

# CAPE TOWN CONVENTION LEGAL ACTIVITY ANALYSIS<sup>1</sup>

Produced by the Legal Advisory Panel to the Aviation Working Group

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Reference: Oceanair Linhas Aéreas, 2018		
Date of Judgment:	13 December 2018 – decision granting protection / 15 June 2020 – decision converting the JR proceeding into liquidation	
Case:	Oceanair judicial recuperation and bankruptcy	
Relevant CTC/Protocol (IR Rules and Procedures)	Articles 13 (1) (a), X (6) (a), IX (1) (a) and (b); Article XI (2), (3), (5), (7), (8), (9), (10) and XIII (3).	IR Rules and Procedures  None
Relevant CTC Jurisdictions	Brazil	

## CTC Facts, Conclusions and Analysis

### I. Facts:

- 1) On 10 December 2018, Oceanair Linhas Aéreas S.A. (“**Oceanair**”) filed for bankruptcy court protection with the São Paulo Bankruptcy Courts. The bankruptcy restructuring procedure in Brazil is called “judicial recuperation”. Oceanair’s initial petition completely ignored the CTC and included a request for a stay against all lessors to suspend repossession actions that were in course, and to prohibit new repossessions. At that time, Oceanair was in possession of around 45 (forty-five) aircraft, all leased under operating lease agreements with different lessors.
- 2) On 11 December 2018 the Bankruptcy Court accepted Oceanair’s arguments, all based on the public nature of the transport service and its need of the aircraft for these purposes, and issued an order granting Oceanair a 180-day of stay<sup>2</sup>.

<sup>1</sup> Unless otherwise indicated, Articles references in Arabic numerals are to those the Convention on International Interests in Mobile Equipment (**Convention**), and in Roman numerals are to those on the Protocol on Matters Specific to Aircraft Objects (**Protocol**). The Convention, as modified by the Protocol, is referred to as **CTC**.

<sup>2</sup> This is the standard stay period provided in Brazilian Bankruptcy Law and is applicable to all categories of creditors and lessors or sellers in conditional sale agreements other than aircraft lessors.

- 3) On 11 December 2018 Constitution Aircraft Leasing (Ireland) 9 Limited and Constitution Aircraft leasing (Ireland) 10 Limited (collectively “**Constitution**”), both of which are related to Aircastle, filed a reconsideration motion with the Bankruptcy Court, based on the Brazilian Bankruptcy Law (the “**BBL**”) article 199<sup>3</sup>, as well as articles 13(1)(a), X(6)(a), IX(1)(a) and (b), XI(2) and XIII(3) of the CTC and convinced the Bankruptcy Court Judge to reduce the initial waiting period from 180 days to 30 days. Rather than fixing a 30-day period for Oceanair to return the Aircraft, however, the Bankruptcy Court Judge, evoking the principle of preservation of the company, scheduled a preliminary hearing at the end of the 30-day period (14 January 2019) with participation of Oceanair and all aircraft and engine lessors. The court also ordered Oceanair to use the 30-day period to negotiate amicable arrangements with its lessors.
- 4) At the 14 January 2019 hearing Oceanair’s counsel admitted the widespread existence of lease defaults and alleged that Oceanair had been unable to reach agreement with its lessors due to the holiday season. The Judge granted a new 18-day stay period to Oceanair to present payment proposals to its lessors and/or an aircraft redelivery plan. The court order also stipulated that from 1 February, Oceanair should resume the timely lease payments.<sup>4</sup>
- 5) Immediately after the 14 January 2019 hearing one of the lessors tried to deregister its aircraft through the filing of the IDERA with the Brazilian Civil Aviation Agency (“**ANAC**”). The Bankruptcy Court Judge convened an urgent hearing and ordered the lessor and ANAC to suspend deregistration, as well as all other judicial or administrative measures that could result in the repossession of aircraft and/or cessation of Oceanair’s operations<sup>5</sup>.
- 6) Between 14 January and 1 February Oceanair sent written proposals to all of its lessors. None of the lessors accepted those proposals and most informed the court of their rejection.
- 7) On 1 February Oceanair filed a motion asking the Court to schedule a general creditors meeting for the first half of April, 2019 and to extend the court order preventing lessors from exercising their rights of repossession until that time. Their arguments were mainly the same: (i) the leased aircraft were essential to its operations; (ii) the principle of preservation of the company should prevail against the right of repossession of aircraft by lessors; (iii) the CTC was not being violated based on a legal opinion of University of São Paulo law professor, Prof. Francisco Satiro, in support and defense of the airline<sup>6</sup>. On 4 February the Judge rendered

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<sup>3</sup> This article stipulates that rights under aircraft leases (and aircraft engine leases) are not subject to suspension or a stay due to a judicial recuperation proceeding. In addition claims arising under such leases are excluded from the judicial recuperation proceedings.

<sup>4</sup> After the 14 January hearing some controversy arose as to whether lessors had agreed to the further extension until 1 February. The Judge required all lessors that were represented to sign the court order and subsequently the Judge claimed that those signatures indicated the lessors’ willing acceptance of the terms. The lessors had not, however, agreed with the order; the lessors had demanded immediate repossession and the Judge imposed the 14 January order on the lessors. In addition the Judge made the 14 January order binding on lessors that had not been represented at the hearing.

<sup>5</sup> The deregistration requests were based on the wording contained in the court order issued on 14 January (please refer to the footnote 5 above) which expressly stated that the lessors’ rights and remedies arising from the Cape Town Convention were reserved. However, the Bankruptcy Court Judge suspended all deregistration proceedings.

<sup>6</sup> Some of Prof. Francisco Satiro’s arguments were: (i) regardless of a broader or narrower interpretation of Art. 47, which that provides for the principle of preservation of the company, its overall purpose is the ensure means for preserving the debtor company from immediate liquidation that would result in loss of value and damages to all parties directly (debtor and creditors) or indirectly (employees, suppliers, market) involved; (ii) Finnish, Italian, Japanese, Canadian and English laws all mitigate protective measures in favor of financiers, which reinforces the general position that a jurisdiction whose legal system allows for the reorganization of airlines must permit extreme measures and that there are other ways to compensate creditors without sacrificing local productive economic activity; and (iii) if there is a solution that reconciliates the interests of lessors with preservation of the debtor as an ongoing concern, a literal application of provisions that allow for immediate repossession of aircraft lack **commercial reasonableness**, which is required in article IX of the CTC.

a decision accepting Oceanair's requests and extending suspension of all lessor repossession rights until the date of the general creditors meeting. In addition to the same general preservation of going entity arguments he had been using since the beginning of the case, the Judge also determined that the meaning of articles 53 and 54 of the CTC was that the Court's discretionary authority was contemplated and accepted in the CTC. On this basis he concluded that CTC was not being violated since the Court would have to approve repossession measures. The Court decision of 4 February also required Oceanair to resume all lease payments and purported to extinguish Oceanair's protection in the event of any future payment default. During the month of February Oceanair did pay rent and other lease amounts on most, if not all, of its leases, however, commencing in March Oceanair again defaulted on lease payments. The lower Bankruptcy Court Judge was slow to react to this development and did not revoke the protective order he had issued prohibiting repossession

- 8) The sequence of decisions rendered between 14 December 2018 and 4 February 2019 were the subject of several appeals filed by a majority of lessors and by ANAC, all alleging violations of the following articles of the CTC: 13(1)(b); IX(1), X(6)(a), XIII(3), XI(1)(b), XI(2)(5)(7) and (9), as well as the article 199 of the BBL.
- 9) During the month of March Appeals Court Judge Ricardo Negrão,<sup>7</sup> (the Judge responsible for all appeals filed in the Oceanair Judicial Recuperation proceeding), granted an interim injunction authorizing ANAC to deregister aircraft based on IDERAs. He also issued an order authorising lessors to repossess aircraft, however, Oceanair appealed to the President of the Superior Court of Justice in Brasilia (the "STJ"). The President revoked Judge Negrão's order on a preliminary basis, accepting Oceanair's arguments that loss of the leased aircraft would violate the principle of company-preservation and would be inconsistent with the company's social role in society. The revocation was not based on the merits of claims and was purported to be valid to enable the creditors to meet.<sup>8</sup>
- 10) As soon as the general creditors meeting finished, on 5 April 2019, lessors reignited Civil Court complaints to repossess leased aircraft. Some Civil Court judges, uncertain that the bankruptcy courts had granted lessors repossession rights, chose to wait for a final decision on the merits of the Interlocutory Appeal had been rendered. On 8 April 2019, 120 days after the filing of the judicial recuperation proceeding, the 2<sup>nd</sup> Corporate Appeals Court Panel of São Paulo granted lessors appeals on its merits. During the remainder of April Lessors repossessed most of Oceanair's fleet, leaving it with just a few aircraft. Oceanair operated with a reduced fleet until the middle of May. In late May Oceanair's AOC was suspended and it completely ceased operations.

### III. Analysis:

#### **Stay period applicable in Brazil / Timing of the case**

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<sup>7</sup> The Superior Court of Justice is Brazil's highest court for commercial disputes. There is a higher court, called the "Supreme Court", however, that court's jurisdiction is limited.

<sup>8</sup> At least two times during the process lessors close to repossession were stopped by higher court orders, this instance and once by the President of the Judicial Courts of the State of Sao Paulo. In both cases the judges wrote that the creditors needed to be given a chance to convene and consider the Plan and that their orders were in fact protecting the relative rights of all parties, including creditors. What these orders did not acknowledge, however, is that due to the way the BBL functions aircraft lessor claims are not included in the bankruptcy procedure. The result was that lessors were prohibited from repossessing supposedly in part to protect creditors, however, the lessors were not part of that "protected" creditor pool. Aircraft lessors are not allowed to attend or vote at general creditor meetings of airlines in judicial recuperation.

11) Brazil adopted Alternative A of the Protocol and declared a waiting period of 30 days. At the time of adoption most industry participants assumed that the result of this was that in future Brazilian judicial recuperation cases a 30-day stay period would apply. A closer analysis of CTC and Article XI (2) and (3) of the Protocol, however, demonstrates that the correct stay period against lessor repossession should be the earlier of the declared "waiting period" or the date on which lessors would be entitled to repossession prior to implementation of the CTC. As we mentioned above, the BBL at its Article 199, expressly provides that aircraft leases to airlines are not subject to any stay period.

Therefore, in Brazil aircraft lessors should not be stayed from repossessing aircraft from an airline in judicial recuperation (ie, zero-day stay). This position relating to a possible zero-day stay would be applicable to leases only. Aircraft that are financed through other means such as mortgages or title retention agreements would be subject to the 30-day waiting period contained in Brazil's declarations under CTC.

The initial stay the Bankruptcy Court was going to impose on lessors, of 180 days, is provided in article 6, § 4 of the BBL. Aircraft lessors are exempt from this rule based on Art 199 of the BBL and on the CTC. Other non-lessor aircraft creditors under the CTC should also be exempt from the 180-day stay based on the CTC.

Due to the sequence of decisions described above lessors in the Oceanair case were ultimately subjected to a stay period 120 days. This violated articles XI(2)(b), (7) and (9) of the CTC.

Although future judicial reorganization cases involving Brazilian commercial airlines should respect the CTC based on the 8 April 2020 decision, though this correct adherence cannot be guaranteed.

#### **Court's Jurisdiction: Bankruptcy Court vs Civil Court**

12) The Bankruptcy Court violated the CTC not only in terms of extrapolating the timing of the stay that should have expired in January 2019, but also in relation to the obligation provided in the article XI.2 of the CTC determining that the insolvency administrator or the debtor, as applicable, must give possession of the aircraft object to the creditor upon the expiration of the stay period, regardless of a civil court proceeding.

13) In terms of Brazilian legislation, the BBL provides that the Bankruptcy Court is the sole court with jurisdiction to handle and take decisions in all insolvency proceedings, including JR proceeding and liquidation. In the liquidation proceedings particularly, the BBL provides that the Bankruptcy Court is indivisible and competent to hear all actions involving the debtor's assets, interests and business, with the exception of labor and tax suits and those not regulated hereunder in which the debtor figures as plaintiff or co-plaintiff.

This concept is not that clear in cases of judicial recuperation, especially in regards the lessor rights, which are expressly excluded from all judicial recuperation proceedings. There is a precedent coming from Superior Court of Justice (Number 480) providing that the Bankruptcy court does not have jurisdiction to decide cases involving assets not contemplated in a Judicial Recuperation Plan, as was the case of the leased aircraft in Oceanair's possession.

Prior to this judicial recuperation proceeding no disputes arose concerning jurisdiction. Repossession actions were filed in Civil Courts, not bankruptcy courts. Based on Art 199 of the BBL this is supposed to continue even if an airline is in judicial recuperation.

Once the Oceanair judicial recuperation proceeding started, however, the Bankruptcy Court ignored the plain language of BBL article 199 and article XI.2 of the CTC and suspended lessor repossession rights. His orders purported to apply to civil courts where repossession cases were pending.

At the same time that the Bankruptcy Court violated the CTC and article 199 of the BBL by interfering with lessors rights not subject to a judicial recuperation proceeding, all to benefit Oceanair. On 8 April 2019, when the 2nd Corporate Appeals Court Panel of São Paulo granted lessor's appeals on its merits, the Bankruptcy Court acting inconsistently and in violation of CTC art XI.2 of the CTC, refused to order Oceanair to return leased aircraft lessors. The Bankruptcy Judge limited his decision to merely lifting the previous order that suspended lessor rights. Since Oceanair did not voluntarily redeliver leased aircraft this forced lessors to continue or, in some cases to file, repossession action in civil courts to repossess their aircraft.

#### **Timing for ANAC to accomplish its obligation to deregister aircraft**

- 14) Since CTC implementation in Brazil ANAC has regularly and expeditiously honoured the IDERAs, despite opposition from Brazilian lessees. ANAC has been issuing deregistration messages based on IDERAs, within five working days, as provided in article X(6)(a) and XI(8)(a) of the CTC. Nearly all of Oceanair's fleet was deregistered through the use of IDERAs.

#### **Aircraft maintenance and lease payments during the stay period**

- 15) Other violations of the CTC committed by the Bankruptcy Court and Oceanair were the provisions of Article XI(5), (7) and (10) of the CTC.

During the stay period at least three different lessors had issues with their aircraft, equipment and components arising either from the expiration of Maintenance Checks, engine bird ingestion, removal or substitution of parts. All of these events were reported to the Bankruptcy Court, which essentially ignored them.

#### **Court consideration of other relevant provisions of the Convention**

- 16) The following summarizes some of the erroneous CTC arguments Oceanair asserted during 2019.

- (i) Article 39 Declaration: Airlines, because they provide a public service, are equivalent to government agencies and therefore their claims have priority over all international interests and
- (ii) Article 8(3): Oceanair alleged that repossession is not "commercially reasonable" and "manifestly unreasonable"; especially when the repossession involves all of an airline's fleet as opposed to just a few.

These articles were never considered by any court on their merits.

Among the arguments Oceanair distorted which were analysed by the Courts, although superficially were:

(i) Articles 53 and 54 Declaration: Oceanair stated that because Brazil does not allow self-help (other than IDERAs), CTC authorizes courts to use their discretion on a case by case basis. The Bankruptcy Court Judge misconstrued this argument in the decision rendered on 1 February 2019, to justify the granting of a new extension of the stay period well beyond the zero day stay of the BBL and the 30-day waiting period of the CTC.

### III. Conclusions

- 1) Oceanair Linhas Aéreas S.A. ("**Oceanair**") was the first Brazilian airline to file for judicial recuperation in Brazil under the auspices of CTC; in early July 2020 the reorganisation process was converted into procedure of definitive liquidation. Thus all the efforts exerted by the Bankruptcy Court and Oceanair proved to be fruitless and caused lessors to bear higher damages than they would have had the CTC been respected.
- 2) The positive side of the case is that the final precedent created through the 8 April 2020 decision rendered unanimously by the 2<sup>nd</sup> Chamber of Corporate Appeals Court in São Paulo reaffirmed Art 199 of the BBL and the CTC<sup>9</sup>.

### IV. Annotations Reflecting Subsequent Legal Developments:

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<sup>9</sup> Arguments used that were relevant and accurate were as follows: (i) arguments in favor of the preservation of the company do not reply satisfactorily to other question as such the fact that there are creditors that according to the BBL are not subject to the JR proceeding; (ii) it is inconceivable to protect a debtor's interests by relativizing the legal precepts to the detriment of both the National and International strategy provided in the law; it would consist in misinterpretation of the BBL; (iii) the simple fact of the filing of a JR proceeding does not prevent the court from analysing and deciding for liquidation, on the contrary, it must be declared as soon as the debtor's formal or economic unfeasibility has been determined (i.e. lack of creditor's interest, breach of procedural requirements, breach of obligations previously undertaken); (iv) Judge Negrão transcribed in his opinion part of a text published in a legal digital library of the Superior Court of Justice, in 2016, about the CTC, that relief pending final determination as provided in article 13 and the default remedies described in article IX of the Protocol, including the use of the IDERA. The use of IDERA was highlighted as a practical innovation and as the most effective response to fears of aeronautical equipment lessors and financiers, as a guarantee that should work in favor of the whole market by decreasing the aeronautical equipment financial costs, reducing judicial involvement in disputes and promoting a greater predictability and security to the creditor's aviation community; (v) it was probably not a coincidence that Judge Negrão also transcribed parts of a literary work published by one of the Oceanair's lawyers in the JR Proceeding, who is also a Bankruptcy Law Professor, in which he wrote that " the recovery trend, both in the JR proceeding and in the liquidation spin around the debtor's assets capacity of paying its debts [...]. Third party assets are neither part of the Estate nor of the assets list of the debtor under JR proceeding and must not be used to pay the debts under the logic of collective insolvency proceedings. They cannot be used as a parameter to determine the debtor's capacity to pay the indebtedness or to succeed recovering in relation to the creditors group – citation of Professor Ivo Waisberg fro *Temas de Direito da Insolvência Estudos em homenagem ao Professor Manoel Justino*, São Paulo: Editora IASP, 2017, p. 494