recuperação Judicial) and an Out-of-Court Reorganization (Recuperação Extrajudicial).50 The Judicial Reorganization is similar to a Chapter 11 reorganization proceeding under the U.S. Bankruptcy Code, with the goal in mind of preserving the operation and assets of a reorganizing corporation as a going concern.

46 Jarvinen et al., Bankruptcy Reform, supra note 40, at 32.
48 See Jarvinen et al., Bankruptcy Reform, supra note 40, at 32. See generally Araujo & Funchal, supra note 47, at 47 (arguing 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] countries of 102% during the period from 1997-2002.).
49 See Jarvinen, Primer on Reorganizations, supra note 38, at 1.
50 See id.
with a greater social value (in terms of employing workers, participating in the economy, paying
taxes, etc.) than would be true in a liquidation proceeding.  

A. The NBRL’s Limited Automatic Stay

One of the key aspects of the NBRL reorganization proceedings is the institution of a limited automatic stay. Conceptually, the stay provides similar protections to that afforded under § 362 of the Code. The stay provides ‘breathing room’ for the debtor to focus on restructuring and developing a reorganization plan to be negotiated with its creditors. Some restrictions apply, however: the stay in the context of the Judicial Reorganization is limited in duration to a single period of 180 days that is not extendable; when the stay expires, creditors may immediately resume collection efforts against the debtor.

The debtor has 60 days from the approval of the petition for judicial reorganization to submit its reorganization plan. The plan must be approved by creditors; if any creditor objects to the proposal, a formal vote will be held and dissident creditors bound provided that at least the statutorily stipulated percentages of creditors in each credit class ratify it.

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51 See id. See also Araujo & Funchal, supra note 47, at 50 (noting that creditors now have a much more active role in the proceedings than under the old concordata; creditors now directly negotiate with the creditor and vote for the reorganization plan).

52 Lei. No. 11.101, 9 de fevereiro de 2005, D.O.U. de 09.02.2005, Art. 52(III) (Brazil), 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); see also Jarvinen, Primer on Reorganizations, supra note 38, at 3.


54 Lei. No. 11.101, 9 de fevereiro de 2005, Art. 6; see also Jarvinen, Primer on Reorganizations, supra note 38, at 3.

55 Lei. No. 11.101, 9 de fevereiro de 2005, Art. 6, § 4; see also Jarvinen, Primer on Reorganizations, supra note 38, at 3.

56 Lei. No. 11.101, 9 de fevereiro de 2005, Art. 53. Given that Brazilian debtors have never before had this opportunity to reorganize rather than liquidate, an argument could be made that 60 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).

57 Felsberg, New Bankruptcy Law, supra note 1, at 2. See also Jarvinen, Primer on Reorganizations, supra note 38, 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” of the Jarvinen article. Id.
B. Prioritization of Claims Under the NBRL

Compared to the prior bankruptcy law, the NBRL significantly enhances the protections available to secured creditors in terms of prioritization of claims.\(^{58}\) The claims of secured creditors now occupy second position in priority (after labor claims), supplanting tax claims in the order of priority.\(^{59}\) Secured creditors’ positions are further strengthened by the NBRL capping the amount of first priority labor claims that will be awarded.\(^{60}\) The NBRL also protects creditors who choose to continue to deal with the debtor post-petition, primarily by granting an administrative post-commencement priority claim to post-petition lenders over other secured, pre-petition claims. In the event that the reorganization is converted to a liquidation proceeding and the estate’s funds are insufficient to satisfy all creditor claims, the post-commencement claims will enjoy a higher priority.\(^{61}\)

The prior bankruptcy law failed to protect potential purchasers of debtor assets from successor liability for claims against the debtor.\(^{62}\) No analogue to § 363 under the Bankruptcy Code existed to authorize sales “free and clear” of liens and interests on the asset, and investors thus were understandably leery of purchasing assets in bankruptcy proceedings that were likely encumbered by labor and tax claims against them.\(^{63}\) Now, certain categories of claims under the

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\(^{58}\) *See* discussion *supra* at Part III; Brazil’s prior bankruptcy code prioritized labor and tax claims above secured claims, frequently leaving secured creditors empty-handed at the close of liquidation or *concordata* proceedings.

\(^{59}\) Lei. No. 11.101, 9 de fevereiro de 2005, Art. 83(II).

\(^{60}\) Lei. No. 11.101, 9 de fevereiro de 2005, Art. 83(I). *See* Jarvinen, *Primer on Reorganizations, supra* note 38, 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 (=150 x 380 reals (monthly minimum wage) / 1.80 reals/dollar (current exchange rate as of October 2007)).


\(^{62}\) Jarvinen et al., *Bankruptcy Reform Coming to Brazil, supra* note 40, at 32.

\(^{63}\) 11 U.S.C. § 363 (2005); Jarvinen, *Primer on Reorganizations, supra* note 38, at 6; Jarvinen et al., *Bankruptcy Reform Coming to Brazil, supra* note 40, at 32 (“Because the actual amounts of such claims are not generally known
NBRL are not subject to successor liability; certain types of debtor assets (such as separate production units or branches of the debtor’s operations) in judicial reorganization will no longer be burdened by the debtor’s obligations for tax claims, labor or work-related injury claims, or social security claims.\textsuperscript{64} The hope is that under the NBRL creditors will have an incentive (and feel well-enough protected) to provide financing to debtors-in-possession “since they 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.”\textsuperscript{65}

C. Air Carrier Reorganization Under the NBRL

The NBRL holds several wrinkles for air carriers undergoing reorganization. Aircraft leases are subject to Section 3 of Article 49 of NBRL, which provides that leased assets cannot be repossessed if essential to the economic activity of a company in recovery.\textsuperscript{66} Additionally, Article 198 of the NBRL disallows reorganization proceedings by companies not allowed to file under the\textit{ concordata} of the old law.\textsuperscript{67} But, under Article 199, corporations identified in Article 187 of the Brazilian Aeronautical Code of December 19, 1986, are not subject to Article 198 and

\begin{itemize}
  \item 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.”).
\end{itemize}

\textsuperscript{64} Lei. No. 11.101, 9 de fevereiro de 2005, 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,\textit{ Primer on Reorganizations, supra} note 38, at 6.


\textsuperscript{66} Lei. No. 11.101, 9 de fevereiro de 2005, 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).

\textsuperscript{67} Lei. No. 11.101, 9 de fevereiro de 2005, 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.,\textit{ supra} note 5, at 42.
thus *may* initiate a Judicial Reorganization; Article 187 identifies companies who have as their primary purpose air services of any nature and indicates that air carriers *can* apply for judicial reorganization.\(^{68}\) The analysis does not end there, however; the airlines may file, but the NBRL requires an analysis the debtor’s contracts to determine which are subject to proceedings, as well as an analysis of what equipment may be preserved by the estate as necessary to preservation of the going concern.

There’s more. One notable loophole in the Brazilian code at the time of Varig’s petition applied Article 199—addressing aviation finance contracts—only to finance leases (as opposed to finance *and* operating leases).\(^{69}\) Article 199 of the NBRL identified finance leases of aircraft as being outside of the judicial recovery proceedings, so that the non-debtor party to the lease could pursue collection on its collateral notwithstanding the stay provisions of the NBRL.\(^{70}\) The provision completely prohibits Brazilian airlines from rescheduling any obligations arising from aircraft and equipment *leases*; in other words, there is no stay period at all.\(^{71}\) At the time of the Varig case, however, the Article only applied to finance leases, which comprised only 4 of the 87 total aircraft in the Varig fleet, and so the majority of the aviation assets in the Varig case were

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\(^{68}\) 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 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* New Brazil Bankruptcy Law Likely to Improve Recovery Prospects for Creditors, *but Challenges Remain,* *supra* note 65, 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 . . . .").

\(^{69}\) Lei. No. 11.101, 9 de fevereiro de 2005, 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.").

\(^{70}\) *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.” *See* Lobo et al., *supra* note 5, at 72.

\(^{71}\) Lei. No. 11.101, 9 de fevereiro de 2005, Art. 199.
subject to the stay as it applied to the general category of creditors.\textsuperscript{72} In November of 2005, Brazil’s Congress closed the loophole to apply Article 199 to both finance and operating leases.\textsuperscript{73}

Be that as it may, there is a 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.\textsuperscript{74} As it stands now, then, airlines may file for judicial reorganization under the NBRL (an improvement from the prior bankruptcy law, which prevented them from proceeding under a \textit{concordata}) but both finance and operating leases are outside the scope of the stay \textit{unless} Article 49 is determined to apply and the leases are necessary for the corporation to continue as a going concern; it is difficult to imagine that this would not be determined to be the case.\textsuperscript{75} For cases in the U.S. courts, then, no relief akin to § 1110 is apparent for aircraft creditors if comity is granted to Brazilian law.

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 use to facilitate the maximization of value of insolvent companies.\textsuperscript{76} Given the relative newness of the statute (and its literal newness at the time of the Varig filing), much remains to be seen as to its

\textsuperscript{72} Basch, \textit{supra} note 2, at 39.
\textsuperscript{73} \textit{See id.}
\textsuperscript{74} \textit{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 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.”). \textit{But cf.} Lobo et al., \textit{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.”).
\textsuperscript{75} \textit{See Lobo et al., supra} note 5, at 72.
\textsuperscript{76} See Araujo & Funchal, \textit{supra} note 47, for an in-depth discussion of the anticipated favorable effects of the NBRL on Brazil’s credit market and overall economic efficiency.
shortcomings. One noted deficiency of the NBRL 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.  

V. Aircraft Equipment and Vessels Under 11 U.S.C. § 1110

In the United States, special protection has long been afforded by Congress to certain equipment financiers of aircraft, aircraft engines, propellers, appliances and spare parts. Due in part to the great capital expense of operating a large fleet of high-maintenance aircraft, and due to the extremely high price of purchasing even one modern airliner, most air carriers—even large ones—are incapable of owning their fleets outright. As a result, air carriers are forced to enter into complex financial arrangements with both financial institutions and aircraft manufacturers themselves. 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

77 Jarvinen, Primer on Reorganizations, supra note 38, at 9. See also Thomas Benes Felsberg et al., Brazil Overhauls Restructuring Regime, INT’L FIN. L. REV., Jan. 2006, at 40, 44 (“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.”).

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


80 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.6 (“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.”).

81 Id. at 282.
equipment with modern aircraft."82 They were, perhaps, predisposed to acquiesce to demands from Financiers for more substantial protections for their investments when considering the codification of such protections.83 Today, 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).84

Prior to the enactment of what is the modern form of the law, the old U.S. § 116(5) of the Bankruptcy Act ("Bankruptcy Act") made reorganization proceedings completely inapplicable insofar as they affected title and the right of aircraft creditors to repossess.85 Because debtors were required to obtain aircraft financiers’ agreement to retain equipment whose financing was in default during insolvency proceedings, § 116(5) essentially gave financiers “the absolute veto power over a reorganization."86 Additionally, the Bankruptcy Act did not give debtors any grace period within 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.87 When the modern § 1110 was enacted in 1977, Congress, rather than perpetuating the aircraft creditors’ veto power, crafted § 1110 such that a debtor may remain in possession of aircrafts and aircraft equipment so long as it

82 H.R. REP. NO. 85-944 (1957), reprinted in 1957 U.S.C.C.A.N. (71 Stat. 716) 1926, 1926. See also Ripple, supra note 80, 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.”).
83 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.”).
84 See, e.g., Ripple, supra note 79, at 282.
87 WILLIAM L. NORTON, JR., ET AL., 4 NORTON BANKRUPTCY LAW AND PRACTICE § 81:1 (2d ed. 2007).
cures its defaults and reaffirms its obligations under any pre-petition security agreements or financing arrangements.\textsuperscript{88}

Section 1110 sets out three prerequisites to be met before a creditor may receive the protection of its provisions. Because the provision only applies to: (1) a specific type of equipment; (2) a specific type of transaction; and (3) a licensed debtor, the protections afforded are available to only a very narrow class of creditors.\textsuperscript{89} Creditors who pass the test for the protections of § 1110 must make a written demand for possession before the trustee must surrender the collateral.\textsuperscript{90} The rights of a § 1110 Financier are not “limited or otherwise affected by any other provision of this title or by any power of the court.”\textsuperscript{91} 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.”\textsuperscript{92}

Section 1110 provides qualifying Financiers with the right—§ 362 and other provisions of the Code notwithstanding—to repossess qualifying aircraft and equipment under the terms of their pre-petition agreements unless, within 60 days of the commencement of the relief proceedings, the debtor either a) “agrees to perform all obligations of the debtor under [the]

\begin{footnotes}
\textsuperscript{88} See Margaret Sheneman & Cecily A. Dumas, \textit{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.” \textit{Id.}
\textsuperscript{89} 11 U.S.C. § 1110(a).
\textsuperscript{90} 11 U.S.C. § 1110(c)(1).
\textsuperscript{91} 11 U.S.C. § 1110(a)(1).
\textsuperscript{92} 11 U.S.C. § 105(a). \textit{See also} United Airlines, Inc. v. U.S. Bank N.A., 406 F.3d 918 (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.”).
\end{footnotes}
security agreement” and cure all pre- and post-petition defaults; or b) agrees, with the secured 
party or lessor whose right to possess is protected, to extend the 60-day period specified.\textsuperscript{93} If the 
debtor or trustee 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.\textsuperscript{94} Section 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 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.”\textsuperscript{95} The legislative history for the 
enactment of § 1110 explicitly clarifies that:

\begin{quote}
[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.\textsuperscript{96}

Additionally, any post-petition default must be cured within 30 days.\textsuperscript{97} The transaction 
must be an equipment security interest, a conditional sale, or a lease to qualify for the
\end{quote}

\textsuperscript{93} 11 U.S.C. §§ 1110(a)-(b) (2006). See also Sheneman & Dumas, \textit{supra} note 88, at, 7-97 (“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.”).
\textsuperscript{94} 11 U.S.C. § 1110(c)(1).
\textsuperscript{95} \textit{7-1110 COLLIER ON BANKRUPTCY, Relationship between § 1110 and Other Provisions of the Code, 1110.05 \textcopyright \textit{COLLIER ON BANKRUPTCY, Relationship between § 1110 and Other Provisions of the Code, 1110.05 \textcopyright (15th ed. 2007).}
protections, and the pre-petition security or lease agreement must give the financier the right to repossess. 98

Section 1110, while limited in scope and applicability, is a potent clause within the Code. 99 “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.” 100 Any lease or security interest in aircraft falls under the aegis of § 1110 – the 1994 amendments specifically clarified that question in response to debtor challenges of the previous § 1110 language in the Pan Am and Continental insolvency proceedings of the early 1990s. 101 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. 102 Also, after the initial 60-day period of protection under 1110 expires, any subsequent default of lease or loan terms gives the secured party an immediate and unqualified right to retake possession and control. 103

99 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.”).
101 In re Pan Am Corp., 929 F.2d 109 (2d Cir. 1991); In re Continental Airlines, Inc., 932 F.2d 282 (3d Cir. 1991).
103 See Ripple, supra note 80, 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. This section authorized cases ancillary to foreign proceedings commenced by filing of a petition by a foreign representative of the debtor. The 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. Ancillary proceedings do not automatically trigger stay protections, grant the petitioner powers of avoidance, or create an estate. The section was, however, 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.”

Stay requests are analyzed on a discretionary basis by the bankruptcy judge using the guidance provided by § 304. The foreign representative must affirmatively seek a protective stay or any other form of relief. The court may, at its discretion, enjoin the commencement or continuation of any action or the enforcement of a judgment against the debtor concerning

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107 See Samet, supra note 106, at 337.
108 In re Koreag, Controle et Revision S.A., 961 F. 2d 341, 348 (2d Cir. 1991).
109 See Interpool, Ltd. v. Certain Freights of the M/V S Venture Star, 878 F. 2d 111 (3rd Cir. 1989) (noting also that “a foreign representative has the alternative of filing a full-scale involuntary bankruptcy case under section 303(b)(4), thereby triggering the automatic stay.”).
property involved in the proceeding, order turnover of such property to the foreign
representative, or order other appropriate relief.\textsuperscript{110}

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

(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
(6) if appropriate, the provision of an opportunity for a fresh start for the
individual that such foreign proceeding concerns.\textsuperscript{111}

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.\textsuperscript{112} The U.S. Bankruptcy Court must then decide what
§ 304(c) factors are applicable and what force 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.\textsuperscript{113} Great deference is given to comity\textsuperscript{114} in the consideration by the U.S. court,

\textsuperscript{110} 11 U.S.C. § 304(b) (repealed 2005).
\textsuperscript{111} 11 U.S.C. § 304(c) (repealed 2005).
\textsuperscript{112} See Samet, supra note 106, at 345; 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) for examples of courts applying the § 304 factors to the
facts of the cases at hand.
\textsuperscript{113} See, e.g., In re Rubin, 160 B.R. 269, 283 (Bankr. S.D.N.Y. 1993) (court enjoined all actions by creditors against
the debtor’s property in the United States, 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) (in which the court denied 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) (court
declined 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).
and comity will be accorded so long as the foreign court is of competent jurisdiction and the laws and public policy of the home forum are not violated.\textsuperscript{115} It 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.\textsuperscript{116}

Numerous commentators have examined the circumstances under which courts either should defer to foreign proceedings or should decline to grant comity by use of public policy arguments.\textsuperscript{117} Section 304(c)(2) is most 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 comes in the form of 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.”\textsuperscript{118}

Courts have not been consistent in their determinations of what constitutes a public policy violation significant enough to warrant not extending comity.\textsuperscript{119} While no fixed rule exists for determining what public interests warrant an increased level of protection when

\textsuperscript{114}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.”).

\textsuperscript{115}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; court reasoned that their primary consideration was “whether the relief petitioners seek will afford equality of distribution of the available assets.”).

\textsuperscript{116}See, \textit{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); \textit{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).


\textsuperscript{118}See Buxbaum, supra note 117, at 40.

\textsuperscript{119}See, \textit{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).
considering foreign proceedings, predictability in the courts’ approaches to each case will result in a greater likelihood of uniform results and thus allow more stability for cross-border financing. 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, because the granting of a petition to initiate an ancillary proceeding under § 304 triggers an automatic stay under 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 them of discrimination will likely entail showing proof of a “transaction which is inherently vicious, wicked or immoral, and shocking to the prevailing moral sense.”

VII. Petition of Varig to Commence a Case under 11 U.S.C. § 304

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). 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

120 Buxbaum, supra note 117, at 55.
121 Intercontinental Hotels Corp. v. Golden, 203 N.E.2d 210, 212 (N.Y. 1924) (“[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.”).
122 Petition Pursuant to 11 U.S.C. § 304, supra note 6, at 1.
“Brazilian Court”) pursuant to the NBRL. The petition sought to “obtain the assistance of [the] Court in protecting the property of Varig for the benefit of all its creditors.” It further asserted that as part of the 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. 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” needed for it to complete its restructuring and rework its balance sheet.

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. A stated goal of the petition was to reduce the costs of litigation by funneling all claims through the Brazilian bankruptcy 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. The petition specifically references five of the factors set forth in § 304(c), and, without elaborating further, claims 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.”

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123 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.
124 Petition Pursuant to 11 U.S.C. § 304, supra note 6, at 1.
125 Id. at 9.
126 Id. at 11.
127 Id.
128 Petition Pursuant to 11 U.S.C. § 304, supra note 6, at 12.
129 Id.
The debtor, Varig, sought the court’s protection principally to enjoin aircraft and engine lessors and Financiers from repossessing their 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. 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. On June 17, 2005, the Court entered a temporary restraining order granting the relief requested pending further consideration of parties’ arguments and briefs.

Varig’s creditors in the United States immediately countered with objections to the temporary restraining order entered by Judge Robert Drain of the Bankruptcy Court. Financiers accustomed to the protections afforded to them by § 1110 of the Code petitioned for relief from the stay and the right to have any faults cured or to repossess their aircraft or equipment. 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

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130 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.”).

131 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.”).


133 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, among other things, 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 Art. 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.).

134 See Lobo et al., supra note 5, at 43.
proceedings in Brazil because the NBRL did not protect claim holders in the same manner to which they were accustomed under the Code.\footnote{Id. See, e.g., Objection of the Boeing Company to Temporary Restraining Order, supra note 133.}

The aircraft 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 begun, then necessarily no ancillary proceeding could follow.\footnote{See, e.g., briefs cited supra note 133. While undoubtedly a matter of great importance to all parties involved at the time, 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; I will not focus on this procedural line of protest from the creditors.} The second centered around § 1110 and the protections afforded therein.\footnote{See Lobo et al., supra note 5, at 43. 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).} The third revolved around the way in which both the Brazilian Court and the U.S. Court handled pre- and post-filing debt obligations.\footnote{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).}

The substantive argument of the Financiers centered on the perceived inequities of the effect that applying Brazilian law would have on the rights available to the creditors regarding their collateral. The Foreign Representative relied heavily on the argument that § 304 of the Code authorized the Court to grant relief in the form of continuation of the initial preliminary injunction. In particular, it pointed to the flexibility afforded the courts to “broadly mold appropriate relief in near blank check fashion.”\footnote{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)).} This conflict of opinion was the crux of the case and the arguments between the parties as regarded the aircraft collateral.
As a workaround, and instead of extending the protections of § 1110 to the aircraft Financiers, the U.S. Court crafted a “contingency return plan” that purported to approximate some of the protections of § 1110. Varig was required to prepare a schedule showing the location of each asset, trace, and granting a priority claim for any damages incurred as result of missing parts or maintenance documents. The Court directed Varig to seek to have the contingency return plan (including priority claim) approved by the Brazilian court (which it did). But this plan did not provide the relief that the Financiers were seeking; namely, it did not require the debtor to come current on arrearages and default terms incurred pre-petition, nor did it grant creditors the option of repossessing after the prescribed cure period.

VIII. Outcome Analysis

The Court, in extending comity to the debtor’s application, determined that the foreign main proceeding sufficiently protected creditor interests 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 court 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.”

140 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)
141 See Lobo et al., supra note 5, at 72.
142 11 U.S.C. § 304(c)(2). 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), appeal dism’d, 878 F.2d 111 (3d Cir. 1989); In re Toga Manu., Ltd., 28 B.R. 165 (Bankr. E.D. Mich. 1983).
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.\textsuperscript{143} 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 the law in ancillary proceedings in the United States has been somewhat unsystematic.\textsuperscript{144} This of course has the potential to lead to unpredictable outcomes; in the world of finance—especially aircraft finance—unpredictability is a dangerous thing.\textsuperscript{145}

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.\textsuperscript{146} 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 of protecting local creditors from unfairness or prejudice in those proceedings (per § 304(c)(2)).\textsuperscript{147} Section 304 does not provide a bright-line rule to judges on how to apply the decision-making process when evaluating the protections afforded local creditors versus the

\textsuperscript{143} Buxbaum, \textit{supra} note 117, at 29.

\textsuperscript{144} \textit{Id.} at 30.

\textsuperscript{145} \textit{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.”).

\textsuperscript{146} See Buxbaum, \textit{supra} note 117, at 27.

\textsuperscript{147} See \textit{id.}; See also Pottow, \textit{Procedural Incrementalism: A Model for International Bankruptcy}, 45 \textit{VA. J. INTL. 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.”).
deference to grant to the foreign proceeding. Each case in a § 304 ancillary proceeding involves the application of the law by the presiding judge on an ad-hoc basis.

While courts are overwhelmingly likely to defer to the foreign proceedings, courts in the United States nonetheless will use public policy exceptions—often referred to as “escape clauses”—to ensure fair results in the local forum when the foreign law would render an injustice. As Hannah Buxbaum says:

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.

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. In order to establish generally ex ante 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

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148 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 117, at 31-32.

149 See Buxbaum, supra note 117, at 46; see also Pottow, supra note 138, 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 when needed to protect local creditors.

150 See Buxbaum, supra note 117, at 46.

151 See Buxbaum, supra note 117, 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.”).
the selection of jurisdiction.” As discussed infra, the § 1110 provisions are ones that 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’.” The 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 and would fly in the face of 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.”

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152 Buxbaum, supra note 117, at 58.
154 Id. at 158.
1. **In re Maxwell Communication Corp.**

*In re Maxwell Communication Corp.* 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.\(^{155}\) 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.\(^{156}\)

The *Maxwell* court addressed the primary considerations of comity in determining that it should defer to the courts and law of England on a question of avoidance of pre-petition transactions.\(^{157}\) The court begins 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.”\(^{158}\) It then argues that ‘international comity’ is a “canon of construction [that] might shorten the reach of a statute.”\(^{159}\) In *Maxwell*, the court is 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 reasons that unless Congress legislates specifically against it, the doctrine of comity may properly be used to analyze any statute in proceedings with foreign ties. In particular, the court continues:

> 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 . . .

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\(^{155}\) *In re Maxwell Commc'n Corp.*, 93 F.3d 1036 (2d Cir. 1996).

\(^{156}\) *Id.* See also Jay Lawrence Westbrook, *The Lessons of Maxwell Communication*, 64 FORDHAM L. REV. 2531, 2534 (1996).

\(^{157}\) *In re Maxwell Commc'n Corp.*, 93 F.3d 1036.

\(^{158}\) *Id.* at 1047.

\(^{159}\) *Id.*
Having determined that a true conflict exists between U.S. and English law (in that 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 goes on to argue that under the facts, English law has 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. 161 “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 reasons, and as the English court effectuated those same policies with its laws, the court deferred to the English primacy of interest. 162

The court finally concludes 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.” 163 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.

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160 Id. at 1048.
161 Id. at 1051-52.
162 Id. at 1052.
163 Id. at 1053.
What is important to note, however, is 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 analyzes the U.S. and U.K. law and determines that a true conflict does exist between the competing insolvency procedures, thus compelling the use of comity principles.\(^{164}\) In the instant case, the court determines that the U.K. contacts to the case had primacy over U.S. interests.\(^{165}\) In fact, the court characterizes the linkage to U.S. interests as “not particularly weighty” and that the “negative effects [of not applying the Code] are insubstantial.”\(^{166}\) 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.\(^{167}\)

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

2. *In re Treco*

In *In re Treco*, by comparison, the court analyzed the § 304(c) factors in detail when considering a turnover request in a Bahamian main proceeding and U.S. ancillary proceeding.\(^{168}\) At issue was the priority of the secured claim of a U.S. creditor: under Bahamian insolvency law,

\(^{164}\) *Id.* at 1049.

\(^{165}\) *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.”).

\(^{166}\) *Id.* at 1052.

\(^{167}\) Westbrook, *supra* note 156, 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.” *Id.* at 2540.

\(^{168}\) *In re Treco*, 240 F.3d 148 (2d Cir. 2001).
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 count on receiving the full value of its collateral.\textsuperscript{169} 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.\textsuperscript{170} 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.”\textsuperscript{171} 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.”\textsuperscript{172}

The court then dismisses 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.”\textsuperscript{173} 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.

\textsuperscript{169} Id. at 155.  
\textsuperscript{170} Id. at 156.  
\textsuperscript{171} Id. at 156-57.  
\textsuperscript{172} Id. at 157.  
\textsuperscript{173} Id. at 158.
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.” 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.” In the end, comity was not granted to the Bahamian court, 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. 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

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174 *Id.* at 159 (citing § 304(c)(4)).
175 *Id.* at 160.
176 Buxbaum, *supra* note 117, at 68
by bankruptcy legislation is, in the absence of just compensation, a violation of the takings clause of the fifth amendment.°

1. The Public Value of Aircraft Creditor Priority

Going back to the prior discussion supra of Congress’ intention behind the enactment and continuing refinement of the protections given by § 1110, courts might reasonably deduce that a high public value is given to the super-priority of 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.°

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.”179

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 7th 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 …." 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 § 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].180

2. Collateral Value and Financing Predictability

How, then, do 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.181 As discussed, the airline industry depends heavily on outside investments to raise capital. Any legal reforms that

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179 406 F.3d 918, 924 (7th Cir. 2005).
180 In re Vanguard, 295 B.R. at 916-17 (citing Pub. L. 106-181, Title VII § 744(b)).
181 Anthony Saunders et al., The Economic Implications of International Secured Transactions Law Reform: A Case Study, 20 U. PA. J. INTL 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.”).
encourage lending or secured financing increase liquidity, which adds value—the gains from which will in some part be passed back to the borrower.\textsuperscript{182} Within the airline industry, practically all lenders require some sort of security backing to a loan or lease contract, usually in the form of taking collateral in the underlying aviation asset.\textsuperscript{183} 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 quickly and with a minimum of legal uncertainty upon debtor default and then sell or re-lease the collateral.\textsuperscript{184} 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.\textsuperscript{185}

In the United States, § 1110 guarantees to financiers that those financing principles will be met in the event that default occurs. Saunders et al. argue 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.”\textsuperscript{186} The lower credit and liquidity risks provided by § 1110 protection result in lowered spreads over the risk-free interest rate offered by lenders.\textsuperscript{187} Arguably, then, § 1110 has

\textsuperscript{182} Saunders et al., supra note 182, at 313. 
\textsuperscript{183} See id. at 315. 
\textsuperscript{184} See id. at 317. 
\textsuperscript{185} See id. at 316. 
\textsuperscript{186} See id. at 323. 
\textsuperscript{187} 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
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.\textsuperscript{188} 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

Looking at 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 chapter if the action would be manifestly contrary to the public policy of the United States.” However, the committee report for the new Act

\textsuperscript{188} 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, 406 F.3d at 924 (“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.”).
specifically states that “the word ‘manifestly’ in international usage restricts the public policy exception to the most fundamental policies of the United States,” so the bar is set high for convincing the Court to sidestep a request for comity.\(^{189}\) 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.”\(^{190}\) That being said, the primary effect of Chapter 15’s enactment was to move ‘comity’ from the list of six § 304(c) factors and to make it instead an overarching, primary consideration when considering the remaining five factors.\(^{191}\) 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.\(^{192}\) 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.

**E. Harmonization with International Financing Principles**

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

\(^{189}\) H. Rpt 109-31.

\(^{190}\) 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).

\(^{191}\) 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.

\(^{192}\) 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.").
International Interests in Mobile Equipment as modified by the 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 countries at the convention signed the final act; forty-one have signed the Convention and its Protocol. The United States ratified the Convention and Protocol on October 28, 2004. Brazil, however, was not a party to the Convention and has not ratified the measures. The Convention applies “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.” The Convention thus does not apply on its face, but the weight of the international movement toward harmonization of aircraft financing protection swings the pendulum toward the application of those 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 assert-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.

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.”197 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 Protocol would contribute to micro- and macroeconomic benefits in capital and transaction costs for all parties involved. “International commerce demands international law,”198 and as more cross-border transactions are conducted, more standardized cross-border legal remedies are being sought.

IX. Conclusion

The unique protections of § 1110 present a compelling marginal case to be upheld even in the face of foreign main insolvency proceedings that do not provide them. U.S. courts might use the public policy ‘escape clauses’ permitted by modified universalism to enforce the provisions of § 1110 that protect creditors. Financiers approaching a Chapter 15 ancillary proceeding need to emphasize the extent to which their interests would be impaired relative to the Code if a foreign insolvency law is applied and also need to present a strong case that the center of main interests for the specific transactions leading to the § 1110 protections are centered in the United States. It is not a foregone conclusion that a § 1110 financier will not receive the protections it seeks, but those creditors must emphasize the particular equities that would allow a court to apply the comity tests and decline to extend comity.

197 Id. at 327.
198 Gopalan, supra at 117, at 849.
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 all point to the choice that courts may be inclined to make in future cross-border insolvency proceedings: modify the foreign proceedings as necessary to make available the § 1110 protections and therefore comfort the aviation financing community that is seeking predictability in lending and speedy enforcement of rights in debtor default situations.