The Impact of Airline Bankruptcies on Airports

DETAILS

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THE IMPACT OF AIRLINE BANKRUPTCIES ON AIRPORTS

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I. INTRODUCTION

A. Scope of the Report

Given the importance of airline revenue to airport operations and the prevalence of airline bankruptcies, lawyers representing airports should be cognizant of bankruptcy issues so that they can anticipate issues when negotiating agreements with airlines before bankruptcies occur, and take appropriate steps in the event of airline bankruptcies, including consulting with and adequately monitoring bankruptcy counsel.

Airline bankruptcies not only pose significant financial hardship on airports dependent on airlines for revenue, but also raise significant legal issues concerning treatment of airlines' obligations to airports under the bankruptcy process. The objective of this report is to examine those legal issues presented by the filing of airline bankruptcies that are relevant to airports, and to explore how airport lawyers and courts have responded to those issues. The report is intended to provide a solid understanding of the basics of bankruptcy theory and law relevant to airport operating agreements with airlines, and to identify issues such as lease recharacterization and payment of stub period rent[1] that particularly affect airports dealing with airlines in bankruptcy. Such an understanding should assist airport lawyers in conducting research on bankruptcy-related issues in their own jurisdictions, in negotiating agreements that include appropriate protections of the airport's interests in the event of airline bankruptcy, and in mitigating damages to the airport's financial interests in the event of bankruptcy under existing as well as future agreements.

The balance of the Introduction provides an overview of airport financial issues, including the precarious nature of airline finances, the importance of airlines to airport financing, and the Federal Aviation Administration (FAA) study on the *Impact of Air Carriers Emerging from Bankruptcy on Hub Airports, Airport Systems, and U.S. Capital Markets*. The main body of the report:

- Discusses bankruptcy theory.
- Provides an overview of the most salient provisions of the Bankruptcy Code and relevant federal aviation requirements.
- Discusses the bankruptcy process.
- Reviews bankruptcy cases on several topics most relevant to airport concerns.
- Examines the treatment of airport claims under the Bankruptcy Code and under federal aviation requirements.

After reviewing applicable legal authority, the report concludes by:

- Reviewing the major legal issues at play under the Bankruptcy Code and under federal law and regulation that should be of greatest concern to airport counsel.
- Offering some points for airports to consider in order to mitigate losses due to airline bankruptcy, both before and after airlines file for bankruptcy protection.
- Sounding a cautionary note about steps that appear helpful, but in fact may not be.

The report primarily addresses federal business bankruptcy cases, although it does identify issues on which state law will govern. The analytical emphasis is on airline bankruptcy cases, although nonairline cases are also referenced. The intent is to provide a starting point for airport lawyers to conduct research on the law in their specific jurisdictions in evaluating airline agreements and other issues; further research is advisable. In fact, given the complexity of bankruptcy law, airport lawyers are likely to be working with bankruptcy counsel, and the report may be particularly useful to airport counsel in that regard.

The report is meant to provide an overview of bankruptcy basics. Readers in need of specific details of bankruptcy procedure should consult practice guides[2]

[1] Stub period rent is the rent owed for the "stub period," that is "the period from the bankruptcy filing date to the end of the first month of bankruptcy administration." In re UAL Corp., 291 B.R. 121, 122 (Bankr. N. D. Ill. 2003). Discussed in § II.D.4, *Stub Period Rent*, *infra*.

[2] *See, e.g.,* PAMELA EVERETT NOLLKAMPER, BANKRUPTCY COURTS AND PROCEDURES (2005) (Procedural information on Chapter 7, Chapter 11, creditors' proceedings, adversary proceedings, appeals, and U.S. Bankruptcy Courts); THOMAS J. SALERNO & JORDAN A. KROOP, BANKRUPTCY LITIGATION AND PRACTICE: A PRACTITIONER'S GUIDE (4th edition 2007). (Overview of U.S. bankruptcy law—including suggested resources, bankruptcy court system, Chapter 7, and Chapter 11; Appendices include forms and samples of pleadings and related documents); D.M. LYNN, MICHAEL R. ROCHELLE & SANDER L. ESSERMAN, HANDBOOK FOR DEBTORS IN POSSESSION (2007) ,

and bankruptcy counsel. Rejection of collective bargaining agreements, while important to airlines in bankruptcy,[3] is also beyond the scope of this report.

It is beyond the scope of the report to render legal opinions or recommend specific approaches to negotiating operating agreements with airlines. However, the report will identify legal issues that airport authorities may want to consider in negotiating such agreements. Operational considerations will also affect airport authorities' negotiating strategies and efforts to insulate themselves from the effects of airline bankruptcy, for example, by increasing retail and other nonairline revenues. Such operational considerations are beyond the scope of the report as well.

B. Overview of Airport Financial Issues

Turbulence in the airline industry leads to less revenue for airports. When the FAA asked for comments on the impact of airlines emerging from bankruptcy on airports, those commenting cited negative effects such as "…rejected leases, discontinued or reduced services, non-payment of rates and charges, non-payment or reduction in PFC receipts, extended uncertainty with leaseholds, and the attempts to reject payment on a special facility bond obligation while continuing to operate at the SFB-financed facility, paying only non-capital costs."[4]

More specifically, for example, the recent bankruptcies of Aloha Airlines, Skybus Airlines, and ATA Airlines may cost Oakland International Airport over $2 million in annual revenue, due to loss of gate leases and landing fees.[5]

While airports draw to varying degrees on nonairline revenues,[6] many airports are dependent on airlines for financial support, so airlines' financial difficulties affect the airports they serve. A significant number of airlines nationwide face such difficulties, a trend that began in the 1980s[7] and has since gotten worse, in part due to declines in traffic following the terrorist attacks of September 11, 2001 (9/11)[8] In addition to a decline in traffic due to fear of terrorist attacks, fuel price increases both before and after September 2001 have severely damaged airlines' profitability, as have borrowing and labor costs.[9] The Severe Acute Respiratory Syndrome (SARS) outbreak and the Iraq War also depressed air travel and thus airline revenues.[10] Changes in business travel patterns have also played a role for some airlines.[11] In

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COLLIER HANDBOOK FOR TRUSTEES AND DEBTORS IN POSSESSION; Marvin E. Jacob, Richard P. Krasnow & Scott E. Cohen, *Special Provisions Relating to Chapter 11 Airline Cases* (Ch. 15 in WEIL, GOTSHAL & MANGES, REORGANIZING FAILING BUSINESSES, A COMPREHENSIVE REVIEW AND ANALYSIS OF FINANCIAL RESTRUCTURING AND BUSINESS REORGANIZATION, ABA Section of Business Law (2007)).

[3] 11 U.S.C. 1113, Rejection of collective bargaining agreements. Unlike railroads, airlines in bankruptcy proceedings may, under some circumstances, reject collective bargaining agreements. 2 PAUL STEPHEN DEMPSEY, ROBERT HARDAWAY & WILLIAM E. THOMS, AVIATION LAW AND REGULATION (1992, § 17.12, the Bankruptcy Amendments and Federal Judgeship Act of 1984, 98 Pub. L. No. 353, 98 Stat. 333–346. *See, e.g.*, Northwest Airlines v. Association of Flight Attendants (In re Northwest Airlines Corp.), 483 F.3d 160 (2d Cir. 2007). *See also* Babette Ceccotti, *What About My Pension? Bankruptcy Invades What Was Once a Secure World*, 16 BUSINESS LAW TODAY (Nov./Dec. 2006) , *available at* www.abanet.org/buslaw/blt/2006-11-12/ceccotti.shtml (Last visited Dec. 15, 2008). Note that while it is bad faith to file bankruptcy solely to modify or reject a collective bargaining agreement, it is permissible to file bankruptcy when one of the purposes is to modify or reject the agreement to achieve other legitimate bankruptcy goals. Jeffrey S. Heuer & Musette H. Vogel, *Airlines in the Wake of Deregulation: Bankruptcy as an Alternative to Economic Deregulation*, 19 TRANSP. L.J. 247, 261 (1991).

[4] FAA, Discussion of comments received in response to Request for Public Comment on the Impact of Airlines Emerging From Bankruptcy on Hub Airports, Airport Systems, and U.S. Capital Bond Markets, 68 Fed. Reg. 38108 (June 26, 2003), at 5, *available at* www.regulations.gov/fdmspublic/component/main?main=DocumentDetail&o=0900006480313b4f (Last visited Dec. 16, 2008).

[5] Matt Andrejczak, *Airports Weigh Prospects Amid Industry Turmoil*, MARKETWATCH, Apr. 15, 2008. Accessed Apr. 17, 2008, *available at* www.marketwatch.com/news/story/airports-weigh-prospects-amid-industry/story.aspx?guid=%7B0FCF7F2F%2DD1FE%2D4BCD%2DB50F%2D8B28AEFE885F%7D (Last visited Dec. 16, 2008).

[6] CINDY NICHOL, ACRP SYNTHESIS 1, INNOVATIVE FINANCE AND ALTERNATIVE SOURCES OF REVENUE FOR AIRPORTS, at 2, 24–34 (Transportation Research Board, 2007), http://onlinepubs.trb.org/onlinepubs/acrp/acrp.syn.001.pdf. Airport bonds, which are financed by both airline and nonairline revenue, are the largest source of funding for airport capital projects. Statement of Greg Principato, President, Airports Council International–North America (ACI-NA) and Fredrick J. Piccolo, Chairman, ACI-NA, CEO, Sarasota-Bradenton International Airport, before the House Transportation and Infrastructure Subcommittee on Aviation, "FAA's Airport Improvement Program," Mar. 28, 2007, http://aci.3cdn.net/ea933d8aa009ff2942_e9m6bxat5.pdf.

[7] Ian Dattner, *Chapter 11 Protection: Who Are We Protecting*?, 38 COL. J.L. & SOC. PROB. 287, 319 (2005). Since the airlines were deregulated in 1978, over 120 airlines have declared bankruptcy. *Id*., n.119.

[8] Kristina McQuaid, *Delta & Northwest File for Bankruptcy: Is It Time to Ground a Major Airline?* 29 HOUS. J. INT'L L. 663, 665 (2007), *available at* http://www.entrepreneur.com/tradejournals/article/168283785.html (Last visited Dec. 16, 2008).

[9] *Id*. at 667.

[10] Statement of Mario Diaz, Deputy Aviation General Manager, Hartsfield-Jackson Atlanta International Airport, at the summit on Trans-Atlantic Relationship–Aviation Policy: Clearing the Way to a More Open Market, Apr. 12, 2003, http://www.uga.edu/ruskcenter/pdfs/occasional3avia.pdf, at 172; Eric Young, *War, Economy Clip Airport's Wings*, S.F. BUSINESS TIMES, Mar. 28, 2003, *available at* www.bizjournals.com/sanfrancisco/stories/2003/03/31/story1.html. (Last visited Dec. 16, 2008).

[11] Jon F. Ash, The Economic Implications of the O'Hare Modernization Program 5–11 (May 2004), http://www.intervistas.com/4/reports/OHareModernizationProgram.pdf.

addition, airports face new federal security requirements.[12] To the extent that new security requirements have prevented nonticketed people from reaching concessionaires situated beyond security checkpoints, those requirements have also led to a reduction in nonaeronautical revenue at some airports.[13]

Some airports are more vulnerable than others. A representative of Moody's Investors Service testified to the House Aviation Subcommittee that airline bankruptcies were expected to affect "those airports with less profitable routes, a high reliance on airline-derived revenues, a service area that is below the median in terms of generating demand for air travel, below-average liquidity levels, and limited ability to cut airport operating costs and/or scale back capital programs."[14] Other factors include: whether the airport's market has a high percentage of origin and destination traffic; whether the Chapter 11 airline operates a significant hub at the airport;[15] the level of airline competition in the market; [16] the type of rate setting agreement; and the presence of majority-in-interest provisions.[17]

Airports may rely on a range of bonds to help finance airport operations, including general obligation (GO) bonds, general airport revenue bonds (GARBs), bonds backed by passenger facility charges (PFCs), bonds backed by customer facility charges (CFC), and special facility bonds.[18] Of these, GARBs, PFC-backed bonds, and special facility bonds depend in whole or in part on revenue from the airlines serving the issuing airport; these bonds are discussed below. Airline bankruptcies do not really affect GO bonds, which are backed by the general tax revenues of the governmental entity that issues them, or CFC bonds, which are backed by CFCs collected by car rental companies.

1. Bond Financing

GARBs.—GARBs must be issued under legal authority such as state law or municipal charter.[19] GARBs have been the predominant means of financing airport infrastructure,[20] and have generally had a very strong credit history.[21] These bonds are generally tax-exempt industrial revenue bonds. Although issued by airports or other public authorities, GARBs are often backed by airlines through use and lease agreements.[22] As of the year 2000, airlines at roughly half of the largest U.S. airports backed GARBs.[23] In addition, when revenues for PFC pay-as-you-go projects are not sufficient, additional GARB funding may be required.[24]

PFCs:[25]—PFCs are fees authorized to be imposed by commercial service airports for each paying passenger enplaned at the airport.[26] The FAA must authorize imposition and collection of PFCs at individual airports. PFCs range from $1 to $4.50 per enplanement, depending on project purpose.[27] As of March 2008, more than $2.5 billion was collected annually at over 360 airports.[28]

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[12] Executive Summary, ACI-NA 2005 Airport Capital Development Needs, www.aci-na.org/static/entransit/Airport%20capital%20development%20needs.pdf.

[13] *See* John F. Brown Company, Inc., *Airport Case Studies in Connection with Study on the Impact of Air Carriers Emerging from Bankruptcy on Hub Airports, Airport Systems and U.S. Capital Bond Markets*, Nov. 2003, at 98, http://ostpxweb.dot.gov/aviation/domav/dotspecterstudy.pdf.

[14] AAAE Airport Report, Panel Considers Airline Outlook, Oct. 15, 2005. Accessed Nov. 3, 2008, at http://www.aaae.org/news_publications/airport_report/arannual.cfm?e=getFile&efs=29E7BA2F8C60BD8F8D4C9609EBAC21518CA041E967F00A0F91DDDC0AD7C7E08958D5.

[15] *Fitch Places Delta U.S. Hub Airports on Negative Outlook; Sectorwide Impact Seen to be Minimal*, BUSINESS WIRE, Sept. 15, 2005, *available at* http://findarticles.com/p/articles/mi_m0EIN/is_/ai_n15391979 (Last visited Jan. 2, 2009).

[16] AAAE Comments in response to June 26, 2003, Notice, p. 3, *available with membership login at* http://airlineinfo.com/rulespdf3/161.pdf (html file available).

[17] *See generally* Fitch Ratings, *Public Finance, Airports Rating Criteria Handbook for General Airport Revenue, Passenger Facility Charge, and Letter of Intent Bonds* (Revenue Criteria Report), Mar. 12, 2007, assessable through Fitch Ratings Web site account, available at http://www.fitchratings.com.

[18] NICHOL, *supra* note *6*, at 13–18. Nichol also discusses other financing mechanisms and issues, such as bonds backed by future grants, tax credit bonds, and the effects of the alternate minimum tax. *See also* PAUL STEPHEN DEMPSEY, THEORY AND LAW OF AIRPORT REVENUE DIVERSION 4-9 (Airport Cooperative Research Progam, Transportation Research Board, Legal Research Digest 2, 2008), http://onlinepubs.trb.org/onlinepubs/acrp/acrp.lrd_002.pdf.

[19] National Federation of Municipal Analysts, *Recommended Best Practices in Disclosure Airport Debt*, May 2004, at 16, www.nfma.org/disclosure/rbp_airport.pdf. *See, e.g.*, Brown Company, *supra* note 13, at 17, describing GARBs issued by Allegheny County, and at 50, describing GARB authority and restrictions for St. Louis.

[20] NICHOL, *supra* note 6, at 14. Under O'Hare's Modernization Plan, GARBs will finance more than 50 percent of three major components of the plan. Ash, *supra* note 11, at ES-4.

[21] Fitch Ratings, *supra* note 17, at 1.

[22] PAUL STEPHEN DEMPSEY, AIRPORT PLANNING AND DEVELOPMENT HANDBOOK: A GLOBAL SURVEY 187 (2000).

[23] *Id.* at 188.

[24] *See* Brown Company, *supra* note 13, at 39.

[25] ACI, *Passenger Facility Charges*, www.aci-na.org/static/entransit/Passenger%20Facility%20Charges%20Fact%20Sheet.pdf.

[26] Aviation Safety and Capacity Expansion Act of 1990 (Title IX of the Omnibus Budget Reconciliation Act of 1990), Pub. L. No. 101-508, 104 Stat. 1388, Nov. 5, 1990; Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (AIR21), Pub. L. No. 106-181, 114 Stat. 61, Apr. 5, 2000; 14 C.F.R. pt. 158.

[27] 14 C.F.R. pt. 158.15, Project eligibility at PFC levels of $1, $2, or $3, pt. 158.17, Project eligibility at PFC levels of $4 or $4.50. *See, e.g.*, Fitch Ratings, *supra* note 17, at 10–12; NICHOL, *supra* note 6, at 8–9, 16–17.

[28] Bernard F. Diederich, *Federal Government Updates: PFCs (DOT White Paper—Airline Bankruptcy Issues)*, presented at Airports Council International–North America 2008 Spring

PFCs can be used on a "pay-as-you go" basis to fund small projects, as a means to fund bonds that pay for large projects,[29] and to repay tax-exempt bonds issued to finance improvements.[30] The purpose for PFC revenues can be changed. For example, Lambert-St. Louis International Airport (STL) received approval to apply PFC revenues to fund construction of its east terminal, and later used GARBs to substantially replace the PFC revenue and redirect PFC revenue to its runway project.[31] Between 2001 and 2005, approximately $2.2 billion in PFCs were collected, of which 30 percent could go to bond financing.[32] PFCs fund approximately 30 percent of current U.S. airport capital investment[33] bonds, and directly fund another 11 percent of capital investment.[34]

Special facility bonds.—In order to be tax-exempt, special facility bonds must be issued by a governmental entity, which must have legislative authority to issue bonds.[35] However, the issuance is on behalf of an airline or group of airlines. Multi-tenant bonds have stronger credit because of their more diverse revenue base.[36] The bonds are nonrecourse with respect to the governmental authority, which passes the bond payments through to the Bond Trustee.[37] The structure of special facility bond transactions affects the security of the bonds in the event of bankruptcy:

> The structure and security of special facility transactions vary considerably, from a simple guarantee of the airline, in which case the investor's claim ranks behind secured creditors with limited chance for recovery, to secured structures, such as mortgage, and leases, which may provide the investor with a much higher likelihood of recouping their investment.[38]

The United cases, *infra*, illustrate the extent to which the transaction structure may affect the security of debt recovery in the event of airline bankruptcy.[39]

These bonds are backed solely by airline lease payments, with those payments structured to cover the bonds' debt service.[40] United Air Lines, which had constructed improvements at San Francisco International Airport (SFO), New York John F. Kennedy International Airport (JFK), and Los Angeles International Airport (LAX) financed by special facility bonds that were structured as lease-leaseback transactions with the airports, obtained rulings during its bankruptcy proceedings recharacterizing those leases. By recharacterizing those leases as "disguised financings," United—the first airline in bankruptcy to do so—was able to transform about $600 million in rent into $248 million in prepetition debt.[41] Given the potential financial impact of avoiding bond obligations, the possibility of lease recharacterization is an emerging issue to be aware of.[42] *See* Section II.D, Cases, *infra*. Since the United rulings, fewer of these bonds have been issued.[43] In fact, one aviation analyst stated, "airline backed financing of airport facilities will face increased scrutiny and probably increased yields, which will likely increase the difficulty of bringing airline-backed debt to the market."[44] Although at least one bankruptcy expert has observed that the United Airlines recharacterization cases may

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Legal Affairs Committee Conference, Session II: Current Airport Legal Issues, Apr. 18, 2008.

[29] Jacobs Consultancy, *Issues for Airports in the 2007 FAA Reauthorization*, Dec. 2006, at 3, http://www.jacobs-consultancy.com/pdfs/publications/Jacobs-Focus-2006-12.pdf; NICHOL, *supra* note 6, at 16–17.

[30] Humberto Sanchez, *Airport Lobbyists Seek Higher Passenger Fees to Pay Debts*, THE BOND BUYER 358.32492 (Oct. 23, 2006), at 6; Yvette Shields, *Chicago OKs $1.4B for O'Hare: Mix of New Money, Refunding, and CP*, THE BOND BUYER 360.32638, (May 24, 2007), at 1 (Chicago to use PFCs to retire GARBs), *available at* http://www.accessmylibrary.com/coms2/summary_0286-23807072_ITM (Last visited Dec. 16, 2008).

[31] Brown Company, *supra* note 13, at 55.

[32] *Observations on Planned Airport Development Costs and Funding Levels and the Administration's Proposed Changes in the Airport Improvement Program*, GAO-07-885 (June 2007), at 3, 8, http://www.gao.gov/new.items/d07885.pdf.

[33] ACI, *supra* note 25.

[34] Trends in Airline Use Agreements–Rates/Charges and the Allocation of Risk, slide 4, www.jacobs-consultancy.com/pdfs/publications/Trends_In_Airline_Agreements.pdf. *See also*, Robert S. Kirk, *Airport Improvement Program: Issues for Congress*, Feb. 26, 2007, http://cstsp.aaas.org/files/RL33891.pdf.

[35] Charlotte County Industrial Development Authority, Industrial Development Revenue Bond Financing Guidelines and Procedures, www.pureeconomics.org/New_Shtml_Files/PDF_Folder/CCIDA_Guidelines.pdf.

[36] NICHOL, *supra* note 6, at 18.

[37] *See, e.g.*, Kenton County Bondholders Comm. v. Delta Air Lines, Inc. (In re Delta Air Lines, Inc.), 374 B.R. 516 (S.D.N.Y. 2007), in which the Kenton County Airport Board issued bonds on behalf of Delta Air Lines, with lease payments from Delta passing to the Bond Trustee.

[38] *Fitch Places Delta U.S. Hub Airports on Negative Outlook, supra* note 15. If the bonds are unsecured debt, in the event of bankruptcy the bondholders may be reduced to receiving distribution as an unsecured creditor. *See* Massport 2007 Bond Issuance, at 68, A-47, www.massport.com/about/pdf/ac_07_os.pdf.

[39] *Id.*

[40] ACI-NA, *Primer: Airport Financing*, *available at* www.aci-na.org/index/issues_financing_primer (Last visited Dec. 16, 2008).

[41] Brian E. Davis, *Lease Recharacterization in Bankruptcy: United Air Lines Recharacterization Cases Bolster the Debtor-Tenant's Cause*, PRATT'S JOURNAL OF BANKRUPTCY LAW 135, 135–36 (2006). Delta Air Lines had also sought to recharacterize a lease at LAX, but ultimately filed a motion of dismissal. Delta Form 8-K, 2.7.07, Ex-99.1, at 58, *available at* www.secinfo.com/d1488v.uab.d.htm (Last visited Dec. 16, 2008).

[42] *See*, *e.g.*, Daniel S. Reimer, 1 AIRPORT MANAGEMENT 97, 99–100 (Sept. 2006), www.kaplankirsch.com/data/Legal_and_Regulatory_Dev_USA.pdf.

[43] ACI–NA, *supra* note 40.

[44] Ash, *supra* note 11, at 24.

have doomed special facility bonds as a viable financing mechanism,[45] these bonds are not entirely dead.[46] To the extent that such bonds are issued in the future, the issuer may retain a substantial economic interest to deter recharacterization of the leases.[47]

2. Precarious Airline Financial Condition

There were difficulties in the airline industry even before the terrorist attacks on 9/11, including the recession that began earlier that year.[48] That situation became worse in the wake of those attacks,[49] as airlines suffered a massive decrease in traffic.[50] A number of airline bankruptcies ensued, including those of United Air Lines, US Airways, and Hawaiian Airlines.[51] The SARS outbreak and increasing fuel prices also hurt the airline industry.[52]

Other legacy carrier bankruptcies since deregulation include TWA (Chapter 7), which resulted in lease rejections;[53] US Airways (Chapter 11), which resulted in lease rejections[54] and lease modifications; [55] and Delta Air Lines (Chapter 11), with a proposed reorganization plan allowing Delta to default on $1.2 billion of its special facilities revenue bond debt.[56]

As of the beginning of 2008, the airline business had again entered into a financially turbulent period, primarily due to sharply increased fuel prices.[57] One industry analyst expected the industry to lose $1.2 billion in the first quarter of 2008,[58] although by the end of the second quarter airlines were projecting as much as a $10 billion loss for 2008, due in large part to fuel costs.[59] Four small airlines, Frontier Airlines, Skybus Airlines, ATA Airlines, and Aloha Airgroup, all filed for bankruptcy within a few weeks of each other,[60] although Frontier said it had filed Chapter 11 for protection from a credit card processor that was seeking to substantially increase the amounts the processor withheld from ticket sales.[61] Skybus, ATA, and Aloha, however, ceased all operations/passenger operations.[62]

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[45] Jodi Richards, *Growing the Bottom Line: Opportunities, Challenges for the Airport Finance Side of the Ledger*, AIRPORT BUSINESS MAGAZINE, Apr. 2006, *available at* www.airportbusiness.com/print/Airport-Business-Magazine/Growing-the-Bottom-Line/1$5981 (Last visited Dec. 16, 2008).

[46] *Chicago City Council OKs $108 Mln Airport Bonds*, Reuters, June 13, 2007 (Chicago approved $108 million revenue bond refunding for American Airlines at O'Hare, refunding 1994 debt that in turn refunded bonds issued in 1984), available at http://uk.reuters.com/article/marketsNewsUS/idUKN1338523220070613 (Last visited Jan. 3, 2009).

[47] Fitch Report: *UAL Bankruptcy's Impact on Airport Special Facility Debt*, BUSINESS WIRE, Apr. 27, 2004, available at http://www.allbusiness.com/banking-finance/financial-markets-investing-securities/5598379-1.html (Last visited Jan. 2, 2009).

[48] Ash, *supra* note 11, at ES-7, 5-6.

[49] Indianapolis Airport Authority, *Comprehensive Annual Financial Report, Fiscal Year Ended December 31, 2004*, at 40, www.indianapolisairport.com/uploads/docs/2004-cafr_1C7T3T.pdf.

[50] Fitch Update: *U.S. Airports, Attacks' Impact on PFC Debt*, BUSINESS WIRE, Oct. 5, 2001, *available at* http://findarticles.com/p/articles/mi_m0EIN/is_/ai_78920493 (Last visited Jan. 2, 2009).

[51] *See, e.g.,* San Francisco International Airport Competition Plan Update, Dec. 10, 2003, at 8, www.flysfo.com/web/export/sites/default/download/about/competition/pdf/Competition_Plan_Update_Final_-_121003.pdf.

[52] Ash, *supra* note 11, at ES-7.

[53] *See* Fitch*: TWA Bankruptcy Filing May Affect Aircraft Securitizations,* BUSINESS WIRE, Jan. 11, 2001, *available at* http://www.allbusiness.com/banking-finance/leasing-industry-capital-equipment-leasing/6033867-1.html (Last visited Jan. 2, 2009).

[54] *E.g.*, Allegheny County Airport Authority (A Component Unit of County of Allegheny, Pennsylvania), *Financial Statements as of and for the Years Ended December 31, 2007 and 2006, and Independent Auditors' Report* 16, http://www.pitairport.com/UserFiles/File/pdf/2096890_12.pdf.

[55] *Id*.

[56] Yvette Shields, *Judge OKs Delta Reorganization; Airline Set to Shed Bankrupt Status Monday*, THE BOND BUYER 360.32618, Apr. 26, 2007, at 30.

[57] Andrew Ross Sorkin & Jeff Bailey, *Delta-Northwest Merger Talks Pick Up Pace Again*, N.Y. TIMES, Apr. 14, 2008, *available at* www.nytimes.com/2008/04/14/business/14deal.html?ref=business (Last visited Dec. 16, 2008).

[58] Graham Bowley, *Frontier Airlines Files for Bankruptcy*, N. Y. TIMES, April 12, 2008, *available at* www.nytimes.com/2008/04/12/business/12frontiercnd.html?ref=business (Last visited Dec. 16, 2008).

[59] John Crawley, *Major U.S. Airlines See $10 Billion Loss in 2008*, Reuters, June 17, 2008, *available at* http://www.reuters.com/article/ousiv/idUSWBT00920120080617 (Last visited Jan. 2, 2009).

[60] Jeff Bailey, *Aging Jet Fleets an Added Strain on U.S. Airlines*, N.Y. TIMES, Apr. 12, 2008, *available at* www.nytimes.com/2008/04/12/business/12air.html?ref=business (Last visited Jan. 2, 2009).

[61] Bowley, *supra* note 58 (Last Visited Dec. 16, 2008); Simon Kennedy, *Frontier Airlines files for Chapter 11 bankruptcy*, MARKETWATCH, Apr. 11, 2008, *available at* www.marketwatch.com/news/story/frontier-airlines-becomes-latest-irline/story.aspx?guid=%7B3518C93E&2D5AAE&2D4AED%2D8D36%2D1D4781A515D6%7D&siteid=bnb. (Last visited Dec. 16, 2008). Rising fuel costs are also causing airline retrenchment short of bankruptcy. *E.g.*, Mary Schlangenstein, *American Air, Eagle to End Flights to Eight Airports*, Bloomberg, June 25, 2008, *available at* www.bloomberg.com/apps/news?pid=20601087&sid=aTHuLkyRm.0E&refer=home (Last visited Dec. 16, 2008).

[62] *ATA Airlines Files for Bankruptcy* (ceases all operations), CNN Money.com, Apr. 3, 2008, *available at* http://money.cnn.com/2008/04/03/news/companies/ata_bankruptcy/index.htm (Last visited Jan. 2, 2009); Jim Kelly, *Aloha Airlines Goes Out of Business*, EAST BAY BUSINESS TIMES, Mar. 31, 2008 (ceases all operations), *available at* www.bizjournals.com/eastbay/stories/2008/03/31/daily1.html (Last visited Dec. 16, 2008); *Skybus Airlines to Cease Operations*, USA Today.com, Apr. 4, 2008, *available at* www.usatoday.com/travel/news/2008-04-04-skybus-shutdown_N.htm (Last visited Dec. 16, 2008).

3. Importance of Airlines to Airport Finances

As noted above, airline-based revenues back, in whole or in part, several critical financing mechanisms for capital improvements. Landing fees, aircraft parking and hangar charges, terminal service fees, cargo service charges, security charges, and ground handling charges all provide airline-based revenues that are critical to airport operations.[63]

A 2007 report noted that the percentage of airport operating revenues derived from airline revenues ranges from 55.9 percent for large hub airports to 44.7 percent for small hub airports,[64] although a more recent source reported an overall share of nonaeronautical revenue of 50 percent, with up to 60 percent at larger airports.[65] In addition to being significant sources of revenue for airports, airlines often exercise control over airport projects through majority-in-interest (MII) provisions or other provisions in airport use agreements.[66] Under such provisions, specified capital expenditures cannot be factored into airline fees such as terminal rental rates and landing fees unless they receive MII approval from the airlines that have signed the use agreements.[67] In fact, at some airports, the MII clause prevents the capital expenditure altogether.[68] MII is defined under airline agreements and considers such factors as percentage of payment of landing fees and percentage of landing weights.[69]

The type of use agreement in effect at a particular airport will affect the impact of airline bankruptcies on the airport. Use agreements—which govern the use of terminal buildings, concourses, airfields, and related facilities for air transportation, covering obligations including debt service, deposit requirements, operating expenses, and ground rent[70]—may be residual, compensatory, or a hybrid of the two approaches,[71] although more recently the trend is toward compensatory agreements.[72]

Historically, residual agreements provide airlines with long-term gate leases, MII clauses, and return of excess revenues.[73] Under the residual cost approach, an airport authority "first deducts from its expenses the income that it receives from non-airline sources (such as parking and concessions) and then divides the remaining expense amount among the airlines, on a ratable basis, through rents and landing fees."[74] For example, the Allegheny County Airport Authority explains its residual agreement as follows:

> Airline revenue at [Pittsburgh International Airport ("PIT")] is based upon a residual arrangement as determined in the [Airline Operating Agreement]. Airlines that sign this agreement ("Signatory Airlines") agree to pay for the operations of the airport based upon a Rates and Charges calculation that takes into account all revenues, expenses and debt service at PIT, as well as creating certain funds to be used for capital expenditures. The agreement is designed to minimize the landing fee, terminal rent and ramp fee costs to the Signatory Airlines while assuring the payment of all net operating costs and debt service related to PIT.[75]

Because of the pro rata nature of the airline contributions, when one airline decreases its flight volume at an airport, the expenses for the other signatory airlines increase. Moreover, if one airline decreases its flights and the decrease in flight volume is not made up by other airlines, the concomitant decrease in nonairline revenue will further increase airline expenses.[76] Such agreements tend to mitigate the economic effects of individual airline economic woes on the airport, although it is possible that the other signatory airlines will not be able to absorb increased costs.[77]

Thus, airline bankruptcies can adversely affect airport finances by decreasing revenues due to decreased traffic and renegotiated leases. In addition, bankrupt-

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[63] RICHARD DE NEUFVILLE & AMEDEO R. ODONI, AIRPORT SYSTEMS: PLANNING, DESIGN, AND MANAGEMENT 198–99, 261–68 (2003). *See also* DEMPSEY, *supra* note 22, at 178, 197; ACI-NA, *supra* note 40.

[64] NICHOL, *supra* note 6, at 25.

[65] Joshua Zumbrun, *How Airports Profit from Your Wait*, USA TODAY, June 13, 2008, *available at* www.usatoday.com/travel/flights/2008-06-13-forbes-airport-vendors_N.htm (Last visited Dec. 16, 2008).

[66] For example, at O'Hare under the Airport Use and Lease Agreements, the carriers must approve the issuance of GARBs. Ash, *supra* note 11, at 30.

[67] *See* Brown Company, *supra* note 13, at 54.

[68] FAA/OST Task Force, *Airport Business Practices and Their Impact on Airline Competition*, Oct. 1999, at 8, 29, http://ostpxweb.dot.gov/aviation/domav/airports.pdf.

[69] For example, the STL airline agreements define MII as the "signatory airlines that have more than 50 percent of the aggregate landed weight that represent at least 50 percent in number of airlines signatory to the use agreements"; MSP airline agreements define MII as "the signatory airlines who (a) represent at least 50 percent in number of the then-operating signatory airlines, and (b) paid at least 40 percent of the preceding year's signatory airline landing fees." Brown Company, *supra* note 13, at 54, 73.

[70] *See id*. at 19, 52.

[71] Trends in Airline Use Agreements, *supra* note 34. Airports also have nonsignatory operating agreements, *see, e.g.*, Non Signatory Airline Operating Agreement at Orlando International Airport, www.orlandoairports.net/avleasing/non-sig_agreement.pdf. Since those types of agreements do not require the same sort of commitments as signatory use agreements, they are not discussed here.

[72] John F. Infanger, *Focus on Airport Economics (Managing Airports Today)*, 21 AIRPORT BUSINESS 8 (July 2007).

[73] DEMPSEY, *supra* note 22, at 187.

[74] United Air Lines v. U.S. Bank Trust (In re UAL Corp.), 346 B.R. 456, 464 (Bankr. N.D. Ill. 2006). *See also* DEMPSEY, *supra* note 22, at 197.

[75] Allegheny County Airport Authority (A Component Unit of County of Allegheny, Pennsylvania), Financial Statements as of and for the Years Ended December 31, 2007 and 2006, and Independent Auditors' Report 2, http://www.pitairport.com/UserFiles/File/pdf/2096890_12.pdf.

[76] United Air Lines 346 B.R. at 464.

[77] *See, e.g.*, Indianapolis Airport Authority, *supra* note 49, at 10, 69.

cies can increase airport expenses because of resultant bad debts.[78]

Finally, the link between airlines—including their financial situation—and airports' credit rating is clear. The mere presence of a dominant carrier can be detrimental. For example, early in 2008 Moody's rating service revised its outlook on the bond rating for Midway Airport from positive to stable, based in part on Midway's "growing dependence" on a single carrier, Southwest Airlines.[79] The presence of a hub can affect even generally stable GARB ratings.[80] However, the effect of airline bankruptcy on airport credit ratings will vary depending on assessment of the airport's overall strength, including level of competition from other airports and percentage of origin and destination traffic.[81]

4. FAA Study

In 2003 Congress directed FAA to study "the impact that airlines emerging from bankruptcy could have on hub airports, as well as the ramifications on airport systems and U.S. capital bond markets." [82] As part of its study, FAA commissioned four case studies on the following airports: Pittsburgh International Airport (PIT), STL, Minneapolis St. Paul International Airport (MSP), and San Francisco International Airport (SFO). These case studies describe airline competition, passenger trends, and financing and facilities for the airports in question. While airport counsel may find these case studies of interest in their entirety, for purposes of this report, the discussion of airline bankruptcies' effect on the airports' bond financing and credit ratings are most relevant. The summary that follows is deemed current as of November 2003.

PIT operates under a residual rate-making agreement: the airport authority collects fees from the airlines to meet operating costs minus nonairline revenues.[83] PIT was a hub airport for US Airways. The case study illustrates the negative fallout of the bankruptcy of a hub airline. The county had financed through GARBs airline facilities usually financed by the airlines, including US Airways exclusive use facilities.[84] Nonetheless, when US Airways entered Chapter 11, the airline threatened to reject its PIT leases, using that threat of rejection to force a renegotiation of 18 leases at PIT: "AOA, hangar maintenance leases, one Rockwell hanger lease, hangar and simulator center general office/administration leases, two hydrant fuel system leases, two cargo leases, a lift-use agreement, and three terminal-related leases."[85] US Airways then sought to have PIT reduce PIT's outstanding debt from $676 million to $176 million by refinancing the debt and to provide infrastructure improvements ($115 million), a maintenance hangar and training center ($40 million), and rent relief ($140 million). Allegheny County and the Allegheny County Airport Authority agreed to settle all their bankruptcy claims against US Airways by accepting a $211 million general unsecured claim.[86] As described in the case study, US Airways' bankruptcy and subsequent lease rejection led to downgrading of the airport's credit rating and withdrawal of the airport's line of credit.[87]

STL has compensatory rate-making for its airline terminals[88] and residual rate-setting for its landing fees.[89] STL's hub carrier is American Airlines; STL is also a focus city for Southwest Airlines.[90] In addition to federal funding, STL has used GARBs and PFC revenues to fund its capital development program.[91] TWA, STL's original major hub carrier, assumed its leases in its first two bankruptcies and received approval to sell most of its assets to American Airlines under TWA's third bankruptcy filing. US Airways rejected two PIT leases under its Chapter 11 plan.[92] When American announced service reductions to STL, the ratings agencies placed STL on their watch lists for negative action, with Standard & Poors going so far as to drop STL's bond rating.[93]

MSP's major hub airline is Northwest Airlines. The Minneapolis-St. Paul Metropolitan Airports Commission (MAC) owns the airport.[94] As of June 1, 2003, 19.57 percent of MAC's capital funding sources derived from

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[78] *See, e.g.*, Allegheny County Airport Authority, *supra* note 54, at 6, 16.

[79] Moody's U.S. Public Finance–2008 U.S. Airport Sector Outlook, Feb. 2008, at 12. *See also* Brown Company, *supra* note 13, at 62, noting presence of dominant carrier as risk factor for credit rating, Webcast replay available at http://v2.moodys.com/cust/event/eventdetail.aspx?id=4400000000876&mod=2 (Last visited Jan. 2, 2009).

[80] Fitch Ratings: *Public Finance, Airline Bankruptcies and Airport Bonds: 2003–2006* (Revenue Special Report), at 4, *available at* http://www.fitchratings.cl/Upload/airlinebank03.pdf (Last visited Jan. 2, 2009).

[81] *See, e.g.,* Brown Company, *supra* note 13, at 103; BUSINESS WIRE, *supra* note 15. *See also Fitch Rates Wayne County Airport Authority, Michigan's $145MM Revenue Refunding Bonds 'A',* Reuters, Apr. 15, 2008 (Not specifically dealing with bankruptcy, but rating factors nonetheless), available at www.reuters.com/article/pressRelease/idUS226153+15-Apr20088+BW20080415 (Last visited Dec. 16, 2008).

[82] H.R. REP. NO. 108-76 [see p. 2 of 2003 USDOT report], cited by FAA, Request for Public Comment on the Impact of Airlines Emerging From Bankruptcy on Hub Airports, Airport Systems and U.S. Capital Bond Markets, 68 Fed. Reg. 38108 (June 26, 2003).

[83] Brown Company, *supra* note 13, at 30.

[84] *Id.* at 15.

[85] *Id.* at 31.

[86] *Id.* at 33.

[87] *Id.* at 3–4, 26, 35–37.

[88] *Id.* at 39, 53.

[89] *Id.* at 54.

[90] *Id.* at 41.

[91] *Id.*

[92] *Id.* at 56.

[93] *Id.* at 40, 62.

[94] *Id.* at 64.

pay-as-you-go PFCs and 57 percent from bonds.[95] Although historically MAC financed capital construction at MSP through general obligation revenue bonds, since 1998 it has relied on GARBs (except for refinancing the original bonds). MAC also has authority to issue general commercial paper, which it refunds from GARB proceeds.[96] MSP's airline agreements run for about 10 years. Under the agreements, terminal rentals are calculated under a compensatory methodology, while landing fees are set under a cost-center residual methodology.[97] As of 2003, MAC lost about $450,000 out of $570,000 in prepetition obligations owed by Sun Country, a Chapter 11 carrier that rejected its airline lease agreement and was in dispute with United Airlines over whether approximately $86,000 in facility rentals constituted a prepetition or postpetition obligation.[98] Although rating agencies had lowered the credit rating of Northwest Airlines, the dominant carrier, MAC's credit rating had not suffered.[99]

SFO has reprogrammed PFC revenue from a runway program to reduce airlines' costs by helping to pay debt service on master plan projects.[100] SFO has a 30-year residual airlines lease and use agreement.[101] United defaulted on a special facility lease and had refused to pay stub period rent on rejected leases. Both issues are discussed in detail in Section II.D, *Cases*, *infra*. Rating agencies have downgraded/kept on negative watch SFO's credit rating, in part due to United.[102] Most of the cost of SFO's capital projects from the 1990s was funded through GARBs. SFO's PFC revenue has for the most part gone to pay debt service on those bonds.[103] As part of its efforts to monitor United's bankruptcy proceedings, SFO obtained a nonvoting position on the Unsecured Creditors' Committee.[104]

FAA also requested public comments centered on four issues:

> (1) How airport's operations have been affected by air carriers going bankrupt and emerging from bankruptcy; (2) the financial impact that carriers' bankruptcies have had on airports; (3) the impact that carriers emerging from bankruptcy have had on markets for airport debt; and (4) actions that the federal government or airports themselves could take to ameliorate any significant financial disruption from airline bankruptcy.[105]

The FAA made available its discussion of the 16 comments (from the Montgomery Airport Authority (MAA); the Sarasota Manatee Airport Authority (SMAA); the Metropolitan Nashville Airport Authority (MNAA); Mr. Joshua Telser; the Kansas City Aviation Department (Kansas City); Delta Air Lines; the Air Transport Association (ATA); the American Association of Airport Executives (AAAE) jointly with the Airports Council International–North America (ACI-NA); City of Chicago, Department of Aviation (Chicago for O'Hare and Midway airports); Frontier Airlines; the Kenton County Airport Board (KCAB); the Sacramento County Airport System (SCAS); the Ithaca Tompkins Regional Airport (Ithaca); the Massachusetts Port Authority (Massport); the City of Atlanta (Atlanta); and the Metropolitan Washington Airports Authority (MWAA)) received in response to the 11 questions the agency had posed in its June 26, 2003, *Federal Register* Notice.[106] The portions relevant to airline bankruptcy were as follows:

1. *Is an airport's health tied to a particular carrier:* Seven of the respondent airports replied yes, two of them indicating they were tied to airlines either in or emerging from bankruptcy; four airports indicated they were not tied to a particular carrier. Delta and the ATA asserted that residual agreements spreading costs and airport reserve accounts meant that airline bankruptcy would not necessarily harm an airport.

2. *What actions have airports taken to aid airlines emerging from bankruptcy:* Five of the respondent airports had come up with payment plans for prepetition debt for carriers in and emerging from bankruptcy. Another airport had suspended landing fees for all carriers for 3 months after 9/11. Another airport had entered into a large bond refinancing to reduce airline charges, and had to date foregone discontinuing its dominant airline's use of exclusive gates, despite the carrier's failure to make required bond payments.

3. *Has any airport canceled or deferred any capital development projects based on the financial condition of a particular carrier:* Two airport respondents noted that they had canceled or deferred projects because of a specific carrier, in one case because of its sole carrier, which had recently emerged from bankruptcy. All but two of the remaining airport respondents had reassessed their capital programs due to generally poor operating environments. Frontier indicated that it had been precluded from accessing gates it needed for expansion at Denver because of United's bankruptcy.

4. *What carriers that have filed for bankruptcy have defaulted on lease payments or rejected leases and con-*

[95] *Id.* at 69.

[96] *Id.* at 70.

[97] *Id.* at 72–73.

[98] *Id.* at 74–75.

[99] *Id.* at 82–83.

[100] *Id*. at 84–85.

[101] *Id*. at 85.

[102] *Id*. at 86, 102.

[103] *Id*. at 90–91.

[104] *Id*. at 101.

[105] Docket No. FAA-2003-15481, Request for Public Comments on the Impact of Airline Bankruptcy on Hub Airports, Airport Systems and U.S. Capital Bond Markets, 68 Fed. Reg. 38108 (June 26, 2003).

[106] *Impact of Airline Bankruptcy on Hub Airports, Airport Systems and U.S. Capital Bond Markets*, Discussion of Comments Received In Response to *Federal Register* Notice, Sept. 12, 2003, *available at* www.regulations.gov/fdmspublic/component/main?main=DocketDetail&d=FAA-2003-15481 (Last visited Dec. 17, 2008). The comments themselves are available at the same location.

tracts: Eight of the airport respondents had had carriers defaulting on or rejecting leases or contracts. Four of these respondents had been able to work out subleasing arrangements with the bankrupt airlines or to reclaim facilities, and therefore were able to reallocate facilities to some degree to other carriers. One airport had been unable to reclaim facilities from Vanguard. Frontier noted that remaining carriers at Denver (including Frontier) had had increased costs to cover United's prepetition debt.

5. *What financial impact did the airport experience from those carriers filing for bankruptcy or emerging from bankruptcy:* Two airports indicated significant losses directly attributable to a single carrier's bankruptcy. Other airports indicated losses mitigated by cutbacks and reassigning facilities. Several respondents indicated concern that decreased PFC revenues would affect airport development projects. Six respondents claimed that FAA's policy of allowing commingling of PFC revenue with other airline revenue made it difficult to collect PFC revenue from airlines in bankruptcy. [The commingling issue was addressed in Section 124 of Vision 100—Century of Aviation Reauthorization Act.[107]] The ATA asserted that airline reorganizations have had limited effects on airports.

6. *What would be the financial impact to the airport if the bankruptcy carriers defaulted on lease and contract agreements, rejected these agreements, or reduced or ceased service:* Two airports merely indicated revenue losses would occur. Two airports indicated that the loss of their dominant airline would be devastating. Another airport was concerned that the loss of signatory carriers to its residual cost agreements would hurt its dominant carrier. Three large airports expected short-term fee increases under their residual agreements, but thought they would be able to attract replacement carriers. One compensatory airport foresaw substantial losses if all of its bankrupt carriers actually stopped serving the airport. The other compensatory airport, with no dominant hub airline, indicated that it would be able to attract replacement carriers.

7. *Has any airport changed any of its policies regarding leases and operating permits due to a carrier bankruptcy:* Four of the respondent airports had changed policies. The changes cited were: upon rejection, replacing long-term exclusive leases with short-term common-use or preferential leases; using other financial instruments for security deposits to avoid having cash deposits become part of the bankrupt estate; increasing a rainy day fund; and requiring line of credit deposits and holding PFCs in trust under new leases. Other respondents are considering policy changes.

8. *Have the bankrupt carriers caused an airport to incur higher debt and service costs:* Six of the airport respondents indicated no. One had to borrow money to cover for carriers, thus increasing its cost. One had increased borrowing costs due to downgraded credit ratings related to its dominant carrier's bankruptcy. Two others had significant bond insurance increases, and one of those also had an increased rate for its debt on its May 2003 bond issue. A compensatory airport noted it was covering debt service and operating costs for space vacated by a bankrupt carrier.

9. *Have the carriers' recent financial problems caused any airports to defer or cancel Airport Improvement Program or Passenger Facility Charge funded development programs:* Seven airport respondents indicated "no." One indicated "yes." Two others indicated "possibly" depending on circumstances.

10. *Do the benefits that carriers obtain from bankruptcy help or hurt airports*: Several airport respondents noted that continued service benefits their communities. Cited drawbacks included: "rejected leases, discontinued or reduced services, non-payment of rates and charges, non-payment or reduction in PFC receipts, extended uncertainty with leaseholds, and the attempts to reject payment on a special facility bond obligation while continuing to operate at the SFB-financed facility, paying only non-capital costs." One airport respondent noted the unfair competitive advantage afforded a bankrupt carrier that is able to avoid paying the capital cost of the facilities it occupies. Two respondents referenced the attorney's fees required to protect PFC revenues as a significant negative for airports. The effects of the various drawbacks were described as ranging from "inconvenient to potentially devastating," depending on airport circumstances. Delta and the ATA asserted that access to AIP grants and PFCs as well as the ability to spread costs under airline agreements minimize the effects of airline bankruptcy.

11. *What actions, if any, could the federal government take now to help airports adjust to their current financial environment:* [bankruptcy-related responses only]:

- Clarify PFC legislation to ensure that PFCs are not interpreted as air carrier assets; prohibit commingling of PFCs so that they are not commingled with other air carrier revenue.
- Issue the final PFC handling fee rule.
- Enact regulations to ensure that leases are not reassigned during bankruptcy procedures without airport approval.
- Foster accounting changes to preclude airlines in bankruptcy from using unremitted PFC revenue as a pledge of liquidity.
- Permit airports to charge less than comparable rates for use of facilities rejected by bankrupt airlines.
- Require that airlines post a letter of credit to secure airport payments.
- Change bankruptcy laws to:
  - give airports greater control of gate usage during and following bankruptcy;
  - treat lease-backed special facilities as integrated transactions, so that an airline can't assume a ground lease and reject the rest;
  - reduce uncertainty by reducing the routine extension of time allowed to assume or reject leases; and

[107] 108 Pub. L. No. 176, 117 Stat. 2502 (Dec. 12, 2003).

• require timely payment of bankrupt airline for the entire month in which it declares bankruptcy.

In December 2003 the FAA issued its report.[108] The report noted that airline reorganization under bankruptcy may tie up gates and other assets; recent bankruptcy actions had lessened the security of airline/airport finance contracts; PFC stand-alone financing had mostly not been affected by airline bankruptcies; and special facility bond financing had come under great scrutiny due to recent airline bankruptcies.[109] The report discussed the risk of relying on a dominant airline, *i.e.,* that the traditional approach of entering long-term relationships with major airlines, and giving those airlines veto power over airport investments in exchange for coverage of airport costs, left airports vulnerable when those airlines entered bankruptcy and rejected their leases. The report explained that bankrupt airlines have considerable leverage because airports are faced with accepting minor damages or renegotiating leases on terms more favorable to the airlines. Similarly, allowing airlines to finance improvements through special facility bond financing also put the bankrupt airlines in a position of having leverage over the airports, even though the bonds are not technically obligations of the issuing airports.[110] Finally, the report referenced the fact that airline bankruptcy—and even the specter of airline bankruptcy—had resulted in lowered credit ratings for airports.[111]

II. LEGAL ISSUES[112]

A. Bankruptcy Theory

The United States Constitution authorizes federal bankruptcy law,[113] now embodied in the Bankruptcy Code.[114] Federal courts have exclusive jurisdiction over bankruptcy cases.[115]

1. Purpose of Bankruptcy Code

Bankruptcy is intended to "give worthy debtors a fresh start."[116] At the same time that the Code is intended to protect debtors, it is also intended to satisfy creditors and provide for the orderly distribution of assets.[117] The purpose of Chapter 7 is to dispose of the assets of a debtor that can no longer continue as a viable enterprise. The purpose of Chapter 11 of the Code is to allow the debtor to reorganize and continue in business. The specific aims of Chapter 11 include:

> …to relieve the debtor from immediate payment of prepetition debt; to reorganize the debtor's finances; to return the debtor to the marketplace as a viable enterprise; to reform or rescind burdensome contracts; to provide continued employment to the debtor's workforce; to treat creditors in an even-handed manner; to further the public interest; to attempt to ensure the stockholders a fair return on their investment; and to consolidate in as great a manner as possible all of the debtor's widespread interests. (Citations omitted).[118]

The advantages of filing for Chapter 11 protection include the "automatic stay, the reduction in debt load, the ability to cancel or restructure unfavorable contracts."[119]

Some have argued that Chapter 11 is no longer being used for its original purpose, but is used to force the sale of assets.[120] In fact, while the aim of Chapter 11 is reorganization, most courts recognize that liquidation is also possible under Chapter 11.[121]

2. Application in Airport Context

Before airline deregulation in 1978, no major airline had gone out of business, although the regulatory agency had administratively disposed of failing airlines by merging them into other successful airlines.[122] Since deregulation, many airlines, including a number of legacy carriers, have filed for bankruptcy protection.[123] Some view bankruptcy as an appropriate market substitute for regulation.[124] Others have suggested that in

[108] U.S. Dep't of Transp., *Impact of Airline Bankruptcy on Hub Airports, Airport Systems and U.S. Capital Bond Markets,* Dec. 2003, *available at* www.regulations.gov/fdmspublic/component/main?main=DocketDetail&d=FAA-2003-15481 (Last visited Dec. 17, 2008).

[109] *Id*. at 5.

[110] *Id*. at 13–14.

[111] *Id*. at 15.

[112] *See generally* AM. JUR. 2D *Bankruptcy* § 2311, chs. 7, 11, 13.

[113] U.S. CONST. art. I, § 8.

[114] 11 U.S.C. §§ 101 *et seq*.

[115] 28 U.S.C. § 1334. Venue is determined under 28 U.S.C. § 1408–09.

[116] In re Carp, 340 F.3d 15, 25 (1st Cir. 2003).

[117] DEMPSEY, *supra* note 3, §17.14, Bankruptcy and Deregulation.

[118] Heuer, *supra* note 3, at 257–58.

[119] Dattner, *supra* note 7, at 298.

[120] DOUGLAS G. BAIRD & ROBERT K. RASMUSSEN 3, n.1, THE END OF BANKRUPTCY (John M. Olin Law & Economics Working Paper No. 173 (2D Series), www.law.uchicago.edu/Lawecon/WkngPprs_151-175/173.dgb.bankruptcy.end.pdf, *citing* Susan Carey, *American Airlines,' TWA Financing Plan Is Approved, Although Rivals Cry Foul*, WALL ST. J., Jan. 29, 2001, at A3; Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673 (Dec. 2003).

[121] Loop Corp. v. U.S. Trustee, 379 F.3d 511, 517 (8th Cir. 2004), *citing* In re Jartran, Inc., 886 F.2d 859, 868 (7th Cir. 1989) (liquidating plans permissible under Chapter 11); Matter of Sandy Ridge Dev. Corp., 881 F.2d 1346, 1352 (5th Cir. 1989) ("[A]lthough Chapter 11 is titled 'Reorganization,' a plan may result in the liquidation of the debtor.").

[122] DEMPSEY, *supra* note 3, § 17.02, The Bankruptcy Reform Act of 1978.

[123] McQuaid, *supra* note 8, at 665. The Air Transport Association posts an unofficial list of airline bankruptcies since 1979, *available at* http://www.airlines.org/economics/specialtopics/USAirlineBankruptcies.htm (Last visited Dec. 17, 2008).

[124] Heuer, *supra* note 3, at 257, 259.

fact a bankruptcy process that allows bad management to stay in control is a questionable solution.[125] In addition, despite the ostensible purpose of the Bankruptcy Code, some airline executives have viewed—or have been viewed as using—bankruptcy proceedings as a competitive tool.[126] In fact, a filing made solely to avoid an executory contract may be subject to a challenge on the grounds of bad faith in violation of Section 1129(a)(3).[127] However, the fact that "a financially troubled company, which is losing money and is insolvent (or nearly so), is unable to pay its debts as they mature, has no credit and no free assets, and is about to run out of cash" has rejection of an executory contract as part of its reorganization plan does not mean the plan is in bad faith.[128]

B. Statutes/Regulations

Airline bankruptcy proceedings are subject to requirements of the federal Bankruptcy Code[129] and rules of procedure,[130] including the requirement that any requested relief is within the jurisdiction of the Bankruptcy Court.[131] Such proceedings are also affected by state law concerning issues such as contract construction and by federal aviation law and regulations. This section discusses the Bankruptcy Code and relevant federal aviation provisions.

1. Bankruptcy Code Overview

The first significant modern amendment of U.S. bankruptcy law was made by the Bankruptcy Reform Act of 1978, which repealed existing federal bankruptcy law and replaced it with the Bankruptcy Code.[132] Additional amendments were enacted in 1984, 1994, and 1997.[133] A more comprehensive revision of the Bankruptcy Code was enacted in 2005.[134]

The following provisions of the Bankruptcy Code are subjects of analysis in airline bankruptcy cases or have otherwise been identified as particularly relevant for airports in airline bankruptcy cases, but are not specific to airline bankruptcy. A list of these provisions with links to online versions of the Code is included in Appendix A. The emphasis here is on substantive issues presented, although procedural issues may preclude consideration of such issues.[135]

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[125] DEMPSEY, *supra* note 3, § 17.25.

[126] *Judge Approves Markair's Plan for Reorganization*, THE SEATTLE TIMES, June 10, 1993, *available at* http://community.seattletimes.nwsource.com/archive/?date=19930610&slug=1705814 (Last visited Dec. 17, 2008); McQuaid, *supra* note 8, at 669, n.45 (2007), *citing* Robert M. Lawless, Stephen P. Ferris, Narayanan Jayaraman & Anil K. Makhija, *Industry-Wide Effects of Corporate Bankruptcy Announcements*, 12 BANKR. DEV. J., 293, 298, n.17 (1996).

[127] Heuer, *supra* note 3, at 260–61 (1991), *citing* In re Continental Airlines Corp. 38 B.R. 67, 71 (Bankr. S.D. Tex. 1984).

[128] *See* In re Continental Airlines Corp. 38 B.R. 67 (Bankr. S.D. Tex. 1984).

[129] Some have argued that practices that have no direct authorization in the Bankruptcy Code constitute a federal common law of bankruptcy. Adam J. Levitin, *Toward a Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime*, Paper 939, bepress Legal Series, 2006, *available at* http://law.bepress.com/expresso/eps/939 (Last visited Jan. 2, 2009).

[130] U.S.C., tit. 11A.

[131] Under 28 U.S.C. § 157, each district court may refer any or all proceedings arising under title 11 to its bankruptcy judges. Those judges have authority to decide all core proceedings arising under title 11, including:

> (A) matters concerning the administration of the estate;
>
> (B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;
>
> (C) counterclaims by the estate against persons filing claims against the estate;
>
> (D) orders in respect to obtaining credit;
>
> (E) orders to turn over property of the estate;
>
> (F) proceedings to determine, avoid, or recover preferences;
>
> (G) motions to terminate, annul, or modify the automatic stay;
>
> (H) proceedings to determine, avoid, or recover fraudulent conveyances;
>
> (I) determinations as to the dischargeability of particular debts;
>
> (J) objections to discharges;
>
> (K) determinations of the validity, extent, or priority of liens;
>
> (L) confirmations of plans;
>
> (M) orders approving the use or lease of property, including the use of cash collateral;
>
> (N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate; and
>
> (O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims.

28 U.S.C. § 157(b)(2). *See* SALERNO, *supra* note 2, § 3.07, Judicial Gloss on Core and Non-Core Proceedings.

[132] SALERNO, *supra* note 2, § 1.04[A].

[133] NOLLKAMPER, *supra* note 2, § 100.

[134] Bankruptcy, Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), 109 Pub. L. No. 8, 19, Stat. 23, Apr. 20, 2005. *See* Douglas W. Jessop, *New Changes in the Bankruptcy Code Affecting Airports and Special Facility Bonds in Bankruptcy*. Available from Jessop & Company, PC, jmail@jessopco.com or jwjessop@jessopco.com.

[135] *E.g.*, Interface Group-Nevada, Inc. v. Trans World Airlines, Inc. (In re TWA, Inc.), 145 F.3d 124 (3d Cir. 1998) (failure to adequately state issue of award of interest on administrative claim as required under Bankruptcy Rules 8006 and 8010 precluded court from ruling on issue on appeal).

11 U.S.C. § 105, Power of court

This section is the source of a bankruptcy court's equitable power, although the extent of those powers is not clearly settled.[136]

11 U.S.C. § 361, Adequate protection

Sets forth the methods by which adequate protection required under §§ 362, 363, or 364 may be provided. The determination occurs before the contract/lease is assumed or rejected. Periodic rental payments compensating the creditor for use and occupancy of the premises may serve as adequate protection.[137] Issues posed under this section include appropriate valuation method (time of determination of value); factors in determining adequacy of protection; who is entitled to adequate protection; and burden of proof. Adequate protection is only available when the debtor retains collateral under § 362. Once the automatic stay is no longer applicable, automatic protection is moot.[138]

11 U.S.C. § 362, Automatic stay

The stay is one of the basic protections of the Bankruptcy Code. [139] The stay stops the "race to the courthouse,"[140] giving the debtor breathing room without ultimately affecting creditors' rights. The stay is self-executing, taking effect when the bankruptcy petition is filed.[141] In addition, a debtor may obtain preliminary injunctions preventing its lessors from interfering with its leasehold interests.[142]

The stay may be lifted on the motion of creditors under specific circumstances, *e.g.*, lack of adequate protection (which must be ruled on within a specified time period) and the existence of a cause of action unrelated to the bankruptcy. The stay does not cover perfecting purchase money security interests that were granted prepetition.

The Bankruptcy Code does not expressly prohibit prepetition waivers of the automatic stay,[143] and courts have differed on whether contractual waivers of the automatic stay are enforceable.[144] The arguments for refusing to enforce such waivers include: the debtor cannot act prebankruptcy on behalf of the debtor-in-possession; specific provisions of the Bankruptcy Code (§§ 363, 365, 541) render such waivers unenforceable; and the Bankruptcy Code "extinguishes the private right of freedom to contract around its essential provisions."[145] It seems that recent cases have held that a prepetition waiver of the automatic stay is a factor for the court to consider in evaluating whether to grant requested relief from the stay.[146] Where courts have enforced such waivers, they appear to have generally considered the facts of the case to determine whether the waiver should be enforced, taking into account public policy issues and the rights of third-party creditors.[147] Factors to consider include "(1) the sophistication of the party making the waiver; (2) the consideration for the waiver, including the creditor's risk and the length of time the waiver covers; (3) whether other parties are affected including unsecured creditors and junior lienholders, and; (4) the feasibility of the debtor's plan."[148]

In addition, courts appear to differentiate between waivers that are part of prepetition agreements and those that are included in prior bankruptcy proceedings, with the former being unlikely to be enforced and the latter more likely to be enforced.[149] Courts also seem more likely to enforce waivers in single-asset cases.[150]

For property to be subject to the automatic stay, the debtor must have an interest in the property before the beginning of the bankruptcy case.[151] Where, for example, an airline lost its airport slots due to failure to use them before the airline declared bankruptcy, any subsequent action concerning the slots could not be stayed under § 362(a)(1) because such action was postpetition.[152] A government attempt to collect prepetition debt under exercise of its regulatory power is subject to the stay.[153] However, at least under some circumstances, administrative proceedings by the U.S. Department of Transportation (USDOT) to reallocate authority to operate scheduled service away from an airline in bank-

[136] *See* Levitin, *supra* note 129.

[137] Memphis-Shelby County Airport Auth. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.), 783 F.2d 1283 (5th Cir. 1986).

[138] HSBC Bank USA, Nat'l Ass'n v. United Air Lines, Inc., 360 B.R. 780, 782, 784–785 (Bankr. N.D. Ill. 2007) (request for adequate protection of bank's interest in collateral).

[139] SALERNO, *supra* note 2, § 4.07, Automatic Stay.

[140] John K. Rezac & Richard E. Lear, *Application of Bankruptcy's Automatic Stay to Actions Against Non-Debtors*, 5 BANKRUPTCY AND CREDITORS' RIGHTS (Holland & Knight) 4 (2d Quarter 2004).

[141] In re Gruntz, 202 F.3d 1074 (9th Cir. 2000).

[142] Braniff Airways, 783 F.2d 1283.

[143] Judith Greenstone Miller & John C. Murray, *Waivers of Automatic Stay: Are They Enforceable (and Does the New Bankruptcy Act Make a Difference)?*, 41 REAL PROP. PROB. & TR. J. 1, 5 (2006), http://www.firstam.com/ekcms/uploaded Files/firstam_com/References/Reference_Articles/John_C_ Murray_Reference/Real_Estate_Bankruptcies/autostaywaivers. pdf.

[144] In re Trans World Airlines, 261 B.R. 103 (Bankr. D. Del. 2001); In re Desai, 282 B.R. 527, 530 (Bankr. M.D. Ga. 2002); Jeffrey W. Warren, *On the Edge: The Enforceability of a Pre-Petition Waiver of the Automatic Stay*, AM. BANKR. INST. J. , Apr. 2008, *available at* http://findarticles.com/p/articles/mi_qa5370/is_/ai_n25419346 (Last visited Jan. 2, 2009).

[145] In re Pease, 195 B.R. 431, 433 (Bankr. D. Neb. 1996).

[146] Miller, *supra* note 143, at 6.

[147] Pease, 195 B.R. at 432–33.

[148] Desau 282 B.R. at 532 (on balance factors did not support granting relief from stay).

[149] In re Bryan Road, 382 B.R. 844, 849 (Bankr. S.D. Fla. 2008).

[150] Pease, 195 B.R. at 432–33.

[151] In re Bigalk, 75 B.R. 561 (Bankr. D. Minn. 1987).

[152] FAA v. Gull Air, Inc. (In re Gull Air, Inc.), 890 F.2d 1255 (1st Cir. 1989).

[153] SALERNO, *supra* note 2, § 4.07[B], n.182.

ruptcy are exempt from the automatic stay under the express police and regulatory exception of § 362(b)(4).[154] Where a lease expires by its own terms either prepetition or during the bankruptcy case, actions by the landlord to regain possession are not subject to the stay.[155]

The party seeking relief from the stay under § 362(d)(1) [for cause, including the lack of adequate protection of an interest in property of such party in interest] has the burden of making an initial showing of cause.[156] The party seeking relief from the automatic stay under § 362(d)(2) [related to property in which the debtor does not have equity and which property is not necessary to an effective reorganization] has the burden of proof on the issue of the debtor's equity in the property in question (showing that the debtor had no equity and the property is not necessary for effective reorganization);[157] the party opposing relief from the automatic stay has the burden of proof on all other issues, including adequacy of protection.[158] Conversion to Chapter 7 does not revive the stay if relief from the stay had been granted in the preceding Chapter 11 proceedings.[159]

So long as the automatic stay applies, the court must approve any payments other than § 363 ordinary course of business payments. Once the reorganization plan is confirmed, the automatic stay is lifted as to any property that revests to the debtor under the plan.[160]

11 U.S.C. § 363, Use, sale, or lease of property

This section governs the sale of corporate assets before the reorganization plan is approved.[161] It divides actions into two categories: use, sale, or lease in the ordinary course of business and use, sale, or lease outside the ordinary course of business. The bankruptcy court must approve the latter.[162] Subsection (b) requires that assets proposed to be disposed of outside the ordinary course of business be property of the estate.[163] The most common type of sale outside the ordinary course of business is sale of all or part of the debtor's estate.[164] However, a proposed transaction releasing claims by all parties against the Chapter 11 debtor, secured creditors, officers, and directors is not a "use, sale, or lease" authorized by § 363 under which a trustee may, after notice and hearing, use, sell, or lease, other than in ordinary course of business, property of the estate.[165] Whether an agreement amended after the Chapter 11 petition is filed is an asset that can be sold only with court permission under § 363(b) or is a prepetition executory contract that may be assumed under § 365 depends on the materiality of differences between the original agreement and the amended agreement, and other factors such as public statements concerning the status of the original agreement.[166]

The debtor in possession (DIP) has a duty to "protect and conserve property in his possession for the benefit of creditors."[167] In order for the DIP or trustee to meet its fiduciary duty, there must be "some articulated business justification for using, selling, or leasing the property outside the ordinary course of business."[168] In addition, the court must consider whether the proposed transaction is in the best interests of the estate.[169] In other words, the debtor cannot use its authority under § 363(b) to circumvent the requirements of Chapter 11.[170] The debtor bears the burden of proving that "a sale of property out of the ordinary course of business under § 363(b) of the Code will aid [the debtor's] reorganization and is supported by a good business justification."[171] The Second Circuit has suggested the following factors in evaluating whether a proposed sale meets the business judgment test:

> the proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganization will be proposed and confirmed in the near future, the effect of the proposed disposition on future plans of reorganization, the proceeds to be obtained from the disposition vis-a-vis any appraisals of the property, which of the alternatives of use, sale or lease the proposal envisions and, most impor-

[154] In re USAfrica Airways Holdings, Inc., 192 B.R. 641 (D. Del. 1996) (DOT has significant regulatory power over international travel; flights to South Africa limited by South African government, lack of flights by Chapter 11 airline harming consumers).

[155] SALERNO, *supra* note 2, § 4.07[B][8], Additional Exceptions to the Stay.

[156] In re Bogdanovich, 292 F.3d 104, 110 (2d Cir. 2002) (discussion of grounds for lifting stay to allow litigation to continue in another court).

[157] In re Anthem Communities/RBG, LLC, 267 B.R. 867 (Bankr. D. Colo. 2001).

[158] SALERNO, *supra* note 2, § 4.07[F], nn. 273–75.

[159] Mark A. Bailey, *Bankruptcy Practice* (ch. 19 in Washington Lawyers Practice Manual, 2006), 19.4.33, Duration of Stay, *citing* In re State Airlines, Inc., 873 F.2d 264 (11th Cir. 1989).

[160] United Air Lines, 360 B.R. at 785.

[161] Matthew T. Gunlock, *An Appeal to Equity: Why Bankruptcy Courts Should Resort to Equitable Powers for Latitude in Their Interpretation of "Interests" Under Section 363(f) of the Bankruptcy Code*, 47 WM. & MARY L. REV. 347 (2005).

[162] United Retired Pilots Benefit Protection Ass'n v. United Air Lines, Inc. (In re UAL Corp.), 443 F.3d 565, 568 (7th Cir. 2006).

[163] Institutional Creditors of Continental Air Lines v. Continental Air Lines (In re Continental Air Lines, Inc.), 780 F.2d 1223, 1226 (5th Cir. 1986).

[164] Heuer, *supra* note 3, at 267, n.121.

[165] Pension Benefit Guaranty Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.), 700 F.2d 935 (5th Cir. 1983).

[166] In re Ionosphere Clubs, Inc., 100 B.R. 670, 673–674 (Bankr. S.D.N.Y. 1989).

[167] In re Devers, 759 F.2d 751, 754 (9th Cir. 1985), citing In re Halux, Inc., 665 F.2d 213, 216 (8th Cir. 1981). *See* § 1107, *infra*.

[168] Continental Airlines, 780 F.2d at 1226.

[169] In re America West Airlines, Inc., 166 B.R. 908, 912 (Bankr. D. Ariz. 1994).

[170] Continental Airlines, 780 F.2d at 1227.

[171] Ionosphere Clubs, 100 B.R. at 675, *citing* In re Lionel Corp., 722 F.2d 1063, 1071 (2d. Cir. 1983).

> tantly perhaps, whether the asset is increasing or decreasing in value.[172]

The decision must also be the product of an independent business judgment.[173]

Subsection (c) prohibits a debtor from using cash collateral unless each entity with interest in the collateral consents or the court authorizes such use after notice and a hearing. See Section II.D.5, *Passenger Facility Charges*, *infra*. Essentially the court must find that the entities with interest in the collateral are adequately protected.[174]

Subsection (e) provides that a creditor may request that the court prohibit or condition use, sale, or lease of property as needed to provide adequate protection of its interest in the property. The debtor has the burden of proof on this issue.[175] The term "adequate protection" is not defined under the Code; its meaning is determined under the facts of the case.[176] Requests under this subsection become moot once the reorganization plan is confirmed.[177]

Subsection (f) governs the situations under which the trustee may sell property free and clear of any interest in such property of entities other than the estate. Construction of the term "interest" determines whether a plaintiff with an "interest" may pursue a claim against the purchaser of the property or must compete for compensation from the pool of remaining assets of the estate.[178] While the Third Circuit has held that Equal Employment Opportunity Commission (EEOC) and travel voucher claims were within "interests" that could be extinguished under § 363(f),[179] that reading of § 363(f) is not unanimous.[180]

Where the debtor's rights in a portion of an airport terminal building purchased from an airline could be partitioned and sold separately from the remainder of the airline's interests in the building without prejudice to the airline, the debtor could sell its portion.[181]

Subsection (l) prohibits contractual clauses that purport to affect a debtor's interest in property upon filing for bankruptcy. This provision has also been held to invalidate contractual provisions that purport to terminate or modify the debtor's interest in property because of bankruptcy filing, including waiving the automatic stay.[182] *See* discussion of automatic stay, *supra*.

11 U.S.C. § 365, Executory contracts and unexpired leases

Section 365 modifies rights of nondebtors under executory contracts; allows the trustee/DIP to assume or reject executory contracts within specified timeframes; and allows the assignment of an assumed contract "if adequate assurance of future performance by the assignee…is provided."[183] This is perhaps the single most significant provision for airports dealing with airlines in bankruptcy. Its main purpose

> is to allow a debtor to reject executory contracts in order to relieve the estate of burdensome obligations while at the same time providing "a means whereby a debtor can force others to continue to do business with it when the bankruptcy filing might otherwise make them reluctant to do so,"[184]

thus maximizing the value of the estate for creditors.[185] The authority to object is vital to the basic purpose of reorganization under Chapter 11.[186]

The term "executory contract" is not specifically defined in the Bankruptcy Code. [187] However, a widely used definition of "executory contract" is as follows: A contract is executory where the obligation "of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other."[188] The actual determina-

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[172] *Id*.

[173] *Id*. at 678–79.

[174] LYNN, *supra* note 2, ¶ 24.19[1], Cash Collateral.

[175] In re Air Vermont, Inc., 39 B.R. 684 (Bankr. D. Vt. 1984).

[176] In re O.P. Held, Inc., 74 B.R. 777 (Bankr. N.D.N.Y., 1987).

[177] United Air Lines, 360 B.R. at 785.

[178] Gunlock, *supra* note 161 at 355.

[179] In re Trans World Airlines, Inc., 322 F.3d 283 (3d Cir. 2003) (airline workers' employment discrimination claims, as well as flight attendants' rights under travel voucher program that debtor-airline had established in settlement of sex discrimination action, both qualified as "interests in property," under bankruptcy statute that provided for sale of assets of estate free and clear of interests in property) [MBNA v. TWA, 275 B.R. 712 (Bankr. D. Del. 2002)].

[180] Gunlock, *supra* note 161, at 363–64, *citing* In re Eveleth Mines LLC, 312 B.R. 634, 364 (Bankr. D. Minn. 2004). Gunlock argues that the Third Circuit outcome is only defensible if § 363(f) is read with the equitable powers of § 105(a).

[181] In re Air Florida System, Inc., 48 B.R. 437, 440 (Bankr. S.D. Fla. 1985).

[182] Matthew P. Goren, *Chip Away at the Stone: The Validity of Pre-Bankruptcy Clauses Contracting Around Section 363 of the Bankruptcy Code*, 51 N.Y.L. SCH. L. REV. 1077, 1086 n.42, 1087 n.44. (2006–2007), *citing* In re Pease, 195 B.R. 431 (Bankr. D. Neb. 1996) (holding that prepetition waivers of the automatic stay were per se invalid and unenforceable) and In re Nat'l Gypsum Co., 118 F.3d 1056, 1067 n.18 (5th Cir. 1997) (prepetition arbitration clause was effectively an ipso facto clause and thus unenforceable).

[183] In re Fleming Cos., 499 F.3d 300, 305 (3d Cir. 2007) (where material and significant term of agreement cannot be performed by prospective assignee, contract may not be assigned).

[184] In re Chateaugay Corp., 10 F.3d 944, 954–55 (2d Cir. 1993), *citing* Richmond Leasing Co. v. Capital Bank, N.A., 762 F.2d 1303, 1310 (5th Cir. 1985) (per curiam).

[185] In re Midway Airlines Inc., 6 F.3d 492 (7th Cir. 1993).

[186] N.L.R.B. v. Bildisco and Bildisco, 465 U.S. 513, 528, 104 S. Ct. 1188, 1197, 79 L. Ed. 2d 482, 497 (1984).

[187] In re Terrell, 892 F.2d 469 (6th Cir. 1989).

[188] Pacific Express v. Teknekron Infoswitch Corp (In re Pacific Express Inc.), 780 F.2d 1482, 1487 (9th Cir. 1986), *citing* Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973); Terrell, 892 F.2d at 471 n.2, *citing* Countryman; In re Lawson, 14 F.3d 595 (4th Cir. 1993);

tion of whether the failure to perform the remaining obligations of an executory contract would constitute material breach excusing performance by the other party is made under state law.[189] Thus the determination of whether an executory contract was terminated prepetition—and therefore cannot be assumed by the DIP—is made under state law.[190] At least in the Second Circuit, the creditor cannot take actions postpetition under a contract that was executory at the time of bankruptcy so as to preclude the debtor from rejecting the contract.[191]

The term "lease" for purposes of § 365 is also not defined under the Bankruptcy Code.[192] As noted above, the requirement of performing postpetition obligations only applies to true leases. As discussed in Section II.D.1, *Lease Recharacterization*, *infra*, this can be a big issue for airports that have participated in special facility revenue bond-funded improvements. Whether an agreement is a lease or rental agreement for purposes of assumption or rejection of unexpired leases generally depends on state law,[193] unless state law is contrary to provisions of the Bankruptcy Code.[194] Depending on the facts of the case, the court may look to the principle of equitable estoppel and determine that the debtor is estopped from claiming that its lease agreement is in fact a financing instrument not subject to § 365.[195]

The time frame for assumption or rejection of nonresidential real property leases for bankruptcy cases begun on or after October 17, 2005, is 120 days after the order for relief or plan confirmation order, whichever is earlier, instead of the 60 days allowed for pre-Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) bankruptcy cases.[196] However, BAPCPA also eliminated the routine multiple 60-day extensions previously allowed, instead allowing one extension of 90 days past the initial 120-day period—only for cause—and requiring the landlord's consent for any additional extensions. It has been suggested that this new time requirement under BAPCPA may provide incentives for debtors to seek to recharacterize leases as secured financings.[197] Section 365(d)(2) requires that all other unexpired leases and all executory contracts be assumed or rejected by plan confirmation.

Generally the trustee may assume or reject without the lessor's consent. Moreover, contractual provisions purporting to waive rights under § 365 to reject executory contracts are generally held to be unenforceable, as they are contrary to the purposes of § 365.[198] However, the lessor may seek to compel the debtor under § 365(d)(2) to either assume or reject the lease in question.[199]

Generally *ipso facto* clauses, *i.e.*, clauses stating that the fact of bankruptcy terminates the agreement, are not enforceable. However, actual default by a debtor airline is not affected by the presence of an *ipso facto* clause, and the fact that bankruptcy precludes making payments does not preclude nonpayment from constituting default.[200] In addition, subsection (e)(2)(A) provides that if applicable law excuses a nondebtor party from accepting or rendering performance and that party does not consent, the prohibition against *ipso facto* clauses does not apply. However, the Federal Circuit Courts are split over whether the nondebtor party must show more than a hypothetical possibility that the contract will be assigned before the exception will apply.[201]

Anti-assignment clauses in the lease[202] do not prevent assignment, provided the debtor assumes the lease under § 365 and the assignee provides adequate protection. There are some additional restrictions on assignment: Subsection (c) provides that if applicable law excuses a nondebtor party from accepting or rendering performance and that party does not consent, the debtor may not assume or assign the lease in ques-

In re Columbia Gas System, Inc., 50 F.3d 233 (3d Cir. 1995); In re Ravenswood Apartments, Ltd., 338 B.R. 307 (6th Cir. 2006).

[189] 892 F.2d at 472 (quoting Hall v. Perry (In re Cochise College Park, Inc.), 703 F.2d 1339, 1348 n.4 (9th Cir. 1983)); *see also* Butner v. United States, 440 U.S. 48, 54–55, 99 S. Ct. 914, 918, 59 L. Ed. 2d 136, 141 (1979) (state law determines property rights unless a federal purpose mandates otherwise).

[190] SALERNO, *supra* note 2, § 4.11[A][1], Requirements for Assumption: Existence.

[191] COR Route 5 Co. LLC v. Penn Traffic Co. (In re Penn Traffic Co.), 524 F.3d 373 (2d Cir. 2008).

[192] In re Harris Pine Mills, 862 F.2d 217 (9th Cir. 1988); United Air Lines v. HSBC Bank (In re UAL Corp.), 416 F.3d 609, 611 (7th Cir. 2005); Davis, *supra* note 41.

[193] Harris Pine Mills, 862 F.2d 217.

[194] In re Re-Trac Corp., 59 B.R. 251 (Bankr. D. Minn. 1986).

[195] In re Martin Bros. Toolmakers, Inc., 796 F.2d 1435 (11th Cir. 1986).

[196] Wendy Tien, *Treatment of Unexpired Leases: Post-Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, UNITED STATES ATTORNEYS' BULLETIN 35 (July 2006), www.justice.gov/usao/eousa/foia_reading_room/usab5404.pdf. The author asserts that this new language means that an unexpired commercial lease may not be assumed or rejected after plan confirmation.

[197] Guy B. Moss & Stephanie W. Mai, *Business Bankruptcy Implications of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, BANKRUPTCY LAW SECTION NEWSLETTER (Boston Bar Association Bankruptcy Law Section, Boston, Mass.), May 2005, at 5.

[198] Trans World Airlines, 261 B.R. at 103 (debtor may not agree prebankruptcy to assume or reject executory contract; DIP may not make unilateral decision to assume or reject). The court distinguished such waivers from prepetition waivers of the automatic stay, which may be allowed, particularly in single-asset cases. *Id*. at 114.

[199] Braniff Airways, 783 F.2d at 1285 (5th Cir. 1986); CIT Commc'ns Finance Corp. v. Midway Airlines Corp. (In re Midway Airlines Corp.), 406 F.3d 229 (4th Cir. 2005) (lease of telephone equipment).

[200] U.S. Bank Nat'l Ass'n v. United Air Lines, Inc. (In re United Air Lines), 438 F.3d 720, 732, n.5 (7th Cir. 2006).

[201] In re Mirant Corp., 440 F.3d 238 (5th Cir. 2006).

[202] *See* Fleming, 499 F.3d 307 (§ 365(f)(1) prohibits explicit anti-assignment clauses and provisions so restrictive that they constitute de facto anti-assignment clauses).

tion.[203] The Seventh Circuit has held that if the lease explicitly addresses (and contemplates) assignment of the lease in the event of bankruptcy, the airport will not be able to object to assignment on the ground that it is in contravention of federal or state law. The court expressly found that a specific contractual provision allowing assignment in case of bankruptcy must govern over a general policy in favor of competition.[204] Subsection (c) also prohibits assumption of a contract to extend debt financing or of a nonresidential real property lease that was terminated under applicable nonbankruptcy law before the order for relief was entered.

Section 365(d)(3) requires the debtor to timely perform all obligations of the debtor arising from and after the order for relief under an unexpired lease for noresidential real property until the lease is assumed or rejected,[205] notwithstanding the provisions of § 503(b)(1), which means the debtor must pay postpetition rent and other charges as they come due.[206] The provision does not specify consequences of noncompliance.[207] The purpose of § 365(d)(3) is to ensure that the landlord continues to receive payment for lease obligations;[208] the requirement only applies to true leases. However, when the payment obligation becomes due, to what period in time the obligation relates (before or after the relief order date, in whole or in part), and when the payment is made will determine whether a particular payment obligation comes under § 365(d)(3) at all and whether the particular obligation is considered a prepetition or postpetition obligation.[209] In addition, the courts have split between the performance date (billing) approach and the proration (accrual) approach to determine the amount and timing of payments under § 365(d)(3).[210] The issue of the scope of the requirements of § 365(d)(3) as it has affected airports is discussed in Section II.D.4, *Stub Period Rent*, *infra*.

If assuming, the trustee/DIP must assume the entire agreement, "rather than assuming only the beneficial aspects and rejecting the burdensome ones."[211] However, in assuming a particular executory contract or unexpired lease, the trustee/DIP need not perform under other substantially unrelated agreements, even where separate agreements are included in the same document.[212] This is true even if separate agreements are linked by a cross-default clause. As the court noted in a recent Illinois bankruptcy case, "assumption under § 365 is subject to a 'well-established' cross-default rule: '[C]ross-default provisions do not integrate executory contracts or unexpired leases that otherwise are separate or severable.'"[213]

In order to assume a contract the debtor must cure, or provide assurance of prompt cure of, any defaults. The purpose of the cure and adequate assurance conditions was to ensure that contracting parties receive the full benefit of their bargain.[214] Although the scope of cure had been a subject of dispute,[215] amendments to § 365 under BAPCPA made clear that the cure requirement now includes nonmonetary as well as monetary faults.[216] However, defaults from failure to perform nonmonetary obligations that cannot be cured need only be cured prospectively following assumption, with compensation provided by any financial losses resulting from the nonmonetary default.[217] Defaults triggered by the bankruptcy itself are an exception to this rule.[218]

If the debtor assumes the lease, assumption renders future obligations under the lease administrative expenses.[219] The Third Circuit has held that assumption of contracts under § 365 precludes a trustee from avoiding contract payments as preferences under § 547.[220]

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[203] Metro. Airports Comm'n v. Northwest Airlines, 6 F.3d 492 (7th Cir. 1993).

[204] *Id.* at 497.

[205] Adelphia Bus. Solutions, Inc. v. Abnos, 482 F.3d 602, 605–06 (2d Cir. 2007); United Air Lines, 291 B.R. at 124.

[206] In re Iron Age Corp., 378 B.R. 419 (Bankr. D. Mass. 2007).

[207] LYNN, *supra* note 2, ¶14.07, Power to Assume or Reject Executory Contracts; SALERNO, *supra* note 2, § 4.11[A][7], *citing* 3 COLLIER ON BANKRUPTCY, ¶ 365.04[3][g] (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev.) for discussion of developing case law.

[208] Cukierman v. Uecker (In re Cukierman), 265 F.3d 846, 851 (9th Cir. 2001).

[209] Prepetition rent is generally not payable unless the contract or lease is assumed. *See* Lynn, *supra* note 2, ¶ 24.08[1], Executory Contracts.

[210] *See* Victoria Kothari, 11 U.S.C. § 365(D)(3): *A Conceptual Status Argument for Proration*, 13 AM. BANKR. INST. L. REV. 297 (2005).

[211] United Air Lines, 346 B.R. at 467, *citing* 465 U.S. 532; In re Shangra-La, Inc., 167 F.3d 843, 849 (4th Cir. 1999). *See also* Fleming, 499 F.3d at 308 (debtor could not assume and assign store lease because essential term of lease required service from warehouse whose lease had already been rejected).

[212] United Air Lines, 346 B.R. at 467–68.

[213] *Id.* at 468 (citation omitted). *See* § II.D.3, *Cross-Default Clauses*, *infra*.

[214] In re Ionosphere Clubs, Inc., 85 F.3d 992 (2d Cir. 1996).

[215] In re Bankvest Capital Corp., 360 F.3d 291, 293 (1st Cir. 2004) (First Circuit disagreed with Ninth Circuit over nonmonetary cure requirements).

[216] Paul H. Deutch, *The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: Important Implications for the Equipment Leasing Industry*, 24 LJN's EQUIPMENT LEASING NEWSLETTER 1 (June/July 2005), www.troutmansanders.com/mc/art-deutch.pdf.; Valerie P. Morrison & Rebecca L. Saitta, *Impact of the Bankruptcy Abuse Prevention and Consumer Protection Act on Franchise Reorganizations Under Chapter 11*, 27 FRANCHISE L. J. 125 (2007). Posted at www.wileyrein.com/docs/publications/13304.pdf; Salerno & Kroop, § 1.04[B][2], at 1–15.

[217] Moss, *supra* note 197, at 5–6.

[218] United Air Lines, 346 B.R. at 468, n.10.

[219] Cukierman, 265 F.3d at 850; *See also* Jacob, *supra* note 2, at 15-8–15-9.

[220] Kimmelman v. Port Auth. N.Y & N.J. (In re Kiwi Int'l Air Lines, Inc.), 344 F.3d 311, 318–19 (3d Cir. 2003).

Rejection constitutes a breach deemed to have occurred immediately before the filing date of the petition.[221] Thus, if the debtor rejects the lease, the lessor will generally have a nonpriority unsecured claim for damages[222] under § 365(g) for prepetition rent and expenses, which claim must be addressed under the reorganization plan.[223] If the assets of the estate are insufficient to pay all unsecured creditors in full, the lessor may receive only a small portion of its unsecured claim.[224] However, the lessor is entitled to an administrative expense priority for the reasonable value of the debtor's use and occupancy of the property postpetition.[225]

If the debtor neither assumes nor rejects an unexpired lease of real property "by the earlier of 120 days after entry of the order for relief or of an order confirming a plan of reorganization, the lease is deemed to be rejected and the trustee (or chapter 11 debtor) must immediately surrender the property to the lessor."[226] See §§ 502 and 503, *infra*, for discussion of limitations on lease rejection damages.

11 U.S.C. § 366, Utility service

This section allows a utility to discontinue service if the trustee does not provide adequate assurance of payment within 20 days after the date of the order for relief. Airports that provide utility service will benefit from BAPCPA amendments to this section that specify what constitutes adequate assurance to prevent the utility from denying service to a chapter 11 debtor, precluding the argument that historic timely payments constitute adequate assurance. In addition, administrative expense priority does not constitute adequate assurance.[227]

11 U.S.C. § 502, Allowance of claims or interests

This section determines whether a claim[228] is allowable. For example, § 502 would be one of the bases for relief in a claim for payment of stub period rent,[229] see Section II.D.4, *infra*. If a claim is allowable, its priority is determined under § 506.[230] Subsection (a) provides that a claim is deemed allowed unless a party in interest objects. Therefore, once a proof of claim is filed, other parties in interest may challenge the claim, even though the underlying claim is outside the bankruptcy estate, for example because it relates to an executory contract that the trustee has already rejected.[231]

Subsection 502(b)(6) places a cap on a claim for damages resulting from the termination of a lease of real property,[232] particularly relevant in airline bankruptcy disputes.[233] The purpose of the cap is to prevent landlords from realizing a windfall from a breach of a real property lease and to ensure that the landlord receives compensation for damages without crowding out the other unsecured creditors.[234] The statutory cap only applies to true leases.[235] The Second Circuit held that the cap does not apply to administrative expenses, and so "cannot cap future rent due under an assumed lease."[236] That *In re Klein Sleep Products* holding was modified by BAPCPA's addition of § 503(b)(7), *infra*.

The provision caps the landlord's claim at:

> (A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of—
>
> (i) the date of the filing of the petition; and
>
> (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus
>
> (B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates.

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[221] Penn Traffic, 524 F.3d at 378; In re Dehon, Inc., 352 B.R. 546, 558–59 (Bankr. Mass. 2006).

[222] United Air Lines, 346 B.R. at 467. *See* § 502(g), *infra*.

[223] LYNN, *supra* note 2, ¶ 24.08[1], Executory Contracts.

[224] *See* Penn Traffic, 524 F.3d at 378.

[225] Braniff Airways, 783 F.2d at 1286. *See* § 503 *infra*.

[226] Titus & McConomy v. Trizechahn Gateway (In re Titus & McConomy, LLP), 375 B.R. 165, 173 (Bankr. W.D. Pa. 2007), *citing* 11 U.S.C. § 365(d)(4)(A). *See* SALERNO, *supra* note 2, § 1.04[B], at 1-15. A different rule applies for executory contracts. *See* Diamond Z Trailer, Inc. v. JZ L.L.C. (In re JZ L.L.C.), 371 B.R. 412, 422 (9th Cir. BAP 2007), emphasizing permissive nature of assumption or rejection under § 365, allowing for "ride through."

[227] SALERNO, *supra* note 2, § 1.04[B], at 1-16.

[228] Broadly defined under 11 U.S.C. 101(5):

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

See LYNN, *supra* note 2, ¶ 20.05[17], Claim, ¶ 20.05[18], Proof of Claim.

[229] In re UAL Corp., Chapter 11, Case No. 02-B-48191, Debtors' Motion for an Order Approving and Authorizing Payment Under the Agreed-Upon Stub Rent Procedures, July 28, 2003, par. 3.

[230] UPS Cap. Bus. Credit v. Gencarelli (In re Gencarelli), 501 F.3d 1, 5 (1st Cir. 2007) (to extent that prepayment penalties against a solvent debtor that were part of otherwise allowed claim were unreasonable, they constituted unsecured claim under § 506(b), rather than being unallowed).

[231] Durkin v. Benedor (In re G.I. Indus.), 204 F.3d 1276, 1280 (9th Cir., 2000).

[232] Solow v. PPI Enters. (In re PPI Enters. (U.S.) Inc.), 324 F.3d 197, 207 (3d Cir. 2003).

[233] In re Delta Air Lines, Inc., 370 B.R. 537, 543 (Bankr. S.D.N.Y. 2007).

[234] Titus & McConomy, 375 B.R. at 171.

[235] *See* Malden Mills Indus. v. Maroun (In re Malden Mills Indus., Inc.), 303 B.R. 688, 703 (BAP 1st Cir. 2004).

[236] Nostas Assocs. v. Costich (In re Klein Sleep Products, Inc.), 78 F.3d 18, 28 (Cal. 1996).

Courts have split over whether the "15 percent" refers to the total rent due under the rest of the lease or the time remaining under the lease.[237]

In order to apply the cap, the court must determine the proper date for calculating the amount allowed: the date the bankruptcy petition is filed (11 U.S.C. § 502(b)(6)(A)(i)) or the date the lessor repossessed or the lessor surrendered the leased property (11 U.S.C. § 502(b)(6)(A)(ii)).[238] The determination of what constitutes repossession or surrender for purposes of § 502(b)(6) is made under state law.[239] Some courts will apply the security deposit against the amount allowed under the statutory cap.[240]

Subsection 502(d) requires the bankruptcy court to disallow claims from a creditor from whom property is recoverable or who is the recipient of avoidable transfers under § 545 unless the creditor has turned over the property or paid the transferred amount.[241] This is true even if the underlying avoidance action would be time-barred.[242] Courts are split over whether a debtor is precluded from pursuing a preference avoidance action under § 547 once a claim has been allowed under § 502. The rationale for precluding the avoidance action is that it is only fair to resolve all issues related to a creditor's claim at one time; that it is unfair to engage in a claim objection while concealing a preference action. The rationale for allowing the avoidance action is that § 502(d) offers an affirmative defense to debtors, but does not preclude bringing an avoidance action after the claims allowance process.[243] *See* Section II.D.4, *Other* (*Preferential transfers*), *infra*.

Subsection 502(g) provides that rejection of an unexpired lease under § 365 gives rise to a general unsecured claim for contract damages.[244] The Second Circuit has held that by implication, claims arising from assumed leases should be treated as administrative expenses.[245]

Subsection 502(h) governs the treatment of claims for recovery of property under §§ 522 [Exemptions, not relevant to airline bankruptcy], 550 [Liability of transferee of avoided transfer], and 553 [Setoff], providing that such claims will be treated as if they had arisen prepetition. The effect of subsection 502(h) is that if a transfer is avoided under § 547 and recovered by the bankruptcy estate under § 550, the transferee will have a claim that will be determined under § 502 and allowed as if the claim had arisen prepetition.[246]

11 U.S.C. § 503, Allowance of administrative expenses

Under § 503(b)(1), administrative expenses are the "actual, necessary costs and expenses of preserving the estate." Obtaining this administrative expense status is significant because such expenses receive a high priority. See § 507, *infra*. Unpaid postpetition rent that accrues during the period the debtor considers whether to assume or reject an unexpired lease should be entitled to administrative priority[247] and postpetition, postrejec-

[237] In re Connectix Corp., 372 B.R. 488, 491 (Bankr. N.D. Cal. 2007) (adopting total time approach), citing "total rent" approach: In re New Valley Corp., No. 98-CV-982, 2000 WL 1251858, at 11–12 (D. N.J. 2000); In re Andover Togs, Inc., 231 B.R. 521, 545–46 (Bankr. S.D.N.Y. 1999); In re Today's Woman of Florida, Inc., 195 B.R. 506, 507–08 (Bankr. M.D. Fla. 1996); In re Gantos, Inc., 176 B.R. 793, 795–96 (Bankr. W.D. Mich. 1995); In re Financial News Network, Inc., 149 B.R. 348, 351 (Bankr. S.D.N.Y. 1993); In re Communicall Central, Inc., 106 B.R. 540, 544 (Bankr. N.D. Ill. 1989); 2 NORTON BANKRUPTCY LAW AND PRACTICE 2d, § 41.24 (2006) and "total time" approach: In re Blatstein, No. 97-CV-3739 WL 560119, at 15-16 (E.D. Pa. 1997); In re Allegheny Int'l, Inc., 136 B.R. 396, 402–03 (Bankr. W.D. Pa. 1991); In re Ace Electrical Acquisition, LLC, 342 B.R. 831, 833 (Bankr. M.D. Fla. 2005); In re Iron-Oak Supply Corp., 169 B.R. 414, 419-20 (Bankr. E.D. Cal. 1994); In re Bob's Sea Ray Boats, Inc., 143 B.R. 229, 231 (Bankr. D.N.D. 1992); 4 COLLIER ON BANKRUPTCY (15th ed. rev.) at ¶ 502.03[7][c].

[238] PPI Enters., 324 F.3d at 197, 208 n.18.

[239] Titus & McConomy, LLP, 375 B.R. at 165, 171.

[240] PPI Enters., 324 F.3d at 208.

[241] El Paso City of Texas v. America West Airlines, Inc., 217 F.3d 1161, 1163 (9th Cir. 2000) (claim based on statutory lien not perfected or enforceable against bona fide purchaser at time bankruptcy case is begun shall be disallowed unless claimant pays amount or turns over property for which it is liable).

[242] *Id*. at 1167.

[243] Allison R. Axenrod, *Section 502(d) Does Not Preclude Actions to Avoid Allowed Claims*, 11 BANKRUPTCY BULLETIN (Weil, Gotshal & Manges) 5, 6 (2004), *citing* TWA Inc. Post Confirmation Estate v. City & County of San Francisco Airports Comm'n (In re TWA Inc. Post Confirmation Estate), 305 B.R. 221 (Bankr. D. Del. 2004) (preference avoidance action not precluded); Caliolo v. Azdel, Inc. (In re Cambridge Indus. Holdings Inc.), No. 00-1919, 02-03293, 2003 Bankr. LEXIS 794 (Bankr. D. Del. July 18, 2003) (preference avoidance action precluded); LaRoche Indus., Inc. v. Gen. Am. Transp. Corp. (In re LaRoche Indus., Inc.), 284 B.R. 406 (Bankr. D. Del. 2002) (preference avoidance action not precluded). *See also* Rhythms NetConnections, Inc. v. Cisco Systems (In re Rhythms NetConnections), 300 B.R. 404 (Bankr. S.D.N.Y. 2003) (preference avoidance action not precluded); Robert S. Brady, Edmon L. Morton & Joseph M. Barry, *TWA Evens the Score on the Availability of the 502(d) Claim Preclusion Defense in Delaware*, 23-3 ABI JOURNAL 44 (2004), *available at* http://findarticles.com/p/articles/mi_qa5370/is_/ai_n21347712.

[244] Eagle Ins. Co. v. BanVest Capital Corp. (In re BankVest Corp.), 360 F.3d 296. *See* Davis, *supra* note 41, at 143.

[245] Klein Sleep Prods, 78 F.3d at 26–28.

[246] Solow v. Greater Orlando Aviation Auth. (In re Midway Airlines, Inc.), 175 B.R. 239, 247 (Bankr. N.D. Ill. 1994).

[247] LYNN, *supra* note 2, ¶ 14.07, Power to Assume or Reject Executory Contracts; SALERNO, *supra* note 2, § 4.11[A][7]. Executory Contracts: Administrative Rent ("With respect to a lease, a landlord is entitled to the rent provided for in the lease from the petition date through the date the lease is rejected; all such rent is accorded administrative expense priority status."). *But see* In re Amber's Stores, Inc., 193 B.R. 819 (Bankr. N.D. Tex. 1996) and In re Palace Quality Services Industries, Inc., 283 B.R. 868 (Bankr. E.D. Mich. 2002), both reviewing cases

tion services may also be entitled to administrative expense priority under § 503(b)(1) based on the debtor's use of the premises during that postpetition period.[248] *See* Sections II.D.4, *Stub Period Rent,* and II.D.5., *Other* (*Lease Rejection*), *infra*. The effective date of the rejection "determines when a debtor's obligation to pay rent ceases"[249] and thus will affect the rent owed, so making a rejection date retroactively effective can reduce or eliminate administrative rent claims.[250] Although the rejection of an unexpired nonresidential lease does not take effect until approved by the bankruptcy court, the court may, based on its equitable powers, make such approval retroactive. [251] Turning over the keys and vacating the premises prepetition are factors that weigh heavily in favor of allowing retroactive approval;[252] most cases that have provided retroactive approval have involved debtors that had vacated the premises.[253] However, the Ninth Circuit approved a retroactive rejection date in a case where neither the landlord nor lessee debtor occupied the premises, in part because the landlord's conduct and motives appeared to be more geared toward running up its administrative rent claim than to obtaining its rights to re-let the premises.[254]

Where the debtor assumes an ongoing executory contract or unexpired lease before the bankruptcy plan is confirmed—or enters into a new executory contract during reorganization—and then breaches the agreement, the breach is deemed to have occurred postpetition and gives rise to an administrative expense claim under § 503(b).[255] However, claims for nonresidential real property leases that are assumed and then rejected are subject to the specific provisions of § 503(b)(7). Under subsection (b)(7), a landlord whose nonresidential real property lease was assumed and then rejected is entitled to an administrative claim for money owed—except for failure to operate or penalty—for 2 years from the rejection date or actual turnover date (whichever is later), without reduction or setoff except for sums received from entities other than the debtor. The claim for any remaining sums due for the balance of the lease comes under the statutory cap of § 502(b)(6).

11 U.S.C. § 506, Determination of secured status

Section 506(a) provides that—unlike a lessee, who under § 365 must assume the lease and fully perform or surrender the property—a secured borrower may retain the property without paying the full price as agreed. The secured borrower must provide the lender the economic value of the secured property; to the extent the loan is greater than that economic value, the balance becomes an unsecured debt.[256] *See* Section II.D.1, *Lease Recharacterization*, *infra*.

Section 506(b) provides that if creditors are oversecured, they may collect reasonable fees. The intent of this provision is to prevent oversecured creditors from prioritizing unreasonable fees, but not to prevent them from collecting them altogether.[257] The limitation under § 506(b) on claims a landlord can make for unpaid rent against the bankrupt estate only applies to true leases, not transactions intended as secured financings.[258]

11 U.S.C. § 507, Priorities

Priority claims must be paid before general unsecured claims. This section sets forth the order of priority of expenses and claims. Those most relevant to airport cases are certain trustee claims (first priority), administrative expenses under § 503(b) (second priority), unsecured claims under § 502(f) [relates to certain ordinary course of business claims *in involuntary cases*] (third priority), and government tax claims (eighth priority, see § 1129(a)(9)). Fourth and fifth priority claims are personnel-related, and are relevant to the extent that employee claims may deplete the estate before general unsecured airport claims can be satisfied.

11 U.S.C. § 511, Rate of interest on tax claims

This provision was added by BAPCPA. It provided that the rate for interest required to be paid on tax claims is to be determined under applicable nonbankruptcy law.

11 U.S.C. § 541, Property of the estate

With certain exceptions, "all legal or equitable interests of the debtor in property as of the commencement of the [bankruptcy] case" are property of the estate [§ 541(a)(1)], as is "any interest in property that the estate acquires after the commencement of the case." [§ 541(a)(7)] Generally state law determines whether

that require the lessor, despite applicability of § 365(d)(3), to establish administrative expense status under § 503(b)(1)(A).

[248] Malden Mills, 303 B.R. at 706; SALERNO, *supra* note 2, § 4.11[A], Administrative Rent.

[249] Pacific Shores Dev. LLP v. At Home Corp. (In re At Home Corp.), 392 F.3d 1064, 1069 (9th Cir. 2004).

[250] SALERNO, *supra* note 2, § 4.11[C], Executory Contracts: Rejection. *See* Amber Stores, 193 B.R. 819 (lessor entitled to any administrative expense claim for unpaid post-petition lease obligations that occurred before lease rejection without establishing claim for administrative status under § 503(b)(1)(A), but date of effective rejection is date of court order; based on equities of case, lease should be deemed rejected on petition date; lessee moved out and turned over keys prepetition, so no administrative claim for postpetition rent).

[251] Thinking Machines Corp. v. Mellon Financial Servs. Corp. # 1 (In re Thinking Machines Corp.), 67 F.3d 1021, 1029 (1st Cir. 1995).

[252] Amber Stores, 193 B.R. at 827.

[253] Pacific Shores, 392 F.3d 1074.

[254] *Id*.

[255] LYNN, *supra* note 2, ¶ 14.07, Power to Assume or Reject Executory Contracts.

[256] United Air Lines, Inc. v. HSBC Bank USA (In re United Air Lines Corp.), 453 F.3d 463, 465 (7th Cir. 2006); HSBC Bank USA v. UAL Corp. (In re UAL Corp.), 351 B.R. 916, 917–18 (Bankr. N.D. Ill. 2006). *See* Barbra R. Parlin, *Not So Fast: Seventh Circuit Says United Airline's San Francisco Airport Bonds Are a Secured Financing After All*, 6 BANKRUPTCY and CREDITORS' RIGHTS (Holland & Knight) 9, 10 (3d Quarter 2005) (analyzing United Air Lines, Inc. v. HSBC Bank USA, N.A. (In re UAL Corp.), 416 F.3d 609 (7th Cir. 2005)).

[257] Gencarelli, 501 F.3d at 6–7.

[258] Liona Corp., Inc. v. PCH Assocs. (In re PCH Assocs.), 949 F.2d 585 (2d Cir. 1991).

the debtor holds a property interest.[259] Thus, the interest of a debtor under a lease of nonresidential property that has been terminated before the Chapter 11 filing is no longer property of the estate, and thus no longer assumable. The § 541 analysis, which looks to state law to determine the validity of the lease, precedes any analysis of assumability under § 365(b).[260]

One area of particular interest to some airports is whether airline slots are property of the estate. In 1983 the Fifth Circuit held that they are not property,[261] although this holding has been criticized[262] and at least one commentator has argued that subsequent FAA treatment of slots places this holding in question.[263] There are some cases that held that slots could be property under § 541.[264] However, FAA takes a different position.[265] It does not appear that this issue has been recently litigated. This issue may also be of less interest since at present only five airports have government restrictions on the number of takeoff and landing authorizations, whereas control of gates—which are airport property—is of more general interest. In addition, at least one court has held that an airline operating certificate is property under § 541,[266] although USDOT also disputes this position.[267]

Another area of particular interest to airports is whether PFCs can be considered property of the estate under this section. Both airports and USDOT take the position that they cannot.[268] Accordingly, USDOT also takes the position that PFC remittances cannot be recovered as avoidable preferences.[269]

11 U.S.C. § 544, Trustee as lien creditor and a successor to certain creditors and purchasers

The trustee may be able to avoid unperfected liens.[270] Once a lien is determined to be avoidable, payments made on the lien may be an avoidable preference.[271]

11 U.S.C. § 547, Preferences

Subsection 457(b) allows the trustee to avoid certain payments made to creditors, in order to "facilitate 'the prime bankruptcy policy of equality of distribution among creditors of the debtor. Any creditor that received a greater payment than others of its class [prepetition] is required to disgorge so that all may share equally.'"[272] If a payment is recovered as an avoidable preference, that amount goes back into the Chapter 11 estate, and the creditor from whom it was recovered will have an unsecured claim for that amount.[273] As noted, *supra*, the Third Circuit has held that assumption of contracts under § 365 precludes a trustee from avoiding contract payments as preferences under § 547.[274]

One of the requirements for an avoidable preference is that the creditor received more than it would have if instead the creditor had received payment of its debt under Chapter 7. The debtor has the burden of proving that to be the case in order to avoid a payment as a preference.[275] Another issue is whether the debtor was in fact insolvent when an alleged preferential payment was made,[276] which may be a matter of dispute.

Subsection 547(c) provides nine circumstances under which payments cannot be avoided as preferences, essentially those in which the payments are for new value rather than in repayment of existing debt. Subsection 547(g) provides that the debtor has the burden of proving the applicability of these exceptions.[277] The § 547 exceptions include the contemporaneous exchange and ordinary course of business defenses. For example, a preference action to recover a payment made to an unsecured creditor within 90 days of Chapter 11 filing—otherwise avoidable—can be defeated by the ordinary course of business defense: a payment on a debt incurred in the ordinary course of business is either made in the ordinary course of business or made according to ordinary business terms.[278] The debtor has the burden of

[259] SALERNO, *supra* note 2, § 4.06, Creation of the Estate, *citing* Butner v. United States, 440 U.S. 48; In re Contractors Equip. Supply Co. v. Citybank, 861 F.2d 241 (9th Cir. 1988).

[260] Jet 1 Center, Inc. v. City of Naples Airport Auth. (In re Jet 1 Center), 335 BR 771, 781 (Bankr. M.D. Fla. 2005).

[261] Braniff Airways, 700 F.2d at 935. *Accord*, Air Illinois, Inc. v. FAA (In re Air Illinois), 53 B.R. 1, 2–3 (Bankr. S.D. Ill. 1985).

[262] THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW, 97–98, at n.22 (1986).

[263] Heuer, *supra* note 3, at 61-62.

[264] Gull Air, 890 F.2d 1255; American Cent. Airlines, Inc. v. O'Hare Regional Carrier Scheduling Comm. (In re of American Cent. Airlines, Inc.), 52 B.R. 567, 570–71 (Bankr. N.D. Iowa 1985); In re McClain Airlines, Inc., 80 B.R. 175 (Bankr. Ariz. 1987).

[265] The FAA has had several regulations and orders related to congestion management that are relevant to airline bankruptcy, insofar as they relate to the issue of ownership of takeoff and landing slots. *See* App. C—FAA Congestion Provisions.

[266] In re Horizon Air, Inc., 156 B.R. 369 (N.D.N.Y. 1993).

[267] Diederich, *supra* note 28.

[268] In re Vanguard Airlines, Inc., Case No. 02-50802-JWV (Bankr. W.D. Mo. 2003) (Proposed Settlement Agreement).

[269] Author's June 27, 2008, telephone conversation with Bernard F. Diederich, Senior Attorney, Office of General Counsel, U.S. Dep't of Transp.

[270] Heuer, *supra* note 3, at 271–72, *citing* In re Air Florida, 48 Bankr. 440.

[271] *Id.* at 272.

[272] Kimmelman, 344 F.3d at 316, *citing* 2 COLLIER ON BANKRUPTCY ¶ 547.01 (15th ed. rev. 2003).

[273] Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (In re Molded Acoustical Prods., Inc.), 18 F.3d 217 (3d Cir. 1994).

[274] Kimmelman, 344 F.3d at 318–19.

[275] *Id*. at 316–17.

[276] Travellers Int'l, AG v. TWA (In re TWA), 134 F.3d 188 (3d Cir. 1998).

[277] TWA Post Confirmation Estate, 305 B.R. at 227–28.

[278] Before BAPCPA, in order to defeat a preference action under § 547, the "ordinary course of business" defense required that the payment be made in the ordinary course of business *and* made according to ordinary business terms. In re Midway Airlines, 69 F.3d 792, 794 n.1 (7th Cir. 1995) (payment to cabi-

proving that the conditions for the ordinary course of business exception have been met.[279] Establishing that payments were made within the contract terms does not necessarily establish that payments are ordinary.[280] If a debtor obtains a judgment from an airline when the airline is insolvent, payment of the judgment is an avoidable preference.[281]

11 U.S.C. § 553, Setoff

Subsection (a) expressly preserves a creditor's right to setoff to the extent that right is protected under state law.[282]

11 U.S.C. § 1101(2), Substantial consummation

The term is defined as:

(A) transfer of all or substantially all of the property proposed by the plan to be transferred;

(B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and

(C) commencement of distribution under the plan.

Substantial consummation is the primary consideration in determining whether to dismiss a case based on "equitable mootness." Once a reorganization plan is substantially consummated, the court will want to avoid disrupting it. This is sometimes referred to as the doctrine of equitable mootness, allowing the court to dismiss a case "when, even though effective relief could conceivably be fashioned, implementation of that relief would be inequitable."[283]

11 U.S.C. § 1107, Rights, powers, and DIP

For the most part these are the same as those of the trustee, including the right to assume or reject under § 365.[284] The DIP must act as a fiduciary of the creditors, protecting and conserving property for the benefit of the creditors and refraining from acting so as to damage the estate or hinder successful reorganization.[285]

11 U.S.C. § 1108, Authorization to operate business

The trustee has authority to operate the business unless a party in interest requests that the court order otherwise and, after notice and hearing, the court does so. Taken with § 1107 this section authorizes the DIP to operate the business.

11 U.S.C. § 1109, Right to be heard

This section provides that "a party in interest" may raise and appear and be heard on any issue in a case under Chapter 11. The section provides a "non-exhaustive list" of what may constitute a party in interest.[286]

11 U.S.C. § 1121, Who may file a plan

Section 1121(b) establishes an initial period of 120 days after the Bankruptcy Court enters an order for relief under Chapter 11, during which only the debtor may file a plan. Other parties in interest may file plans once the exclusivity period has ended. However, if the debtor files a plan within such 120-day period, § 1121(c)(3) extends the exclusivity period by an additional 60 days to permit the debtor to seek acceptances of such plan. Section 1121(d) also permits the Bankruptcy Court to extend or reduce these exclusivity periods "for cause."

11 U.S.C. § 1123, Contents of plan

Subsection (a)(5)(D) governs the sales of corporate assets pursuant to the reorganization plan.[287]

11 U.S.C. § 1129, Confirmation of plan

This section sets forth the requirements for a bankruptcy court to confirm a proposed reorganization plan, including the requirement that the plan be proposed in good faith. BAPCPA amended subsection (a)(9) to decrease the time period over which tax claims must be paid and to require that tax claims be treated at least as well as the best available treatment of unsecured claims under the plan. The plan must be consensual unless the requirements of subsection (b), including the "fair and equitable requirement," are met.[288] Subsection (b)(2)(A), which sets forth the requirements for fair and equitable treatment of secured claim holders, is one

net maker was preference because creditor had failed to show payment made according to ordinary business terms.).

[279] TWA, Inc. Post Confirmation Estate v. World Aviation Supply, Inc. (In re TWA, Inc. Post Confirmation Estate), 327 B.R. 706 (Bankr. D. Del. 2005).

[280] Hechinger Inv. Co. v. Universal Forest Prod. (In re Hechinger Inv. Co. of Delaware, Inc., 489 F.3d 568, n.6 (3rd Cir. 2007), *citing* In re TWA, Inc. Post Confirmation Estate, 327 B.R. at 709 (finding that transfer made during the preference period was not ordinary because, although it was made within the contract terms, the history of dealings between the parties was that of payments being made well outside such terms).

[281] Trans World Airlines, 134 F.3d 188 (determination of insolvency will be made with reference to 11 U.S.C. 101(32)(A); discussion of appropriate valuation methods). Although not relied on in the appellate decision, the bankruptcy court also held that the creditor's forbearance from levying on a judgment is not new value for purposes of defeating a § 547 action. In re Trans World Airlines, Inc. (In re TWA), 180 B.R. 389, 403 (Bankr. Del. 1994).

[282] United Air Lines, 438 F.3d at 732.

[283] In re Delta Air Lines, Inc., 05 B17923 (ASH), (Jointly Administered) (Bankr. S.D.N.Y. Apr. 30, 2008), www.nysb.uscourts.gov/opinions/ash/161907_28_opinion.pdf at 25, *citing* Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.), 416 F.3d 136, 143 (2d Cir. 2005).

[284] DEMPSEY, *supra* note 3, § 17.17, Powers of Bankruptcy Judge and Trustees; Bankruptcy Courts, *Bankruptcy Basics: The Chapter 11 Debtor in Possession*, *available at* www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter11.html#debtor (last visited Dec. 16, 2008).

[285] In re Ionosphere Clubs, Inc., 113 B.R. 164 (Bankr. S.D.N.Y. 1990).

[286] Doral Ctr. v. Ionosphere Clubs (In re Ionosphere Clubs, Inc.), 208 B.R. 812, 814 (S.D.N.Y. 1997).

[287] Gunlock, *supra* note 161.

[288] *In re* Armstrong World Ind., Inc., 432 F.3d 507 (3d Cir. 2005) (denying confirmation of reorganization plan because it violated absolute priority rule; creditors must be paid before stockholders retain equity interest).

basis for the requirement that the debtor provide the secured lender the economic value of the security interest.[289] Once the reorganization plan is confirmed, the terms of the plan dictate treatment of claims.[290]

11 U.S.C. § 1141, Effect of confirmation

Under subsection (b) all property of the estate—scheduled or not—vests in the debtor upon confirmation, but under appropriate circumstances the debtor may be subject to equitable constraints.[291] Subsection (c) governs the sales of corporate assets pursuant to the reorganization plan.[292]

2. Bankruptcy Code Airline Provision

The only remaining provision that relates solely to airline bankruptcies is 11 U.S.C. § 1110, Aircraft equipment and vessels.[293] This section appears to be of extremely limited relevance to airport counsel, so is only discussed here in brief.[294] Section 1110 offers greater protection than that afforded under § 365;[295] it is intended to offer either repossession or payment.[296] The intent of § 1110 was "to enhance the borrowing ability of airlines…by offering equipment financiers greater certainty with regard to their ability to protect collateral in a bankruptcy proceeding."[297] The true lease question, while still technically an issue, is of far less import under § 1110 than under § 365.[298]

Section 1110 only applies to reorganizations under Chapter 11, not to liquidations under Chapter 7. Where it does apply, it prevents the court from preventing repossession of the covered aircraft equipment, eliminates the requirement that the creditor/lessor move to lift the automatic stay, and places the right of repossession over the debtor's right to use, sell, or lease covered aircraft equipment.[299] Section 1110(a) prevents a bankruptcy court "from using any source of law, including antitrust, as the basis of an injunction against repossession."[300] In addition, if the creditor/lessor has a contractual right to repossession, § 1110 preserves that right despite the provisions of §§ 362, 363, 1129, and other provisions of the Bankruptcy Code, including injunctive powers under § 105(a), unless specified conditions are met,[301] basically agreeing to pay the full amount owed or coming to agreement with the creditor/lessor on a lower price.[302] Payments made to protected creditors within 90 days before the petition is filed are not recoverable as preferences.[303]

Covered equipment includes aircraft, aircraft engines, propellers, appliances, and spare parts; protected creditors are secured lenders, lessors, and conditional vendors. Ground support equipment may not be covered.[304] Section 1110 is to be construed narrowly: the provision only applies if the debtor holds an air carrier certificate issued under 49 U.S.C. § 447,[305] and does not apply to transactions where the debtor is not yet a certified air carrier or is the parent corporation of a certified carrier.[306]

3. Federal Aviation Provisions

The Anti-Head Tax[307] prohibits a public agency from charging taxes or fees on a per-person basis in air transportation. However, in 1990 this restriction was modified to allow the imposition of PFCs (discussed in Section I.B.1, *Bond Financing*, *supra*), subject to FAA approval of the amount (as of April 2008 the amount was set at a maximum of $4.50 per enplaned passenger) and duration of the charge.[308] Airports are allowed to use PFC revenue "to fund FAA-approved projects that enhance safety, security, or capacity; reduce noise; or increase air carrier competition."[309]

PFC funds are collected by airlines on behalf of the airports that impose the charges. Historically the FAA has permitted airlines to commingle PFC revenues and other funds. Airport operators objected that this commingling made it difficult to recover PFC revenues in

[289] United Airlines, 416 F.3d at 610.

[290] United Air Lines, 360 B.R. at 782.

[291] JZ L.L.P., 371 B.R. at 419–21.

[292] Gunlock, *supra* note 161.

[293] Section 328 of BAPCPA, 109 Pub. L. No. 8, 119 Stat. 100, struck the special airport lease provisions of § 365(c)(4) and (d)(5)-(9).

[294] A more comprehensive discussion is found in Jacob, *supra* note 2.

[295] *See* Heuer, *supra* note 3, at 264–65, *citing In re* Airlift Int'l, 761 F.2d 1503 (11th Cir. 1985).

[296] Heuer, *supra* note 3, at 266, *citing* Seidle v. Gatx Leasing Corp., 778 F.2d 659 (11th Cir. 1985).

[297] Airlift Int'l, 761 F.2d at 1507, *citing* H.R. REP. NO. 595, 1st Sess. 238–39 (1977), U.S. CODE CONG. & ADMIN. NEWS 1978, at 5787. *See also* United Air Lines, Inc. v. U.S. Bank N.A., 406 F.3d 918 (7th Cir. 2005), (U.S. 2005) (Right to repossess aircraft equipment in an airline chapter 11 case is absolute). The court notes that improper exercise of § 1110 remedies may subject creditors to liability to Chapter 11 estate. *Id*. at 924.

[298] *See* Jacob, *supra* note 2, at 15-10–15-11.

[299] *Id*. at 15-2.

[300] United Air Lines, 406 F.3d, at 924.

[301] Jacob, *supra* note 2, at 15-4–15-5.

[302] United Air Lines, 406 F.3d 918.

[303] Kimmelman, 344 F.3d 311.

[304] Jacob, *supra* note 2, at 15-9, *citing* A&S Sales & Leasing, Inc. v. Belize Airways, Ltd. (In re Belize Airways, Ltd.), 7 B.R. 601, 602 (Bankr. S.D. Fla. 1980); Cal. Chieftan v. Air Vt., Inc. (In re Air Vt., Inc.), 761 F.2d 130, 133 (2d Cir. 1985).

[305] Jacob, *supra* note 2, at 15-3, *citing* Swiss Air Transp. Co. v. Tex. Int'l Airlines, Inc. (In re Continental Airlines Corp.), 57 B.R. 854, 857–58 (Bankr. S.D. Tex. 1985).

[306] Jacob, *supra* note 2, at 15-9, citing *In re* Pan Am Corp., 124 B.R. 960, 974 (Bankr. S.D.N.Y.).

[307] 49 U.S.C. 40116.

[308] 49 U.S.C. 40117.

[309] Passenger Facility Charge (PFC), *available at* www.faa.gov/airports_airtraffic/airports/pfc/ (Last visited Dec. 16, 2008).

the event of airline bankruptcy, a point disputed by airline representatives.[310]

In 2003 Section 40117 was amended to set forth requirements for financial management of PFCs for a "covered air carrier" (an air carrier that files for bankruptcy or has an involuntary bankruptcy proceeding begun against it).[311] Subsection (m):

- Requires that a covered air carrier segregate its PFC revenue in a separate account, maintaining an amount equal to the average monthly liability for those fees;
- Stipulates that if a covered air carrier fails to segregate PFC funds as required, the trust fund status of those funds will not be defeated by an inability to identify and trace the precise funds that should have been segregated;
- Prohibits covered carriers from granting any security or other interest in PFC funds to third parties;
- Provides for compensation to eligible entities for expenses incurred to recover or retain PFC revenue due to failure by a covered air carrier to comply with the financial management requirements of subsection (m);
- Allows covered air carriers to retain the interest on the required accounts if those accounts are established and maintained in compliance with subsection (m); and
- Provides that regulations allowing commingling do not apply to covered air carriers.

Section 40117(m) is implemented through 14 C.F.R. Part 158. On May 23, 2007, the FAA issued the final rule on the PFC program that amended 14 C.F.R. Part 158 to include the measures to protect PFC revenues in bankruptcy proceedings.[312] Under the regulation, the definition of "covered air carrier" provides a 90-day grace period to allow an air carrier to dismiss involuntary bankruptcy proceedings (protection against frivolous involuntary bankruptcy filings), although the grace-period is limited to air carriers that are current on their PFC remittances. The regulation also provides that an air carrier ceases to be a covered air carrier when it emerges from bankruptcy proceedings. The regulation did not expand the definition of covered air carrier to include an airline in financial distress, as the FAA took the position that doing so would exceed its authority under Vision 100.[313]

As amended, 14 C.F.R. Part 158.49(b) requires the collecting carriers to account for PFC revenue separately. While carriers that are not covered carriers may commingle the PFC funds with other revenue sources, the regulation specifies that:

> PFC revenues held by an air carrier or an agent of the air carrier after collection are held in trust for the beneficial interest of the public agency imposing the PFC. Such air carrier or agent holds neither legal nor equitable interest in the PFC revenues except for any handling fee or interest collected on unremitted proceeds as authorized in § 158.53.[314]

The revised 14 C.F.R. Part 158.49(c) requires that covered carriers go beyond accounting for PFC revenue separately to actually put PFC revenues in a separate account, and deposit into that account an amount equal to its average monthly PFC obligation (PFC reserve). Covered carriers are not, however, required to create separate accounts for each airport for which they collect PFCs. While a covered carrier may deposit collected PFC revenues into its general accounts along with ticket sales revenues, it must remove—at least once daily—all PFC revenue from its general accounts and deposit it in the PFC account (or substitute a prescribed estimate). Commingling is prohibited.

Subsection (c) further specifies that if a covered carrier fails to segregate its PFC funds, the fact that the precise PFC funds can't be traced in the carrier's accounts will not defeat the trust fund status of those PFC funds. The regulation prohibits the covered carrier from granting an interest—secured or otherwise—in PFC funds. Finally, subsection (c) requires that a covered carrier that causes a public agency to spend funds to recover or retain PFC revenues must compensate that public agency for costs incurred to recover PFCs owed.

14 C.F.R. Part 158.49(d) still requires each collecting carrier "to disclose the existence and amount of PFC funds regarded as trust funds in financial statements." This requirement may prevent airlines from making not yet remitted PFC revenues the subject of liquidity covenants for the benefit of nonairport creditors, an issue raised by the airport associations.[315]

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[310] FAA, Discussion of comments received in response to Request for Public Comment on the Impact of Airlines Emerging From Bankruptcy on Hub Airports, Airport Systems and U.S. Capital Bond Markets, 68 Fed. Reg. 38108 (June 26, 2003), at 3, *available at* www.regulations.gov/fdmspublic/component/main?main=DocumentDetail&o=0900006480313b4f (Last visited Dec. 16, 2008).

[311] Section 124,108 Pub. L. No. 176, 117 Stat. 2502–2503, Vision 100—Century of Aviation Reauthorization Act, Pub. L. No. 108-176, adding subsection (m), *Financial Management of Fees*, to 49 U.S.C. 40117.

[312] FAA Final Rule, Passenger Facility Charge Program, Debt Service, Air Carrier Bankruptcy, and Miscellaneous Changes, 72 Fed. Reg. 28837-28851 (May 23, 2007); Technical correction: 72 Fed. Reg. 31713-31714 (June 8, 2007).

[313] FAA Final Rule, Passenger Facility Charge Program, Debt Service, Air Carrier Bankruptcy, and Miscellaneous Changes, 72 Fed. Reg. 28841 (May 23, 2007).

[314] 14 C.F.R. 158.49(b).

[315] AAAE/ACI-NA comments in response to Request for Public Comment on the Impact of Airlines Emerging from Bankruptcy on Hub Airports, Airport Systems and U.S. Capital Bond Markets, 68 Fed. Reg. 38108 (June 26, 2003), at 4, *available at* www.regulations.gov/fdmspublic/component/main?main=DocumentDetail&o=0900006480313b58 [click on docket] (Last visited Dec. 16, 2008).

C. Bankruptcy Process [316]

The bankruptcy process begins when the debtor files a petition for bankruptcy protection. The debtor is not bankrupt until it has been discharged in bankruptcy at the end of the process. A debtor filing for reorganization under Chapter 11 need not be insolvent.[317] Conversely, creditors that fear that the debtor is wasting its estate can file for an involuntary bankruptcy petition to have the debtor declared insolvent and have a trustee appointed.[318]

Each federal judicial district has a bankruptcy court, presided over by a federal bankruptcy judge. The federal district court provides the first level of appellate review, followed by the Bankruptcy Appellate Review (intermediate appellate review), circuit court of appeals, and finally the Supreme Court.[319] The U.S. Bankruptcy Courts provide a good overview of the bankruptcy process.[320] In brief, the Federal Rules of Bankruptcy Procedure, along with each bankruptcy court's local rules, govern bankruptcy procedure. In addition to the bankruptcy petition, the debtor must file: "(1) schedules of assets and liabilities; (2) a schedule of current income and expenditures; (3) a statement of financial affairs; and (4) a schedule of executory contracts and unexpired leases." The debtor bears the risk of nondisclosure.[321]

In Chapter 7 cases the trustee appointed to oversee the bankruptcy case carries out much of the administrative process. Liquidation under Chapter 7 entails the court-appointed trustee reducing the debtor's assets to cash and distributing the proceeds, if any, to creditors. An unsecured creditor receives a distribution only if the creditor has filed a timely proof of claim and if there are assets in addition to the debtor's exempt property and property not subject to the rights of secured creditors.[322]

Chapter 7 cases may be filed where the debtor is organized, has its principal place of business, or has its principal assets. The trustee will meet with creditors between 20 and 40 days after the Chapter 7 petition is filed. Governmental units have 180 days following the case filing to file a claim. If operating the business will benefit the creditors and distribution of assets, the court may authorize the trustee to operate the business for a limited time.

Chapter 11 is used to reorganize businesses. Once the bankruptcy petition is filed, the debtor becomes a DIP, remaining so until the reorganization plan is confirmed, the case is dismissed or converted to Chapter 7, or a trustee is appointed. As one treatise noted, Chapter 11 allows "the management that [flies] the airline into stormy weather to stay at the controls, at least until a trustee is appointed."[323] Virtually all litigation involving a Chapter 11 debtor will come before the bankruptcy court.[324] The filing date marks the demarcation between debts that are generally nonpayable during the case (prepetition) and debts that must be paid before the acceptance of the reorganization plan (postpetition).[325] In addition, the date of the order for relief, which may be but need not be the same as the filing date, will determine numerous rights during the proceedings, such as whether a nonresidential real property lease has been terminated so as to preclude assumption.[326]

A disclosure statement containing information about the debtor's liabilities, assets, and business affairs sufficient to provide a basis for assessing the reorganization plan must be filed. The reorganization plan must classify the claims and explain how they will be treated. The creditors' committee can be a major actor, participating in plan formulation. However, during the first 120 days after the bankruptcy petition is filed—a period that can be extended up to 18 months—only the debtor can file a reorganization plan. The debtor then has an additional 180 days—a period that can be extended up to 20 months or reduced—to obtain acceptance of its plan. Once the exclusive period expires, and assuming acceptance has not been achieved, other parties in interest may file a plan. Any party in interest may object to confirmation of a reorganization plan.

A Chapter 11 creditor need not file a proof of claim if its claim is listed on the debtor's schedules and is not disputed, unliquidated, or contingent, but if the creditor relies on the debtor's schedule listing, it cannot after the bar date dispute the amount or priority of the claim as listed by the debtor. Secured creditors and postpetition creditors generally do not have to file proofs of claim. However, prepetition unsecured creditors whose claims are not listed by the debtor; whose claims are

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[316] For more detailed guidance, s*ee generally* NOLLKAMPER, *supra* note 2 (Procedural information on Chapter 7, Chapter 11, creditors' proceedings, adversary proceedings, appeals, and U.S. Bankruptcy Courts); SALERNO, *supra* note 2 (Overview of U.S. bankruptcy law, bankruptcy court system, Chapter 7, and Chapter 11).

[317] DEMPSEY, *supra* note 3, § 17.19, Filing of Voluntary Petition.

[318] DEMPSEY, *supra* note 3, § 17.20, Involuntary Bankruptcy.

[319] SALERNO, *supra* note 2, § 3.15, Appeals of Bankruptcy Court Orders.

[320] See *Bankruptcy Basics*, *available at* www.uscourts.gov/bankruptcycourts/bankruptcybasics.html (Last visited Dec. 16, 2008). Unless indicated otherwise, information in this section is based on the Bankruptcy Courts' *Bankruptcy Basics*.

[321] JZ, L.L.C., 371 B.R. at 417.

[322] *Bankruptcy Basics: The Process*, *available at* www.uscourts.gov/bankruptcycourts/bankruptcybasics/process.html (Last visited Dec. 16, 2008).

[323] DEMPSEY, *supra* note 3, § 17.25, Critique of Bankruptcy Code.

[324] LYNN, *supra* note 2, ¶ 21.02[2], Centralization of Litigation in Bankruptcy Court. For example, in 2006, United Air Lines sought the bankruptcy court's approval to enter into a settlement of tax claims with 23 California counties. TROUBLED COMPANY REPORTER, Tues., Jan. 31, 2006, vol. 10, no. 26, *available at* http://bankrupt.com/TCR_Public/060131.mbx (Last visited Dec. 16, 2008).

[325] LYNN, *supra* note 2, ¶ 20.05[9], Prepetition and Postpetition; ¶ 21.03[2], Postpetition Bills Must Be Paid; ¶ 24.24[4], Payment of Prepetition Debts Owed to Critical Vendors.

[326] 11 U.S.C. § 365(c)(3).

listed as disputed, unliquidated, or contingent; or who dispute the amount or priority of listed claims must file timely (before the bar date) proof of claims.[327]

Creditors who will be paid less than the value of their claims or whose contractual rights will be modified under the confirmation plan vote on the plan. The court must approve the disclosure plan. Then once the votes are counted, the court conducts a hearing on the confirmation plan.

The bankruptcy court approves case management procedures for each bankruptcy case.[328] These procedures are critical, as they will determine such issues as the parties to receive notice and the manner in which notice must be provided, the amounts the debtor asserts are owed, time periods allowed for disputing debtors' characterization of claims, requirements for resolving disputes before bringing the issue to the bankruptcy court, and time periods for making payments. For example, the bankruptcy court will enter a Bar Date Order, which will establish procedures and set deadlines for filing Proofs of Claim and will approve the form and manner of the bar date notice. Creditors must comply with this and other orders specific to the case in order to be able to file and prosecute their claims.[329] The court may also adopt procedures for specific issues that will supersede even the case management procedures. For example, in the United stub rent dispute, discussed in Section II.D.4, *Stub Period Rent*, *infra*, the Order Approving and Authorizing Payment Under the Agreed-Upon Stub Rent Procedures provided that those procedures would supersede the Case Management Procedures—to the extent inconsistent with the Stub Rent Procedures—for all motions filed for allowance and payment of claim for rent for the rejected leases in question.[330]

D. Cases

This section covers several issues that have come to the fore in airline bankruptcy cases and that are of particular interest to airport lawyers. These include whether a lease[331] associated with tax-exempt bond financing can be recharacterized as "disguised financing" rather than a "true lease" that must be accepted or rejected under § 365;[332] as a matter related to recharacterization, whether a lease that covers both ground rents and bond repayments can be severed; whether a group of leases under a master lease can be assumed or rejected individually; whether a cross-default clause can be enforced; whether § 365(d)(3) requires the payment of stub period rent; whether airlines can claim PFC revenues as property of the bankruptcy estate; and whether airlines can compel segregation of PFC revenues. In addition, because of the importance of lease rejection and preferential transfers in the context of airline bankruptcy, this section includes a pair of illustrative lease rejection and preferential transfer cases. In some instances important issues were not formally adjudicated, but were negotiated by the parties and approved by the bankruptcy court. While the positions adopted are not precedential, they—as well as the arguments raised—are instructive in determining the issues that airports should consider in handling like matters.

In fact, matters containing issues of interest to airports often do not result in reported cases. Instead, important issues are often handled through motions and settlements. Airport counsel may find it helpful, to say the least, to see how other airports have dealt with these issues, even if the cases themselves are not precedential. In addition, even unreported opinions discuss reported cases that are relevant. Also, although not precedential in the strict sense, given the relatively small universe of airline bankruptcy practitioners, language used in one settlement agreement can be picked up and used in other similar agreements. For example, the consent order in a US Airways case heard in a Virginia bankruptcy court and that in an Aloha Airgroup case heard in the Hawaii bankruptcy court contained many similar provisions.[333] Also, settlements are often approved as being in the best interest of a bankruptcy

[327] LYNN, *supra* note 2, ¶ 20.05[18], Proof of Claim.

[328] *See, e.g.*, In re UAL Corp., Reorganized Debtors, Chapter 11, Case No. 02-B-48191, Fourth Amended Case Management Procedures , *available at* www.pd-ual.com/UALRestruct_CMP.html (Last visited Dec. 16, 2008).

[329] *See, e.g.*, In re UAL Corp., Chapter 11, Case No. 02-B-48191, Order Pursuant to Sections 105(a), 501, 502 and 1111(a) of the Bankruptcy Code and Bankruptcy Rules 2002(a)(7), 3003(c)(3) and 5005(a) Establishing a Bar Date for Filing Proofs of Claim and Proofs of Interest and Approving Form and Manner of Notice Thereof, Feb. 27, 2003; Delta Air Lines Form 8-K, Feb. 7, 2007, Airports/Facilities Restructuring, at 63, *available at* http://pcquote.brand.edgaronline.com/EFX_dll/EDGARpro.dll?FetchFilingHTML1?SessionID=gMXgCgomAhfWRT_&ID=4936650 (Last visited Dec. 16, 2008).

[330] In re UAL Corp., Chapter 11, Case No. 02-B-48191, Order Approving and Authorizing Payment Under the Agreed-Upon Stub Rent Procedures (Bankr. N.D. Ill. Aug. 29, 2003), at 2.

[331] All references to "leases" in this section should be read as "nonresidential real property leases" unless otherwise indicated.

[332] All statutory citations in this section are to Title 11 of the U.S.C., unless indicated otherwise.

[333] Consent Order Resolving (A) Multiple Objections to Debtors' Motion for Bridge, Interim and Final Orders (1) Authorizing the Debtors to Use Cash Collateral; (2) Providing Adequate Protection; (3) Scheduling A Final Hearing; (4) Approving Form and Manner of Notice; and (5) Granting Related Relief; (B) Multiple Motions to Compel Debtors to Segregate and Remit Passenger Facility Charges, In re US Airways, Inc., Case No. 04-13819-SSM Jointly Administered Chapter 11 Cases (Bankr. E.D. Va.), Oct. 15, 2004; Consent Order and Stipulation Resolving Port of Oakland's (A) Limited Objection to Interim Order Authorizing Use of Cash Collateral and Other Pre-Petition Collateral; … (C) Motion to Compel Debtors to Segregate and Remit Passenger Facility Charges, etc., In re Aloha Airgroup, Inc., Bk. No. 04-03063, Chapter 11 Jointly Administered (Bankr. D. Haw.), Feb. 10, 2005.

estate because of savings assumed by avoiding prolonged and costly litigation.[334] Therefore this section discusses several unreported, though very relevant, cases.[335]

Several cases involving United Air Lines deal with the recharacterization issue.[336] In three instances, United was able to recharacterize its special facility lease as a disguised financing, resulting in the airline being able to continue to use the facility in question without assuming the lease. In the fourth instance, United was unsuccessful in recharacterizing its special facility lease. These cases illustrate the significance of the distinction between the special facility lease being deemed a true lease as opposed to a secured loan and the factors that contribute to lease recharacterization. In addition, one of the cases discusses the factors, including state law and contract analysis, taken into consideration in determining whether a lease can be severed. For example, as discussed in more detail below, a critical distinction between the court's holdings regarding the Los Angeles/San Francisco transactions and the Denver transaction was that in Denver the ground lease and the bond-related lease were rolled together in one contract, which under Colorado law could not be severed. Moreover, United had admitted that the ground lease provisions constituted a true lease.[337]

Lease severability can be important even in cases where the "true lease" nature of the transaction is not at issue. For example, where a master lease covers a set of individual leases, controversy may arise as to whether the debtor can assume or reject individual leases separately, or must take or leave them as a group.[338] Individual leases with cross-default clauses raise similar issues.

Many airport leases require that rent be paid in advance.[339] The "stub period" is "the time remaining after the entry of an order for bankruptcy relief, in a period for which rent was payable prior to the entry of the order for relief."[340] Issues that arise include whether payment is required under § 365(d)(3), whether the stub period rent should be considered a prepetition claim, and how payment is to be determined. Disputes surrounding United's obligation to pay stub period rent arising from United's December 2002 bankruptcy filing are discussed below.

Finally, accounting for, and remittance of, PFCs by bankrupt airlines are matters of significant concern to airports. Disputes over requirements to account for PFC funds were of greater import before Vision 100 required bankrupt airlines to segregate such funds. Nonetheless, ensuring compliance is still important, as is the question of whether an airport can compel segregation of PFC funds when an airline in bankruptcy has declined to do so. Moreover, while the statute provides that if failure to segregate funds leads to an inability to trace precise PFC funds, such inability will not defeat the funds' trust fund status, in practical terms the failure to trace funds may result in an inability to recover those funds. Thus if an airline in liquidation does not identify revenue in its general accounts as PFC revenue, *i.e.,* refuses to "trace" the funds to PFCs, the airline effectively appropriates the airports' PFC revenue.

1. Lease Recharacterization

At the time that United entered bankruptcy in 2002,[341] it took the position that its transactions entered into to build or improve facilities at the SFO, LAX, Denver (DEN), and JFK airports were not leases that must be assumed or rejected under § 365, but rather secured loans. The Seventh Circuit Court of Appeals, home to United's place of business, heard all of the appeals.

San Francisco.—The transaction relating to the San Francisco airport was the first to be reviewed, with the opinion delivered by Judge Easterbrook.[342] As the court noted, for purposes of the transaction at issue, the difference between a lease and a loan under the Bankruptcy Code is as follows: Under § 365 the lessee must

[334] *See* Delta Air Lines, 370 B.R. 545.

[335] Material cited should be available through PACER, the U.S. Courts' fee-based electronic system, *available with sign-in at* http://pacer.psc.uscourts.gov/ (Last visited Dec. 16, 2008).

[336] Other airlines have brought recharacterization actions, *see, e.g.*, Daniel J. Carragher, *True Lease or Disguised Financing? The "State" of the Law*, 25 ABI J. (2006) (referencing actions begun by Northwest vis-à-vis the MSP and Northwest vis-à-vis LAX); Yvette Shields, *Delta Files Chapter 11 Exit Plan*, THE BOND BUYER, Dec. 20, 2006 (action to recharacterize leases tied to bond repayment at LAX put on hold), *available at* www.bondbuyer.com/article/html?id=200612199D9QOCPX&from=todaysheadlines (Last visited Dec. 16, 2008). However, it appears that the United actions are the only reported cases to date.

[337] PATRICIA A. REDMOND & JESSICA D. GABEL, *The Tip of the Iceberg: What Lies Beneath for Homebuilder Bankruptcies in the Wake of United Air Lines*, 26 ABI J. (2007), http://www.cov.com/files/Publication/65d45c0a-cec3-4436-9bbd-2f6451f401d5/Presentation/PublicationAttachment/0c8b1f8b-3a4a-4c00-bef4-370f4e00518d/The_Tip_of_the_Iceberg_-_What_Lies_Beneath_for_Homebuilder_Bankruptcie.pdf.

[338] *See* MorrisJames Delaware, The Bankruptcy Court for the District of Delaware Holds That Debtors Must Assume or Reject Master Leases as a Whole, June 3, 2008: In re Buffets Holdings, Inc., No. 08-10141 (Bankr. D. Del. May 16, 2008) (Judge Mary F. Walrath), *available at* http://bankruptcy.morrisjames.com/2008/06/articles/the-bankruptcy-court-for-the-district-of-delaware-holds-that-debtors-must-assume-or-reject-master-leases-as-a-whole/. (Last visited Dec. 16, 2008). Opinion, http://bankruptcy.morrisjames.com/Buffets%20Case.pdf. The factors raised in this case are covered in § IV.A.2, *Relationship Between Multiple Agreements*, *infra*.

[339] In re UAL Corp., Case No. 02-B-48191, Debtors' Motion for an Order Approving and Authorizing Payment Under the Agreed-Upon Stub Rent Procedures, at 2.

[340] United Air Lines, 291 B.R. at 123.

[341] Information about United restructuring, including case management procedures and first day motions/orders, is available at www.pd-ual.com/ (Last visited Dec. 16, 2008).

[342] United Air Lines, 416 F.3d 609.

either assume the lease and fully perform or reject the lease and surrender the property. Under §§ 506(a) and 1129(b)(2)(A), a secured borrower may retain the property without fully paying, instead paying the lender the economic value of the property, with any additional loan balance becoming an unsecured debt.

At issue in the San Francisco case was United's obligation to continue making payments on a "lease" of facilities that secured the repayment of $155 million in bonds issued by the California Statewide Communities Development Authority (CSCDA) for United's benefit for airport improvements unconnected with the lease. United used its 40-year lease of 128 acres for a maintenance facility from the airport to structure its facility improvement transaction. There were in fact four documents at issue: 1) sublease: United subleased 20 acres of the 128 acres leased from the airport to CSCDA for a term equal to the debt repayment schedule (not equal to its lease term with the airport) for $1; 2) leaseback: CSCDA leased the 20 acres back to United for rent equal to the bond interest plus an administrative fee, with a balloon repayment of principal at the termination of the leaseback. If United postponed its final payment for 5 years the sublease and leaseback would extend; if United prepaid, the sublease and leaseback would terminate upon the prepayment. If United did not pay, CSCDA could evict it from the 20 acres. The leaseback contained a "hell or high water" clause requiring United to pay the rent regardless of whether the airport lease ended early or some event kept United from using the maintenance facility; 3) trust indenture: CSCDA issued the bonds, without recourse to itself, giving the $155 million to United based on the promises to pay in the sublease[343] and having the bond indenture Trustee receive payments and distribute them to the bond holders; 4) guaranty: United committed to repay bonds out of its corporate treasury.

The court then discussed whether the undeniable lease form of the sublease and leaseback were sufficient for purposes of § 365. The court first determined that "substance controls and that only a 'true lease' counts as a 'lease' under § 365."[344] In beginning its analysis of form versus substance under § 365, the court discussed the difference between financial and economic distress, noting that the Bankruptcy Code allows an entity in financial distress to write off its debts to allow it to begin anew, while requiring it to pay expenses incurred after it files for bankruptcy protection. In examining the differences under the Bankruptcy Code between leases and secured loans, the court emphasized the consumption aspect of leases as opposed to the debt components more properly attributable to loans. The court cited the legislative history of § 365 to support the interpretation that § 365 deals with the economic substance rather than the form of the transaction.

The court found that the determination of what constitutes a lease is made under state law, unless state law identifies a lease formally rather than functionally. Accordingly, the court looked to California law, finding that as a Uniform Commercial Code (UCC) state California must use a functional approach for determining whether personal property is leased or secured credit, with a similar approach for real property. In applying the facts of the United Air Lines transaction to California precedent, the court found that the transaction was not a "true lease" under California law. First, there was a lack of connection between the payment and the value of the rental property, as shown by the rent amount and the hell or high water clause. Second, the lessor retained no interest in the property once the lease expired, and the lessee's full interest, although not ownership, reverted to it, "the UCC's per se rule for identifying secured credit."[345] Third, the balloon payment is a feature of secured credit, not a true lease. Fourth, termination of lessee's interest upon prepayment is contrary to the result of prepayment (right to additional occupation) under a true lease. While financing devices can be true leases, the court found that in this instance United used its asset—the leasehold interest—to secure an extension of credit. Therefore the court held that the transaction between United and CSCDA was a secured loan, not a lease, for purposes of § 365.

In summary, the court held that 1) as a matter of federal law, the economic substance of the transaction, rather than titles and forms, will determine whether a transaction is a lease for purposes of § 365, and 2) generally state law will determine which aspects of a transaction are important in determining whether or not the transaction is a lease, except that if state law takes a formulistic approach state law will not control.

While its appeal to the Seventh Circuit was pending, HSBC Bank USA brought an adversary proceeding before the bankruptcy court to "determine the nature, extent, and value of CSCDA's interest in the subleased property, assigned to HSBC as trustee."[346] Once the Seventh Circuit ruled that the sublease was not a true lease under § 365, United and HSBC stipulated that HSBC held a perfected security interest in the subleased property. The bankruptcy court looked to the appropriate valuation standard under § 506(a): "what the debtor would have to pay to replace it…'the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller.'"[347] The question then was what constitutes "like property." United and HSBC agreed that comparable properties should be used to value the collateral, but

[343] "Sublease," not "leaseback," was the term used by the court. *Id.* at United Air Lines 612.

[344] *Id*., *citing* In re PCH Assocs., 804 F.2d 193, 198-200 (2d Cir. 1986); Duke Energy Royal LLC v. Pillowtex Corp. (In re Pillowtex, Inc.), 349 F.3d 711, 716 (3d Cir. 2003); In re Moreggia & Sons, Inc., 852 F.2d 1179, 1182-84 (9th Cir. 1988); Pacific Express 780 F.2d at 1486–87; In re Continental Airlines, Inc., 932 F.2d 282 (same under 11 U.S.C. § 1110, another part of the Code dealing with leases).

[345] United Air Lines, 416 F.3d 617.

[346] United Air Lines, 351 B.R. 919.

[347] *Id*., *citing* Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 960 (1997).

disagreed on what constituted comparable properties. HSBC argued that a similar hangar facility at the San Francisco airport was the most comparable property. United argued that location was irrelevant to the tasks for which it needed the hangar space and argued for using hangar space in the Portland, Oregon, and Dallas/Fort Worth airports—the least expensive substitutes that would meet its needs—as the most comparable.

The court rejected United's argument that location was irrelevant in valuing real estate, instead stressing that a real estate comparable should provide the location value of the property being valued. The court declared that "if the location of HSBC's collateral provides value that United does not need, that value must nevertheless be considered in assessing what the collateral is worth."[348] The court held that when the debtor chooses to retain the collateral, the appropriate valuation standard is the replacement value of the collateral, not a foreclosure value standard.

Having determined the appropriate comparable, the court determined the actual value of the collateral. This required examining the four types of leased property included in the collateral and valuing them according to the agreement of the parties, the lease on the comparable property, and the existing lease between United and the airport, as appropriate. Once it determined the annual rent, the court determined the present value of future rents, which required looking at the number of future lease years included in the collateral, inflation adjustments, and a discount rate. On that first point the court rejected the argument that the security interest should run beyond the period in operation at the time United filed for bankruptcy protection. The court stated that "[b]ecause United acquired the option after its bankruptcy filing, any additional collateral value the option provided is subject to § 552(a) of the Bankruptcy Code, which generally prevents prepetition liens from attaching to property interests that a debtor acquires postpetition."[349] As to inflation adjustments, the court adopted the average contract adjustment rate used by the airport. The date for valuing the collateral is the date of the hearing on United's plan confirmation; the appropriate discount rate is one that would make either a lump sum or a stream of payments the collateral is likely to provide equally attractive to HSBC. The discount rate is the risk that a likely tenant—another major airline—would default: thus the court concluded that the cost of capital for major airlines would be the appropriate discount rate. The court also subsequently rejected United's argument that its rental payments to the airport under the underlying lease should have been deleted from the value of the collateral, explaining that United had not conveyed its interest in the lease as security, but its right to possess part of the leasehold, while retaining all of its payment obligations.[350]

LAX.—The same appellate panel next reviewed the LAX transaction, although Judge Manion delivered the court's opinion.[351] United had leased space at the airport from the City of Los Angeles (LA) for over 25 years. In 1982 United entered into a transaction with the Regional Airports Improvement Corporation (RAIC), an entity formed by, but legally separate from, the LA, to develop facilities for United at the airport. RAIC has authority to issue tax-exempt bonds. The transaction was achieved pursuant to two agreements. Under the partial assignment, United assigned part of its leasehold with LA to RAIC and RAIC issued $75,750,000 in tax-exempt bonds to develop the United facilities. Under the facilities sublease, RAIC leased the facilities (not yet constructed when the sublease was executed) back to United for a rent amount equal to the bond payments (periodic payments equal to bond interest and balloon payments equal to principal), plus administrative costs. The term of the sublease followed the payments. Once United finished paying the bonds, the sublease expired.

The court reviewed its previous holdings on the issues required for deciding whether a transaction is a lease for purposes of § 365. The court then reviewed its findings in the San Francisco case, stating the five factors underlying its conclusion that the transaction was a loan as follows:

> 1) the fact that United's "rental" payments were tied to the amount borrowed from the bondholders; 2) the presence of a balloon payment; 3) the presence of a "hell or high water" clause, meaning United had to pay the full "rental" amount if even the property became unusable; 4) the fact that prepayment of United's obligations would end the United-CSCDA arrangement; and 5) the fact that CSCDA did not have a remaining interest in the property at the end of the transaction.[352]

The court proceeded to examine the facts in the LAX transaction against the factors from the San Francisco case. First, the LAX "rent" was linked to the amount of the bond repayment. Second, the LAX transaction involved a balloon payment: "The balloon payments here are tremendously revealing in this regard. They make plain that, at the outset, United borrowed $75,750,000 and promised to return that same $75,750,000 in the future. United's balloon obligations are thus powerful evidence that the design of this transaction is that of a loan."[353]

Third, the transaction contained a "hell or high water clause," which was not only a "telling disjoint be-

[348] *Id*. at 920.

[349] *Id.* at 923.

[350] HSBC Bank USA v. United Air Lines, Inc., In re: UAL Corp., Bankruptcy No. 02 B 48191 (Bankr. N.D. Ill. Jan. 22, 2007), www.ilnb.uscourts.gov/opinions/JudgeWedoff/UAL_HSBC2.pdf.

[351] United Air Lines v. U.S. Bank (In re United Air Lines, Inc.), 447 F.3d 504 (7th Cir. 2006).

[352] *Id*. at 507.

[353] *Id*. at 508.

tween rental value and United actual financial obligations"[354] but was at complete odds with the provisions in the underlying lease in the event that the leased premises were damaged. The court concluded that the clause was further evidence that the "rent" was tied not to the value of the use of the facilities but to the money borrowed. Fourth, prepayment terminated the LAX sublease, a provision the court noted that "has a useful purpose in the financing context" but "would be superfluous in the context of a lease."[355] Finally, the LAX sublessor, like a secured lender, retained no reversionary interest once the sublease terminates. The court discounted the argument that LA retained an interest, as the RAIC was a separate legal entity. RAIC argued that the LAX transaction was distinguishable from the San Francisco transaction because at LAX the bond-financed facilities were actually built on the subleased property. The court rejected that argument, characterizing the "property disconnect" as one factor that made it obvious that the transaction was not a lease, and concluding that the lack of such a disconnect was not sufficient to overcome the findings based on the five factors reviewed by the court. The court concluded:

> United's Los Angeles transaction with RAIC has all the hallmarks of a secured loan that were critical to our decision in the San Francisco appeal. In a fashion similar to the San Francisco arrangement, United used a leasehold interest to acquire financing from bondholders, and United's payments to the bondholders do not resemble true rental payments. We see no grounds to treat the San Francisco and Los Angeles transactions differently in this context.[356]

Accordingly the court held that the transaction was not a lease for purposes of § 365.

Denver.—Judge Manion also delivered the third reported opinion,[357] which ruled on the validity of the Denver agreement, the "Special Facilities and Ground Lease." The bulk of the opinion was devoted to the severability issue, and is discussed below. Having determined that the agreement could not be severed under Colorado law, the court held that since the ground lease provisions clearly constituted a lease for purposes of § 365, the entire agreement must be treated as a lease for purposes of § 365. Therefore, the court did not reach the question of had the bond-related provisions stood alone, would they be considered disguised financing rather than a true lease.

2. Severability/Master Leases

United Air Lines (Denver).—The Denver special facilities agreement covered ground space and facilities to be built on the ground space. The facilities were funded by tax-exempt municipal bonds issued by Denver and serviced by United through facilities rentals under the lease. When it declared bankruptcy in 2002, United tried to have the bond-related part of the agreement severed from the ground-related portion and declared to be a loan for purposes of § 365.

The agreement referred to the ground and the to-be-built facilities as the "leased property." Under the agreement United paid monthly ground rentals directly to Denver, based on a square footage rate and the cost of common-use services. United conceded that this portion of the agreement looked like a lease for § 365 purposes. Denver allowed United to build the facilities in question, but ownership and title rested with Denver, and possession of the facilities was to revert to Denver upon the termination of the lease. United paid to service the bonds through "facilities rentals" that were paid to a third agent that made distributions to the bondholders.

The court stated that in order to have the bond-related facilities portions of the agreement not be treated as a lease for purposes of § 365, those portions of the agreement must be severed from the rest of the agreement and the substance of the bond-related portion of the agreement must in fact not be in the nature of a lease. The court noted that the Denver case differed from those of SFO and LAX in that each of those transactions clearly involved separate documents, while in Denver the transaction was memorialized in one document. Thus, before addressing the issue of the nature of the bond-related agreement, the court needed to determine whether the Denver agreement could be severed.

As the court pointed out, state law governs contract severability. The court then applied the Colorado contract severability rule: "A contract cannot be severed unless the language of the contract manifests each party's intent to treat the contract as divisible."[358] The rule requires that to determine severability a court look to the essence of the bargain that the parties struck to assess whether there would have been a bargain if any of the promises were struck out. If there would not have been a bargain, the contract cannot be severed. Put another way:

> For a contract to be severable, the language of the contract must evince the parties' intention to have assented separately to successive divisions of the contract, upon performance of which the other party would be bound. Thus, it is not the number of items in the contract which is determinative of whether it is severable, but the nature of the object or objects in the contract.[359]

The court reviewed two Colorado cases, one involving a contract for a printing press and a paper folder (press could not be used without the paper folder, therefore contract could not be severed into two deals, which would have required the plaintiff to pay for the press even though the folder was not delivered), and the other a contract for a truck with a dump body (contract could not be severed into contract for truck and contract for

[354] *Id.*

[355] *Id.* at 509.

[356] *Id.* at 510.

[357] The dispute regarding the JFK facilities lease was resolved by an unpublished order. United Air Lines, 453 F.3d at 467 n.2.

[358] *Id.* at 468 (citations omitted).

[359] *Id.* at 468–69 (citations omitted).

dump body, even though most of the purchase price was for the truck, because plaintiffs would not have entered into contract for truck without contract for dump body). The court then applied these principles to the Denver–United agreement and found that the contract was "an inherently integrated bargain: an agreement for a leasehold coupled with a bond arrangement to improve that leasehold,"[360] and that the bond facilities agreement would never have been entered into without the ground agreement. The court held that there would not have been a bargain if the ground lease provisions were struck out, so that the agreement cannot be severed.

The court rejected United's argument that the different payment and default schemes for the ground and facilities portions of the agreement were a basis for severing the agreement. The court noted, "the existence of apportionable sums alone is not dispositive."[361] Moreover, the fact that an agreement could have been entered into as two separate agreements to begin with does not meet the test for severability. The court also rejected arguments concerning a local ordinance requiring two agreements and the existence in the agreement of a standard severability clause.

In re Buffets Holdings, Inc.[362]—Although apparently unreported and not relating to airline bankruptcy, the *Buffets* opinion's analysis of the severability of a master lease is nonetheless instructive. The disputed transaction involved the sale/leaseback of 29 properties where the debtor owned the building but not the land on which the building stood. The debtor assigned its ground leases and sold the buildings to a limited liability company (LLC). The debtor then subleased both the grounds and buildings from the LLC under four Master Leases. Upon filing bankruptcy, the debtor moved to reject or assign leases at certain of the locations; the LLC objected.

The bankruptcy court reviewed the case law related to the requirement that if a debtor accepts a contract, he does so "com onere" (with all of its terms),[363] and the § 365(f)(1) right to assume and assign a lease despite lease provisions purporting to inhibit that right.[364] The court then moved on to the central issue of severability, remarking first:

> The fact that there is one document reflecting the parties' agreements does not mean that it is one contract. "The 'all or nothing' requirement [of assumption or rejection under section 365] does not mean…that every document denominated a 'contract' or a 'lease' must be treated as a single, indivisible whole….If a single contract contains separate, severable agreements, however, the debtor may reject one agreement and not another."[365]

The court noted that severability is a question of state law,[366] and then proceeded to review the test for severability under Illinois law. That test is intent: the parties may have intended a single contract, even though expressed in separate agreements, or they may have intended separate agreements, even if bundled together. The next question is how, under state law, to determine intent: in Illinois it is the four corners approach.

Having set forth the legal standards, the bankruptcy court applied those standards to the facts at hand. First, the court reviewed the express terms of the contract. Two Master Leases were at issue, each covering multiple, independently operated properties in "scattered locations," with the rent allocated among the properties. The court rejected the debtor's argument that apportionability of rent mandated finding severable contracts, finding instead that the ability to apportion rent is one factor to consider, not a conclusive factor, citing Illinois state cases that found nonseverable contracts despite the existence of payment apportioned among different items.[367] The court emphasized the fact-intensive nature of the determination of the parties' intent.

The debtors argued that the following facts showed the severability of the contract: the LLC could divide and consolidate individual leases and create new master leases; the LLC has the right to sell property under any particular lease, which would result in severance; debtors can substitute property if a particular property is condemned; and debtors may assign or substitute any of the individual leases, with the LLC's consent. However, the court agreed with the LLC that because all of these actions required the LLC's consent, they in fact demonstrated that the master lease was intended to be integrated except for certain specified circumstances. In

[360] *Id*. at 470.

[361] *Id*. at 470 (citations omitted).

[362] In Re Buffets Holdings, Inc., Case No. 08-10141 (MFW) Jointly Administered (Bankr. D. Del. May 16, 2008), *at* http://bankruptcy.morrisjames.com/Buffets%20Case.pdf.

[363] *Id.* at 5, *citing* In re Italian Cook Oil Corp., 190 F.2d 994, 997 (3d Cir. 1951).

[364] *Id*. at 5–6, *citing* 499 F.3d 307; L.R.S.C. v. Rickel Home Ctrs., Inc. (In re Rickel Home Ctrs., Inc.), 209 F.3d 291, 299 (3d Cir. 2000); The Shaw Group, Inc. v. Bechtel Jacobs Co., LLC (In re The IT Group, Inc.), 350 B.R. 166, 179 (Bankr. D. Del. 2006); In re Convenience USA, Inc., No. 01-81478, 2002 WL 230772, at 7 (Bankr. M.D.N.C. Feb. 12, 2002).

[365] Buffets, at 6-7, *citing* 2 WILLIAM L. NORTON, JR. & WILLIAM L. NORTON, III, NORTON BANKR. L. & PRAC. § 39:11 (2d ed. 1999).

[366] *Id*. at 7, *citing* In re T & H Diner, Inc., 108 B.R. 448, 453 (D. N.J. 1989); In re Adelphia Bus. Solutions, Inc., 322 B.R. 51, 55 (Bankr. S.D.N.Y. 2005); In re Wolflin Oil, LLC, 318 B.R. 392, 397 (Bankr. N.D. Tex. 2004); In re Plum Run Serv. Corp., 159 B.R. 496, 499 (Bankr. S.D. Ohio 1993) (quotations omitted).

[367] Buffets, at 9–11, *citing* City of Chicago v. Sexton, 2 N.E. 263, 264 (Ill. 1885) (contract to furnish ironworks for multi-story building not divisible even though consideration was "made up by stating the estimated cost of each story separately, and the roof, and then adding the whole together."); Meredith v. Knapp, 211 N.E.2d 151, 153 (Ill. App. Ct. 1965) (double indemnity coverage in insurance policy not separate contract even though separate premium was charged for it). The court also cited 453 F.3d 468, 470 and In re Plum Run Serv. Corp., 159 B.R. 496, 499 (Bankr. S.D. Ohio 1993).

addition, the master leases expressly provided that individual leases were not to be merged into one another. Finally, the court found that the parties' prepetition negotiation to substitute one individual lease for another under one of the master leases supported the conclusion that the master lease was not in fact severable.

The LLC argued that the following provisions demonstrated the nonseverable nature of the master leases: rent obligation was joint and several; the master leases could only be extended if all the ground leases were also extended; all rent remained due even if the debtor could not use some of the properties because of "condemnation, destruction, or termination of the ground lease"; and the LLC had the right, on default of an individual lease, of declaring the entire master lease in default or of only treating the individual lease as in default.[368] The court rejected the argument that the fact that the default provision allowed the LLC to exercise its rights against only one property supported severability, emphasizing the fact that the provision allowed the LLC to exercise its remedy against all of the properties, based on a default of one of them. The court also rejected the argument that the default provision was an unenforceable cross-default clause for separate agreements, noting the economic interdependence of the agreements. In addition the court rejected the argument that refusing to sever the master leases would inhibit the debtor's ability to reorganize, noting:

> There is 'no federal policy which requires severance of a lease condition solely because it makes a debtor's reorganization more feasible.'.... Rather, the determination of whether a specific contract or lease is an indivisible agreement or is several agreements in one, which should properly be severable, depends on the application of state law."[369]

Finally, the court discussed the fact that the use of master leases was the subject of negotiation between the parties and in fact was a critical element in the parties' agreement.

3. Cross-Default Clauses

Separate agreements can be connected through cross-default clauses. Yet another case involving United Air Lines illustrates the relationship between cross-default clauses and assumption of unexpired leases under § 365.[370] United had an Airport Use Agreement (AUA) with Chicago granting United exclusive use of certain airport terminal space at O'Hare, including a number of boarding gates. United also was obligated to make payments on a series of bonds issued by Chicago but without recourse to the city. Under the bond payment agreements, United was obligated to make payments to the bond trustees, and the bond trustees, not the city, had the right to enforce the payment agreements. United stopped making payments after it entered bankruptcy and ultimately entered into a settlement agreement with the trustees. United's use of facilities at O'Hare were governed by the AUA, which included a Section 27.08 relating to payments on Special Facility Revenue Bonds. Section 27.08 stated that if a Special Facility Agreement terminated while bonds were outstanding, the AUA would also terminate and that United's right to use and occupy its exclusive use premises were conditioned upon United's performance under the Special Facility Agreement. Section 27.08 further provided:

> (b) In the event that Airline and City are parties to a Special Facility Agreement dated prior to the date of execution of this Agreement, it is the understanding and agreement of City and Airline that City would not have demised and let any Exclusive Use Premises to Airline hereunder if Airline had not heretofore undertaken the duties and obligations required to be performed and observed by the Airline under the terms of such Special Facility Agreement.[371]

Unlike its treatment of the bond obligations, United kept current on its obligations under the AUA.

The court reviewed gate use arrangements in general, actual use of boarding gates at O'Hare, and airport revenue at O'Hare in terms of how revenue is affected by flight volume. The court then noted that if the cross-default clause were enforced, United's right to use gates at O'Hare would be uncertain and its competitive position would be damaged to the extent it loses exclusive use of gates, while airport financing would not be hurt by the inability to enforce Section 27.08. To reach that conclusion about airport financing, the court rejected the testimony of O'Hare's expert that failure to enforce the cross-default clause would make it difficult for the airport to issue Special Facility Bonds and GARBs. In addition, the court found that United's flight volume at O'Hare was unrelated to compliance with the bond repayment agreements.

Following its review of factual conclusions, the court reviewed the cross-default rule. The court noted that there are two principles at play. First, in order to assume an agreement the trustee must generally cure all defaults: "in order to assume or reject an unexpired lease or executory contract, the trustee must deal with the agreement as a whole—cum onere—rather than assuming only the beneficial aspects and rejecting the burdensome ones."[372] However, under § 365(b)(2) and (e)(1), if the default is due to the bankruptcy case itself or the debtor's financial condition, it need not be cured. Second, the performance requirement only applies to the contract or lease the debtor wishes to assume, not to "other, substantially unrelated agreements,"[373] a principle that applies to separate agreements included in one document and to separate agreements linked by a cross-default clause. The court then explained that "assumption under § 365 is subject to a 'well-established' cross-default rule: '[C]ross-default provisions do not integrate

[368] Buffets, at 15.

[369] Buffets, at 18, citations omitted.

[370] United Air Lines, 346 B.R. 456.

[371] *Id.* at 462.

[372] *Id*. at 467.

[373] *Id*.

executory contracts or unexpired leases that otherwise are separate or severable.'"[374]

The court then examined cases that apply the rule, explaining that the issue is "whether agreements linked by a cross-default clause are substantially connected to one another, so that a failure to enforce the clause would deprive the nondebtor party of an essential part of its bargain."[375] The court reviewed two cases in which the agreements subject to a cross-default clause were economically interdependent, so that the parties would not have entered into one of them without the other. In contrast, where two agreements are merely parallel to each other, courts do not enforce cross-default provisions in bankruptcy.

As to the case at issue, the court found that Section 27.08 was clearly a cross-default clause and that the bond payment obligations were not economically linked to the AUA. The court rejected the argument that the statement of intent in Section 27.08 that Chicago would not have provided exclusive use to United absent the agreement to make bond payments—absent an underlying economic reality—was sufficient to support enforcement of the cross-default clause. Rather the court found that the AUA was a separate agreement, which United was allowed under § 365(a) to assume without taking on the obligations of the bond agreement.

Finally the court determined that the cross-default rule was a more appropriate framework for deciding the dispute than was the rule under § 365(b)(2) and (e)(1) against *ipso facto* clauses. The court also rejected United's argument that enforcement of Section 27.08 of the AUA would violate § 525(a), which prohibits a governmental unit from revoking, suspending, or refusing to renew a license, permit, charter, franchise, or other similar grant on account of bankruptcy.

4. Stub Period Rent

In 2003, United moved to extend its 60-day period for assuming or rejecting its leases. Airport operators opposed that motion on the ground that United had not paid the stub period rent as required under § 365(d)(3).[376] In addition, several of the lessors filed motions to compel payment of rent. The bankruptcy court noted that United had failed to pay many of its advance monthly lease payments due on December 1, 2002; filed for Chapter 11 relief on December 9, 2002; and had not paid any December rent since the filing. The order for relief was entered the day the Chapter 11 request was filed. United either paid or acknowledged its obligation to pay rent beginning January 1, 2003. As the court also noted, all of the motions turned on whether United was required under § 365(d)(3) to pay the stub period rent, that is rent for the period from December 9 through December 31. The court explained that § 365(d)(3) creates:

> a special period in the course of a bankruptcy case—the period from the date that an order for relief is entered to the date that an unexpired lease of nonresidential real property is assumed or rejected. This period can be referred to as the "option phase" of the bankruptcy case—the period during which the debtor in possession or trustee, under the protection of the Bankruptcy Code, is allowed to decide whether or not a lease should be assumed.[377]

The court explained that two substantive issues raised in interpreting § 365(d)(3) are 1) what obligations must be performed (those that arise during the option phase), and 2) when the performance must take place (timely—at the time required by the lease). A conflict arises when the time that a lease payment is due and the time to which the lease obligation relates are not both during the option phase, that is the period in which the debtor must decide whether to assume or reject the lease. In such cases, the determination of how much of the obligation must be paid depends on whether the court applies the "payment date" rule or the "proration rule."[378] The payment date cases hold that the lease obligation must be paid in full, but only if the obligation becomes payable during the option phase, regardless of whether the lease period that gives rise to the obligation takes place during the option phase. The proration cases hold that "a payment obligation due during the option phase must be paid under § 365(d)(3) according to how much of the time period related to the payment is within the option phase."[379]

Judge Wedoff noted that when the payment obligation clearly becomes due during the option phase, there is no question that § 365(d)(3) requires the debtor to make payment; the only question is the amount. However, in the case before him, Judge Wedoff held that because in United's case the obligation was related in part to a period within the option phase but became due before the option phase began, the § 365(d)(3) analysis turned on the second interpretative issue: when the obligation must be performed. The court rejected the position that proration could be applied in such a case.[380] Instead the court found that the "plain language of § 365(d)(3), its legislative history, and its context" all indicate that the timely performance requirement of § 365(d)(3) cannot apply to payment obligations that come due prepetition.[381] The court also relied upon the fact that the section is meant to operate without judicial

[374] *Id*. at 468, *citing* In re Convenience USA, Inc., No. 01-81478, 2002 WL 230772, at 2 (Bankr. M.D.N.C. Feb. 12, 2002).

[375] *Id*. at 468–69.

[376] United Air Lines, 291 B.R. 121.

[377] *Id*. at 124 (footnote omitted).

[378] *Id*.

[379] *Id*. at 125, *citing* In re Handy Andy Home Improvement Ctrs., Inc., 144 F.3d 1125 (7th Cir. 1998).

[380] *Cf*., In re Travel 2000, Inc., 264 B.R. 444 (Bankr. W.D. Mich. 2001), In re Victory Markets, Inc., 196 B.R. 6 (Bankr. N.D.N.Y. 1996) (proration) and In re HQ Global Holdings, Inc., 282 B.R. 169 (Bankr. D. Del. 2002); In re CCI Wireless, LLC, 279 B.R. 590 (Bankr. D. Colo. 2002); The 1/2 Off Card Shop, Inc., 2001 WL 1822419 (Bankr. E.D. Mich. 2001); In re Appletree Markets, Inc., 139 B.R. 417 (Bankr. S.D. Tex. 1992) (payment day).

[381] United Air Lines, 291 B.R. at 126.

intervention in holding that the timely performance requirement of § 365(d)(3) does not apply when the payment obligation becomes due before the debtor files for Chapter 11. The court therefore held that in this case § 365(d)(3) did not require payment of the stub period rent. However, the court rejected the conclusion that the stub period rent must be treated as a prepetition claim. The court referenced the practice before § 365(d)(3) was enacted and noted:

> By directing a trustee to make timely payment of rental claims that are due during the option phase, § 365(d)(3) serves to satisfy claims that might otherwise have been asserted under § 503, but where § 365(d)(3) does not require trustee payment, administrative claim status under § 503 would still be available to the extent that the use of rental property benefited the estate.[382]

Therefore the court held that the lessors were free to file an administrative claim under § 503.

The court subsequently ruled that United should generally proceed with paying the stub period rent on leases it rejected. Because of the volume of leases in question, the court directed the parties to consider alternative dispute resolution for resolving the claims. The parties negotiated procedures, incorporating court rulings on the procedures and legal standards to be used in the dispute resolution. The procedures, which were to supersede the case management procedures to the extent of any inconsistency, covered such issues as notice, time frame for disputing proposed claims amount, mediation/arbitration requirements, legal presumptions to apply, time frames for payment, and allocation of fees. The court ultimately approved and authorized payment under the agreed-upon stub rent procedures.[383]

On route to agreeing to procedures, United and the consortium of airports trying to recover stub period rent ("Consortium") sparred over the appropriate legal standards for ruling on the airports' claims.[384] There were three legal issues to be resolved:

1. In determining the amount of stub rent owed, was there any presumption in favor of the lease rate and, if so, what was the standard that the debtors must meet to overcome that presumption? Who bore the ultimate burden of proof as to the amount of the administrative claim?

2. Was a lessor's claim for administrative allowance limited to the debtor's actual use of the property?

3. Could a lessor receive an amount of Stub Rent greater than the contract rate and, if so, might the lessor amend its stub rent motion and/or stub rent claim to seek an amount greater than the contract rate in the event that the parties are unable to resolve their dispute regarding the Stub Rent Motion and/or Stub Rent claim before the Mediation Period ends?[385]

Issue 1.—The Consortium[386] argued that there should be a strong presumption in favor of determining the administrative claims using the contract rate in the rejected leases, unless United is able to rebut that presumption by clear and convincing, contradictory evidence. The Consortium cited several bankruptcy court cases in support of the proposition that there is a presumption that the administrative rent should be set at the contract rate.[387] The Consortium then argued that United had the burden of proof to rebut the presumption "by clear and convincing evidence that the fair market value of the leasehold is less than the Contract Rate."[388] The Consortium also referenced cases that awarded, as Judge Wedoff did not, stub period rent under § 365(d)(3), in support of the proposition that United should have a "heightened burden…to disprove

[382] *Id*. at 127, *citing* HQ Global Holdings, 282 B.R. at 173–74 (agreeing with the parties that a landlord is entitled to an administrative claim for the stub period rent).

[383] *Id*. as In re UAL Corp., Chapter 11, Case No. 02-B-48191, (Bankr. N.D. Ill.), *Debtors' Motion for an Order Approving and Authorizing Payment Under the Agreed-Upon Stub Rent Procedures*, July 28, 2003; In re UAL Corp., Chapter 11, Case No. 02-B-48191 (Bankr. N.D. Ill.), *Order Approving and Authorizing Payment Under the Agreed-Upon Stub Rent Procedures*, Aug. 29, 2003.

[384] *See* Amber Stores, 193 B.R. 819 (adopting position that when § 365(d)(3) applies, lessor is entitled to receive administrative expense priority for the rent due under the lease without needing to establish claim for administrative status under § (b)(1)(A); cases on both side of question reviewed).

[385] In re UAL Corp., Case No. 02-B-48191, Jointly Administered Chapter 11 Cases (Bankr. N.D. Ill.), *Memorandum Regarding Legal Standards to Be Applied in Arbitration of Stub Rent Claims*, July 3, 2003, at 2. "The Mediation Period" was a term of art within the Proposed Stub Rent Procedures, to which these legal standards would apply.

[386] As of July 3, 2003, these included Port of Portland, John Wayne Airport, Detroit Metropolitan Wayne County Airport, Port of Oakland, Metropolitan Washington Airports Authority, Burlington International Airport and the City of Austin, Clark County, Nevada (Las Vegas), City of Cleveland, Columbus Regional Airport Authority, Lee County Airport Authority, Tucson Airport Authority, and Miami-Dade County, Florida. At the time the Airport Consortium memorandum was filed, United had only sought to reject the Port of Oakland's leases. In re UAL Corp., Case No. 02-B-48191, Jointly Administered Chapter 11 Cases (Bankr. N.D. Ill.), *Memorandum Regarding Legal Standards to Be Applied in Arbitration of Stub Rent Claims*, July 3, 2003, at 1–2, n.1.

[387] These cases included: In re Xonics, Inc., 65 B.R. 69, 74 (Bankr. N.D. Ill. 1986) ("there is a presumption that the reasonable rental value of the property is equivalent to the amount of rent fixed in the lease"); Palace Quality Serv., 283 B.R. 889 ("it stands to reason that the actual rental payments associated with that leasehold interest would be a necessary cost associated with the preservation of that particular property interest"): HQ Global Holdings, 282 B.R. 174 ("There is generally a presumption that 'the rental value fixed in the lease will control…'").

[388] In re UAL Corp., Case No. 02-B-48191, Jointly Administered Chapter 11 Cases (Bankr. N.D. Ill.), *Memorandum Regarding Legal Standards to Be Applied in Arbitration of Stub Rent Claims*, July 3, 2003, at 4.

the applicability of the Contract Rate to the Stub Period."[389]

Although United acknowledged the existence of a rebuttable presumption in favor of the lease rate, United disputed the existence of a heightened standard. Instead, United cited several circuit court opinions that the presumption can be rebutted by evidence of a different value.[390] United also argued that ordinarily presumptions do not change the burden of proof, and that there was no reason to do so in this case. Thus, following United's argument, while the presumption shifted the burden of production to United, once United met that burden, the lessors retain the burden of proof on the point of whether the contract rate is appropriate for setting the amount of the administrative claim.

The agreed-upon procedures provided that in order to rebut the presumption, United would have to submit "evidence showing by a preponderance of the evidence that the reasonable rental value of the lease differs from the Lease Rate," and reiterated that the ultimate burden of proof as to amount lies with the lessor.[391]

Issue Two.—The Consortium argued that the administrative claims should be valued at the fair market value of the leasehold interest (which it had argued should be set by the rate in the lease), rather than by United's actual use of the property.[392] United, on the other hand, argued that "the lessors are entitled to stub rent only to the extent that United actually used the property,"[393] drawing this conclusion from cases that held that § 503 administrative claims depend on the extent to which the estate benefited from use of the rental property.[394] United also argued that rent for unused portions of property is "unnecessary" and therefore should not qualify as an administrative expense. The agreed-upon procedures provided that the amount of the claim would be determined based on the reasonable rental value of the leased premises rather than United's actual use of the premises.[395]

Issue Three.—The Consortium argued that if the airports are required to provide evidence concerning the fair market value (FMV) of the leases and that FMV is demonstrably greater than the contract rate of the lease, the airports should be allowed to amend their motions to seek amounts in excess of that rate.[396] United argued that the airports cannot recover more than the lease rate. The argument was based on the "plain language of Section 503(b)(1)," and the purpose of Chapter 11 to allow the debtor to reduce its expenses, rather than on any cases holding that the administrative claim cannot be greater than the lease amount.[397] The agreed-upon procedures provided that the lessor could not receive more than the lease rate.[398]

[389] *Id*. at 4, citing *inter alia*, Towers v. Chickering & Gregory (In re Pacific-Atlantic Trading Co.), 27 F.3d 401, 405 (9th Cir. 1994) ("We observe, however, that section 365(d)(3) expresses the intent of Congress to secure for lessors the full amount of rent due during the 60-day period while the trustee determines to accept or reject the lease, regardless of any benefit to the estate."); Travel 2000, 264 B.R. 451 (debtor "should be required to pay the full rent under the leases for every day that it continued to occupy the property after the bankruptcy filing").

[390] Cases cited included: In re Dant & Russell, Inc., 853 F.2d 700, 707 (9th Cir. 1988) ("presumption may be rebutted upon evidence showing that the reasonable worth of the lease differs from the contract rate"); Trans World Airlines, 145 F.3d at 136 ("However, the amount treated as an administrative expense would not necessarily be the rent provided for in the lease, since administrative expenses are allowable only for 'the actual, necessary costs and expenses of preserving the estate.'"); Thompson v. IFG Leasing Comp. (In re Thompson), 788 F.2d 560, 563 (9th Cir. 1986) ("The rent reserved in the lease is presumptive evidence of fair and reasonable value, but the presumption may be rebutted by demonstrating that the reasonable worth of the lease differs from the contract rate."). In re UAL Corp., Chapter 11 Case No. 02-B-48191 (Jointly Administered), (Bankr. N.D. Ill.), *Debtors' Memorandum on Legal Issues Related to Stub Rent*, July 3, 2003, at 2–3.

[391] In re UAL Corp., Chapter 11 Case No. 02-B-48191 (Jointly Administered), (Bankr. N.D. Ill. Aug. 29, 2003), Stub Rent Procedures, par. 12.A.

[392] *Id*. at 5–6, citing *inter alia* Xonics, 65 B.R. at 73 ("view long followed by the Seventh Circuit [is] that administrative rent claims must be based upon the reasonable rental value of the property regardless of the use made of the property."); 5 COLLIERS ON BANKRUPTCY ¶ 503.06[6][c][ii], at 503–09 (15th ed. rev'd) (reasonable rental value objective standard of benefit to estate; using standard such as extent to which use of property benefits estate too subjective).

[393] In re UAL Corp., Chapter 11 Case No. 02-B-48191 (Jointly Administered), (Bankr. N.D. Ill.), *Debtors' Memorandum on Legal Issues Related to Stub Rent*, July 3, 2003, at 5. Cases cited include: Dallas-Fort Worth Reg'l Airport Bd. v. Braniff Airways, Inc., 26 B.R. 628, 631 (N.D. Tex. 1982) ("This rate is applied, however, on a pro rata basis according to the time and area actually used."); In re Homeowner's Outlet Mall Exch., Inc., 89 B.R. 965, 970 (Bankr. S.D. Fla. 1988) ("[S]ince the Trustee did not occupy the entire premises, rent for the last 33 days will be allowable pro-rata only for the 85,000 square feet actually occupied by the Trustee.")

[394] In re UAL Corp., Chapter 11 Case No. 02-B-48191 (Jointly Administered), (Bankr. N.D. Ill.), *Debtors' Memorandum on Legal Issues Related to Stub Rent*, July 3, 2003, at 6. United cited In re Bauer, 291 B.R. 127. United also cited In re Jartran, Inc., 732 F.2d 584, 587 (7th Cir. 1984) (debt must be beneficial to DIP in operating the business to qualify as administrative expense). It is not clear that these cases reached the issue of whether using only a portion of a leased premises means that the benefit to the estate must be considered so reduced.

[395] In re UAL Corp., Chapter 11 Case No. 02-B-48191 (Jointly Administered), (Bankr. N.D. Ill. Aug. 29, 2003), Stub Rent Procedures, par. 12.A.B.

[396] In re UAL Corp., Case No. 02-B-48191, Jointly Administered Chapter 11 Cases, (Bankr. N.D. Ill.), *Memorandum Regarding Legal Standards to Be Applied in Arbitration of Stub Rent Claims*, July 3, 2003, at 6, citing 65 B.R. 75 (additional rent awarded based on FMV of lease).

[397] In re UAL Corp., Chapter 11 Case No. 02-B-48191 (Jointly Administered), (Bankr. N.D. Ill.), *Debtors' Memorandum on Legal Issues Related to Stub Rent*, July 3, 2003, at 8–9.

[398] In re UAL Corp., Chapter 11 Case No. 02-B-48191 (Jointly Administered), (Bankr. N.D. Ill. Aug. 29, 2003), Stub Rent Procedures, par. 12.C.

As of September 1, 2005, United had paid approximately $270,000 for stub rent and estimated it would pay about $1.2 million for stub rent related to rejected leases.[399]

5. Passenger Facility Charges

Although there do not appear to be any reported cases concerning segregation of PFCs under § 40117(m),[400] there have been numerous instances of Chapter 11 airlines filing motions to fund, maintain, and manage a separate PFC account or being compelled to do so. Most of the examples located have involved settlement agreements rather than airlines requesting on their own that the bankruptcy court authorize them to segregate PFCs. The consent orders generally recite the statutory requirements for financial management of PFCs, including the provision that the trust fund status of the PFCs not be defeated by the inability to specifically trace funds due to the debtor's failure to segregate.[401]

Vanguard.—Vanguard did not remit PFCs as required before it sought bankruptcy protection. Once it did file for Chapter 11 protection, Vanguard filed an Emergency Motion for an Order Authorizing Use of Cash Collateral, to which a number of airports objected to the extent that the collateral included PFCs. Vanguard then agreed to keep $960,000 in its accounts pending resolution of the PFC and other trust fund claims. Vanguard subsequently filed, but did not serve, a declaratory judgment complaint.[402] In that complaint the airline essentially argued that because it had failed to identify and segregate PFCs as trust funds, the PFCs were not subject to a trust in favor of the airports and had become property of the Vanguard's bankruptcy estate under § 541, making any attempt by the airports to collect those PFC funds a violation of the automatic stay. The parties eventually settled the disputes. In the settlement agreement Vanguard stipulated that it held the PFCs in trust for the beneficial interest of the airports; it had no legal or equitable interest in the PFCs; and the PFCs were not property of the bankruptcy estate under § 541(d). Vanguard requested that the bankruptcy court approve the settlement agreement, which avoided litigation with 17 airports,[403] and awarded the airports just under half of their PFC claims.[404]

US Airways.—On September 12, 2004, the airline filed for Chapter 11 protection, for authorization to use cash collateral, and for authorization to assume a Special Purpose Trust that served as a reserve to ensure payment of a variety of fees, charges, and taxes, including PFCs. On September 13, 2004, the Denver and San Francisco airports (later joined by four others) filed objections to the cash collateral motion—to the extent that US Airways sought to include PFCs as part of the cash collateral—and motions to compel the airline to segregate and remit PFCs. The court conditionally approved the trust motion; Denver and San Francisco objected. Denver's objection was based on the argument that a trust that "serves as a reserve to ensure the payment of amounts owing to various administrators, institutions, authorities, agencies and entities in connection with [PFCs] and charges described in 49 U.S.C. § 40117 and 14 C.F.R. Part 158" does not meet the requirements of § 40117(m). In addition, Denver argued that US Airways' failure to specify the amounts being held in the PFC reserve, the methodology used to calculate average monthly liability, and the amounts actually deposited also violated § 40117(m).[405] The following month the parties settled. As part of the consent order, the court adjudged and decreed that the PFCs were trust funds, not property of the estate, and that US Airways would either create a separate PFC trust account or designate such an account within its existing Special Purpose Trust. The consent order also specified steps US Airways would be required to take to segregate and ac-

[399] UAL's Sept. 7, 2005, 8K filling, Exhibit 99.3, *Stub Rent Litigation*, at 81, *available at* www.secinfo.com/dsvRm.zAQa.b.htm (Last visited Dec. 16, 2008).

[400] There are several reported cases concerning challenges to the FAA's approval of PFCs at various airports, *e.g.*, Southeast Queens Concerned Neighbors, Inc. v. F.A.A., 229 F.3d 387 (2d Cir. 2000); Village of Bensenville v. F.A.A., 376 F.3d 1114 (D.C. Cir. 2004). Such cases are beyond the scope of this report.

[401] 49 U.S.C. § 40117(m)(2).

[402] A copy of the complaint was filed on July 29, 2003, by ACI-NA and AAAE as Attachment 1 to Comments of ACI-NA and AAAE in response to Request for Public Comment on the Impact of Airlines Emerging From Bankruptcy on Hub Airports, Airport Systems and U.S. Capital Bond Markets. The attachment, FAA-2003-15481-0010, may be downloaded from www.regulations.gov/fdmspublic/component/main?main=DocketDetail&d=FAA-2003-15481.

[403] Motion to Approve Settlement with PFC and Security Fee Claimants, In re Vanguard Airlines, Inc., I.D. No. 48-1149290, In Proceedings Under Chapter 11, Case No.: 02-50802-JWV (Bankr. W.D. Mo., May 18, 2004), granted: Order Granting Motion to Approve Settlement with PFC and Security Fee Claimants (June 18, 2004); *See also* First Amended Disclosure Statement of Vanguard Airlines, Inc., in Support of Debtor's First Amended Liquidating Plan of Reorganization, Included as part of Vanguard's Dec. 4, 2003, 8-K SEC Filing, *available at* http://sec.edgar-online.com/2003/12/04/0001000578-03-000012/Section4.asp (Last visited Dec. 16, 2008).

[404] City and County of Denver, Mar. 31, 2006, Comments on Proposed Rulemaking for Passenger Facility Charge Program Docket No. FAA-2006-23730, at 2, n.1, *available at* www.regulations.gov/fdmspublic/component/main?main=DocketDetail&d=FAA-2006-23730. The district court approved Vanguard's Liquidating Plan of Reorganization Under Chapter 11 on Dec. 19, 2003. *See* http://msnmoney.brand.edgar-online.com/EFX_dll/EDGARpro.ddl?FetchFilingHTML1?ID=2676610&SessionID=af6iWbLOX20sv_9 (Last visited Dec. 16, 2008). Subsequently the Chapter 11 proceeding was converted to a Chapter 7 case.

[405] Denver International Airport's Limited Objection to Entry of Order Authorizing the Assumption of Certain Executory Trust Fund Agreements Pursuant to 11 U.S.C. § 365(a), In re US Airways, Inc., Case No. 04-13819-SSM Jointly Administered Chapter 11 Cases (Bankr. E.D. Va.), Sept. 24, 2004.

count for PFCs; prohibited US Airways from granting security or other interest in the PFCs to any third party; and included a remedy in case of uncured default by US Airways on its obligation to pay PFCs.[406]

Aloha Airlines.—Upon filing for Chapter 11 protection on December 30, 2004, Aloha requested authorization to pay certain prepetition obligations and for postpetition financing. Shortly thereafter Aloha also moved for authorization for use of cash collateral. The Port of Oakland filed limited objections to the cash collateral and postpetition financing motions and moved to compel Aloha to segregate and remit PFCs. Oakland's motion asked the court to specifically:

> (i) provide that PFC trust funds do not fall within the definition under 11 U.S.C. § 541 of property of the estate, and thus do not constitute cash collateral under 11 U.S.C. § 363(a); (ii) carve out the PFC's [sic] so that there can be no confusion amongst the secured lender community, post-petition lenders, or others that the PFC's [sic] are segregated trust funds; (iii) require the Debtors to open a separate account for the Port's PFC trust funds for collections post-petition and immediately remit the past due collections, if any, to the Port as required in the ordinary course of business consistent with 49 U.S.C. § 40117(m) and 14 C.F.R. § 158; (iv) require the Debtors to remit the Port's PFC trust funds monthly to the Port required by 14 C.F.R. § 158; and (v) require the Debtors to comply with all other accounting and remittance requirements provided in 14 C.F.R. § 158.[407]

The parties came to a settlement agreement very similar to that arrived at in the US Airways case, including a remedy in the event of uncured default by the airline.

Delta Air Lines.[408]—As part of its Chapter 11 proceeding, Delta petitioned the court for authority to fund, maintain, and manage a separate PFC account so that Delta would be able to satisfy its obligations under 49 U.S.C. § 40117(m). Delta's motion set forth the statutory requirements and described actions Delta had taken to meet those requirements, stating, "it is understood that collected PFCs are held in trust and are not considered property of the Debtors' estates."[409] Delta cited the US Airways and Aloha Airlines cases in asking the court to approve its motion so as to avoid "additional and unnecessary litigation."[410]

Northwest Airlines.—On September 14, 2005, Northwest filed for Chapter 11 protection and for authority to assume certain executory trust fund agreements. The Greater Orlando Airport Authority (GOAA) filed a Motion to Compel Debtors to Segregate and Remit Passenger Facility Charges, followed shortly thereafter by Denver International Airport, which asked for substantially the same relief as GOAA. All told, some 30 airports sought to compel Northwest to segregate and remit PFC revenues.[411] Northwest objected to the airport motions on the grounds that Northwest was already complying with § 40117(m) and the airports did not have standing to seek compliance, as that was the sole purview of the FAA and DOT.[412] Northwest took the position that its payment of PFCs into a trust established to ensure timely payment of various taxes and fees as appropriate was in compliance with § 40117(m). Denver argued that Northwest's own description of its trust fund demonstrated that it was commingling PFC revenue in violation of § 40117(m).[413] The parties settled, with Northwest agreeing to establish an irrevocable trust for the benefit of the airports as a "segregated account that is maintained for the specific purpose of ensuring timely deposit and payment of collected PFCs to the appropriate airport operators."[414] As in the US

[406] Consent Order Resolving (A) Multiple Objections to Debtors' Motion for Bridge, Interim and Final Orders (1) Authorizing the Debtors to Use Cash Collateral; (2) Providing Adequate Protection; (3) Scheduling a Final Hearing; (4) Approving Form and Manner of Notice; and (5) Granting Related Relief; (B) Multiple Motions to Compel Debtors to Segregate and Remit Passenger Facility Charges, In re US Airways, Inc., Case No. 04-13819-SSM Jointly Administered Chapter 11 Cases (Bankr. E.D. Va.), Oct. 15, 2004.

[407] Consent Order and Stipulation Resolving Port of Oakland's (A) Limited Objection to Interim Order Authorizing Use of Cash Collateral and Other Pre-Petition Collateral; …(C) Motion to Compel Debtors to Segregate and Remit Passenger Facility Charges, etc., In re Aloha Airgroup, Inc., Bk. No. 04-03063, Chapter 11 Jointly Administered (Bankr. D. Haw.), Feb. 10, 2005, at 3–4.

[408] Delta restructuring information, including case management procedures, claims objections procedure order, and bar date order, *available at* www.deltadocket.com/ (Last visited Dec. 16, 2008).

[409] Debtors' Motion Pursuant to Sections 105(a) and 363(c)(1) of the Bankruptcy Code for Authorization to Continue to Fund, Maintain and Manage a Separate Account for Passenger Facility Charges, In re Delta Air Lines, Inc., Chapter 11 Case No. 05-17923 (pcb) Jointly Administered (Bankr. S.D.N.Y.), Sept. 14, 2005, at 3–4, citing 49 U.S.C. § 40117(g)(4), (m)(2).

[410] *Id.* at 6.

[411] A list of various motions and legal memoranda is included in one of many notices filed by Northwest's bankruptcy counsel, www.nwa-restructuring.com/nwa_downloads/nwa_CaseInformation/agenda_10_26.pdf. While a number of motions and other information on the Northwest Chapter 11 proceedings—including case management procedures—are available on the Northwest restructuring Web site, *available at* www.nwa-restructuring.com/nwa_legalInformation.html (Last visited Dec. 16, 2008), accessing the PFC motions and memoranda online requires a fee-based PACER account, *available at* https://ecf.nysb.uscourts.gov/cgi-bin/login.pl (Last visited Dec. 16, 2008).

[412] Denver International Airport's Reply and Joinder with the Consortium of Airports' Reply to Debtors' Consolidated Opposition to Motion to Compel Debtors to Segregate and Remit Passenger Facility Charges, In re Northwest Airlines Corp., Chapter 11 Case No. 05-17930 ALG (Bankr. S.D.N.Y.), Sept. 16, 2005, at 2–4.

[413] *Id.* at 4–5. Presumably other airports made substantially similar arguments.

[414] Consent Order Resolving Multiple Motions to Compel Debtors to Segregate and Remit Passenger Facility Charges and Consolidated Opposition of Debtors, In re Northwest Air-

Airways case, the consent order specified steps the airline would be required to take to segregate and account for PFCs; prohibited the airline from granting security or other interest in the PFCs to any third party; and included a remedy in case of uncured default by the airline on its obligation to pay PFCs.

6. Other

Preferential transfers.—The case of TWA Inc. Post Confirmation Estate v. City & County of San Francisco Airports Comm'n (In re TWA Inc. Post Confirmation Estate)[415]—heard by Judge Walsh—involved a motion by San Francisco to dismiss efforts of the TWA Inc. Post Confirmation Estate (TWA PCE) to avoid and recover allegedly preferential prepetition transfers.

During the 90 days before filing for Chapter 11 protection, TWA made payments to San Francisco of $1,332,834.16 to cover terminal and gates rent, utilities, security service, parking, and landing and takeoff rights, etc. TWA's liquidation plan, approved in June of 2002, specifically reserved the right to settle claims and to pursue all available claims, including avoidance actions under §§ 547 and 550. In November 2002, TWA and San Francisco entered a stipulation agreement concerning two claims filed by San Francisco, under which agreement San Francisco's administrative claim for $8,735,516.85 was deemed an allowed administrative expense claim in the amount of $92,166.00 and an allowed prepetition unsecured claim of $8,642,752.62 and its administrative claim for $89,296,821.00 was deemed an allowed administrative expense claim in the amount of $1,209,000.00 and an allowed prepetition unsecured claim of $13,094,167.80. TWA's plan administrator then paid the two administrative expense claims. However, TWA also made a demand that San Francisco return the $1,332,834.16 paid prior to the January 10, 2001, Chapter 11 filing date.

When San Francisco did not respond to the demand letter, TWA began an adversary proceeding under §§ 547 and 550, which San Francisco moved to dismiss. San Francisco argued that because it had its prepetition claims allowed under § 502(d) and no avoidance action was brought as part of the Estate's objections to claims, TWA's avoidance action should be dismissed.[416] San Francisco relied on *LaRoche Industries, Inc. v. General American Transportation Corp. (In re LaRoche Indus., Inc.*),[417] in which the court held that

> § 502(d) stands for the proposition that if a claim is allowed there is no longer a voidable transfer due from that claimant. In essence, a voidable transfer, such as a preference, must be determined, as part of the claims process and not at a later time, especially after distribution under the plan has been made.[418]

However, after reviewing *LaRoche* and another Delaware bankruptcy case that held that § 502(d) would be meaningless if debtors could bring new or continuing preference actions after claims are allowed, Judge Walsh noted the split in authority concerning the application of § 502(d). He then reviewed Missouri and New York bankruptcy cases that both rejected La Roche.[419] The *Bridge* court found that § 502(d) is an affirmative defense to a creditor's claim against the DIP and is only relevant when the DIP objects to a claim under § 502(d). The *Rhythms* court, reaching the same result, noted that the debtors agreed to a settlement before they were able to begin a preference analysis or the claims objection process. Judge Walsh found those two cases "a better application of § 502(d)."[420] He further observed that applying § 502(d) as argued by San Francisco would not make sense in the context of large Chapter 11 cases. Finally, Judge Walsh rejected San Francisco's argument that it had conveyed new value under § 547(c)(4),[421] which would have precluded the trustee from avoiding the $1,332,834.16 payment. He found that San Francisco had not carried its burden of proof on that point.

It should be noted that airlines in bankruptcy could seek to recover PFC remittances as avoidable preferences. However, it is the position of the USDOT that PFCs are not property of the estate and their remittance cannot be recovered under § 547.[422]

Lease rejection.—A 1986 case involving the Memphis-Shelby County Airport Authority ("the Airport") illustrates a number of issues that can come up in the course of an airline bankruptcy proceeding, including distinguishing between a request for adequate protection before the Chapter 11 airline decides whether to assume or reject its leases and a request for administrative rent damages once the airline rejects the leases in question.[423] Although the case predates the enactment of § 365(d)(3), given that some courts, despite the applicability of § 365(d)(3), still require the lessor to establish its administrative claim under § 503(b)(1)(A),[424] the *Memphis-Shelby* analysis is still useful. Moreover, it appears that the question of distinguishing between

lines Corp., Chapter 11 Case No. 05-17930 ALG Jointly Administered (Bankr. S.D.N.Y.), Oct. 28, 2005, at 3.

[415] TWA Confirmation Post Estate, 305 B.R. 221.

[416] *Id.* at 224.

[417] LaRouche Indus., 284 B.R. at 406.

[418] TWA Post Confirmation Estate, 305 B.R. at 224–25, *citing* LaRouche Indus., 284 B.R. at 408–09.

[419] Peltz v. Gulfcoast Workstation Group (In re Bridge Info. Sys., Inc.), 293 B.R. 479 (Bankr. E.D. Mo. 2003), and Rhythms NetConnections, 300 B.R. at 404.

[420] TWA Post Confirmation Estate, 305 B.R. at 226.

[421] It appears that San Francisco did not raise the ordinary course of business defense. In any event, the opinion did not discuss that defense.

[422] Author's June 27, 2008, telephone conversation with Bernard F. Diederich, Senior Attorney, Office of General Counsel, U.S. Dep't of Transp.

[423] Braniff Airways, 783 F.2d 1283.

[424] *See, e.g.,* Palace Quality Servs., 283 B.R. 868, which discusses both sides of the issue.

adequate protection prerejection and an administrative expense claim postrejection is still apposite.

Braniff had sought and received—in addition to the § 362 automatic stay—a preliminary injunction preventing the Authority from interfering with Braniff's leasehold interests at the Memphis International Airport. The Airport subsequently asked the bankruptcy court to lift the automatic stay and require Braniff to:

> (1) either assume or reject the Airport leases within a certain time period; (2) pay for the reasonable use of the premises from the date on which the petition was filed until the date on which the leases are assumed or rejected; and (3) pay all rent it received from its sublessees to the Airport as adequate protection.[425]

The Bankruptcy Court granted the first and third portions of the requested relief.

Effective March 1, 1983, Braniff did reject the leases. The Airport sought its lease rejection damages under § 503, the full contract rental rate. Braniff argued that this motion should be dismissed because the court had already ruled on the administrative rent issue the previous year when it ruled on the Airport's automatic stay motion. In essence Braniff argued that the Airport's use of the term "use and occupancy" was a claim for administrative rent under § 503, and that issue was thus already decided; the Airport argued that it had only requested adequate protection and that its use of the term "use and occupancy" was merely descriptive in support for its adequate protection claim.

The Court of Appeals reviewed the typical remedy available at that time for a lessor suffering economic losses under an unexpired lease: move under § 365(d)(2) to compel the debtor to assume or reject the lease within a time certain.[426] The court then distinguished between liability for lease assumption (liability for entire rent per the lease terms) and lease rejection (reasonable value of use and occupancy of the premises, receiving administrative expense priority). The latter claim, sometimes referred to as administrative rent, is "ordinarily presumed to be the contract rental rate, adjusted downward or upward to reflect the extent to which the debtor actually used the demised premises."[427] This claim determines amount and priority, and is generally made following lease rejection.

Nonetheless, a court may order the debtor to make an advance payment that will be categorized later as either a payment for use and occupation in the event of lease rejection or rent in the event of lease assumption. The Court of Appeals distinguished this possible remedy of advance payment from the possible remedy of adequate protection. The court further distinguished the considerations involved in granting adequate protection—which is interim relief—from those involved in granting a claim for administrative rent, which is the final amount owed to a lessor under a rejected lease.

The Court of Appeals then considered whether the claims made by the airport when it sought to lift the automatic stay were the same claims it made in seeking its lease rejection damages. The appellate court agreed with the district court that the use of the term "use and occupancy" without a reference to § 503 did not constitute a claim for administrative rent. In other words, the mere use of the term "use and occupancy" cannot transform a request for reasonable protection into a request for administrative rent. The Court of Appeals noted the absence of testimony about the reasonableness of the rate under the lease, which must be considered to determine administrative rent, as well as the emphasis during the first hearing on the existence of hardship to Braniff in being compelled to assume or reject the lease. Thus the court concluded that Braniff had not met its burden in establishing that the administrative rent issue had already been litigated. The case was remanded to allow the bankruptcy court to hear evidence on the Airport's administrative expense claim.

III. TREATMENT OF AIRPORT CLAIMS

A. Under the Bankruptcy Code

Major issues under the Bankruptcy Code that are relevant to airport claims include: whether lease transactions are subject to § 365 assume or reject requirements; time available for exercising the assume or reject option; treatment of trust funds; time allowed for payment of lease obligations; and the payment day versus proration approach. However, given that a significant number of airport claims in airline bankruptcy proceedings are settled, in many cases the actual results are not widely accessible and in any case do not provide precedent, per se, for how claims will be treated.

1. Prepetition and Postpetition Amounts Owed by Airlines for Terminal Rental Fees, Landing Fees, Fees for the Rental of Other Airport Facilities, and Other Amounts Owed to Airports by Airlines

As noted above, once an airline files for bankruptcy protection, there are restrictions on payment of prepetition debt due to the automatic stay. Prepetition debts generally will not be paid until the reorganization plan is confirmed. Furthermore, general unsecured claims are the last to be paid,[428] and therefore run the greatest risk of not being paid in full.[429] For example, in the United case, the unsecured distribution under the reor-

[425] Braniff Airways, 783 F.2d 1284.

[426] Braniff Airways, 783 F.2d at 1285, citing 2 COLLIER on BANKRUPTCY ¶¶ 365.01-.03 (15th ed. & Supp. 1985); MURPHY, CREDITORS' RIGHTS IN BANKRUPTCY § 9.07 (1985).

[427] Braniff Airways, 783 F.2d at 1285.

[428] SALERNO, *supra* note 2, § 4.08[B][3], General Unsecured Creditors.

[429] LYNN, *supra* note 2, ¶ 25.04[5][B], Lease and Contract Assumption, Assignment and Rejection: Advantages for the Debtor.

ganization plan was estimated to pay 4 percent to 8 percent of the claims.[430]

Postpetition rent must be paid until the lease is rejected. Even in its dispute with the San Francisco Airport (Section II.D.4 *Stub Period Rent*, *supra*), United paid, or acknowledged its obligation to pay, monthly rental beginning with the first month after the date of its bankruptcy filing.[431] As indicated in that case, the obligation to pay rent that accrues during the period following the bankruptcy filing date through the end of the first month of the bankruptcy proceeding may be in dispute. It remains to be seen whether other jurisdictions will follow the Illinois bankruptcy court in holding that if the payment obligation comes due prepetition, § 365(d)(3) does not require payment during that period and/or in holding that rent for that period may be allowed as an administrative expense.

In addition, the court may order the airline to provide adequate protection during the time that the airline is deciding whether to assume or reject the lease. For example, as noted, *supra*, the Memphis-Shelby County Airport Authority obtained an order from the bankruptcy court that Braniff Airways pay all rent Braniff received from its sublessees to the Authority until Braniff either assumed or rejected the leases in question.[432]

Once a lease is rejected, the airline is generally liable for the reasonable value of its use and occupancy of the premises. Braniff attempted—unsuccessfully—to avoid paying that expense following rejection of its leases with the Memphis-Shelby County Airport Authority by arguing that the authority had raised the administrative rent issue (due as rejection damages under § 503) when it sought adequate protection and was therefore barred from relitigating the issue.[433]

Payments for goods and services provided to a Chapter 11 airline before the bankruptcy filing are subject to the requirements of § 547. Therefore, unpaid fees such as accrued rent and landing fees related to prepetition goods and services may be unrecoverable,[434] depending on the application of § 547 and the amount of unsecured claims compared with the resources available to be disbursed among unsecured claimants. *See* discussion of § 547, Section II.B.1, *Bankruptcy Code Overview*, *supra*. The limitations on the debtor's ability to pay prepetition debts creates a financial uncertainty for airports, as an airport's "stream of payments from a debtor airline would be interrupted to the extent of unpaid fees for prepetition goods and services, including accrued rent and landing fees."[435]

In addition, as discussed *supra*, at least one airline—TWA—claimed that rental fees were property of the estate and tried to recover payments as preferences.[436] The amount at stake was $1,332,834.16. The results of the dispute are not publicly available.

Northwest Airlines also tried to avoid a postpetition payment it made under a special facilities lease with the Minneapolis-St. Paul MAC, as part of its argument that the lease was actually a financing transaction. Northwest also took the position that

> (i) the MAC's claim with respect to the Facilities Lease constitutes, to the extent allowed, a pre-petition unsecured claim; and (ii) the MAC is not entitled to exercise any rights or remedies under the Facilities Lease that could not be exercised by a creditor holding only a general unsecured pre-petition claim against a debtor.[437]

The bond trustee argued that the lease was a true lease and that Northwest was obligated under § 365 to pay the lease obligations. The bond trustee also argued that if the lease were a disguised financing under the Bankruptcy Code, the claims would be "secured based upon the governing documents and upon a theory of equitable liens and/or mortgages."[438] It appears that at least as of December 31, 2007, the litigation had not been resolved.[439]

The amounts recoverable out of what is owed to an airport by an airline that files for bankruptcy protection will depend in part on the nature of the obligation. For example, when MarkAir filed for bankruptcy protection, it owed Denver International Airport $3.1 million, of which $1.6 million was for taxes. Denver argued that the taxes were held in trust rather than being property of the estate and therefore that Denver should receive priority in recovering that money.[440] MarkAir left a

[430] United Air Lines, 351 B.R. 919.

[431] United Air Lines, 291 B.R. 123.

[432] Braniff Airways, 783 F.2d at 1284–85.

[433] *Id.* at 1283.

[434] The possibility of not receiving these prepetition fees is a financial risk that airports must disclose in financial offerings. *See, e.g.*, Massport 2007 Bond Issuance, *supra* note 38, at 58.

[435] *Id*.

[436] TWA Post Confirmation Estate, 305 B.R. 221 ("payments covered such matters as terminal and gates rent, utilities, security service, parking, and landing and takeoff rights"). *See* AAAE/ACI-NA comments in response to the June 26, 2003, *Federal Register* Notice, at 3, *available at* www.regulations.gov/fdmspublic/component/main?main=DocumentDetail&o=0900006480313b58 (Last visited Dec. 16, 2008). AAAE/ACI-NA suggested that TWA might have been trying to recover PFCs as well, but PFCs are not mentioned in the bankruptcy court's opinion.

[437] In re Northwest Airlines Corp., Chapter 11, Case No. 05-17930 (ALG) Jointly Administered (Bankr. S.D.N.Y.), Disclosure Statement With Respect to Debtors' First Amended Joint and Consolidated Plan of Reorganization Under Chapter 11 of the Bankruptcy Code, Mar. 30, 2007, at 27–28, www.nwa-restructuring.com/nwa_downloads/nwa_CourtFiledDocuments/DisclosureStatementPlan/FinalDAandPlanHardCopy.pdf.

[438] *Id.* at 28.

[439] Dec. 31, 2007, 10-K, EX-10.7-Material Contract: Amended and Restated Third Amendment to Airline Operating Agreement and Terminal Building Lease Minneapolis-St. Paul International Airport, at 22–23, *available at* www.secinfo.com/d11MXs.tez8.b.htm (Last visited Dec. 16, 2008).

[440] *Markair Bankruptcy May Cost Denver Airport $3.1 Million*, THE SEATTLE TIMES, Nov. 1, 1995, *available at*

string of unpaid debts in its earlier bankruptcy proceedings, including $138,500 owed to the city of Juneau in airport landing and lease fees.[441]

The categorization of rent and other fees owed for the period during which the debtor has under § 365(d)(3) to assume or reject executory contracts and unexpired leases ("stub period rent") may depend on whether the bankruptcy court takes a payment day approach or proration approach. As discussed in Section II.D.4, *Stub Period Rent*, *supra*, the bankruptcy court held that United Airlines' $30 million in rent owed for the period from December 9, 2002 (the day of the Chapter 11 filing), and December 31, 2002, came due prepetition and held that payment was not required under § 365(d)(3). However, the court also found that the airport could file an administrative claim for rent owed during the stub period. Thus even rent that comes due prepetition but covers a postpetition period may be eligible for administrative rent status, and thus receive higher priority than a prepetition claim.

Cash security deposits may be declared assets of the bankruptcy estate,[442] so other financial securities may be preferable: "The SCAS, which had an existing security deposit requirement, has moved away from cash-based deposits to requiring other financial instruments to avoid the cash deposits becoming part of the bankrupt estate."[443]

2. Passenger Facility Charges

Despite the requirements of 49 U.S.C. § 40117(m), there is still some danger for airports that bankrupt airlines will fail to segregate and remit PFC funds as required. That failure could lead to the PFC deposits being transformed into cash collateral for lenders or to there being insufficient funds available to properly remit to the airports on whose behalf the PFCs were collected.[444] As discussed in the *Vanguard* case, *supra*, the airline had failed to segregate PFC funds before filing for bankruptcy. Ultimately Vanguard's failure to segregate the PFC funds led to an insufficiency of funds for virtually all of its airports: 15 airports agreed to settlement amounts that were exceeded by their unsecured claims for the remaining amounts.[445]

While the PFC issue should be less of a problem now since § 40117(m) was amended to require segregation by covered carriers and to specify that failure to do so does not defeat the trust fund status of the funds, the *Vanguard* case shows the economic hit that airports can take if airlines in fact fail to segregate and remit PFC revenues as required.

As discussed in Section II.D.3, *Passenger Facility Charges*, *supra*, airlines routinely move in bankruptcy proceedings to put PFCs in a separate account,[446] or are compelled to do so following motions to compel filed by airports.[447] Where such accounts are established, it is important to ensure that the PFCs are placed in an account that cannot be accessed by other creditors.

Substantial attorney's fees may be required to protect the airport's claim to PFC revenues during the bankruptcy proceedings unless the bankrupt airline moves on its own to segregate PFC funds.[448] As noted, *supra*, this issue may be addressed in the court order authorizing segregation of PFC revenues.

At least one bankruptcy court found that a Chapter 7 trustee did not have the same obligation as a DIP to pay PFCs. That court also found that where the Chapter 7 trustee inherited a very limited amount of funds well below the amount of PFCs that should have been remitted, and then came up with more funding, based on sales of assets, the airports seeking to recover their PFCs could not show a sufficient nexus between their claims and the trustees' funds to be able to recover. Finally, the court rejected the argument that it should impose a constructive trust, holding that to do so in those circumstances would conflict with the bankruptcy policy of ratable distribution.[449] Ultimately, the MarkAir

http://community.seattletimes.nwsource.com/archive/?date=19951101&slug=2150116 (Last visited Dec. 16, 2008).

[441] *Update—Customs Ups the Ante*, THE SEATTLE TIMES, Feb. 1, 1994, *available at* http://community.seattletimes.nwsource.com/archive/?date=19940201&slug=1892819 (Last visited Dec. 16, 2008).

[442] Sacramento County Airport System, July 21, 2003, comments in response to FAA request for comments, FAA-2003-15481-0014, *available at* www.regulations.gov/fdmspublic/component/main?main=DocumentDetail&o=0900006480313b48 (Last visited Dec. 16, 2008).

[443] U.S. DOT/FAA—Discussion of Comments Received in Response to *Federal Register* Notice, FAA-2003-15481-0020, at 4, *available at* www.regulations.gov/fdmspublic/component/main?main=DocumentDetail&o=0900006480313b48 (Last visited Dec. 17, 2008).

[444] ATA Airlines Bankruptcy News, [00007] Orlando Airport's Motion to Compel Segregation of Pfc's, Oct. 27, 2004, *available at* http://bankrupt.com/ata.txt (Last visited Dec. 17, 2008), citing In re Vanguard Airlines, Inc., (Case No. 02-50802-JWV, W.D. Mo., Kansas City Division). The order confirming Vanguard's First Amended Liquidating Plan of Reorganization is included in Vanguard's Dec. 19, 2003, Form 8-K, *available at* http://sec.edgar-online.com/2004/01/06/0001000578-04-000001/Section5.asp (Last visited Dec. 17, 2008).

[445] In Re: Vanguard Airlines, Inc., I.D. No. 48-1149290, Debtor, In Proceedings Under Chapter 11, Case No.: 02-50802, (Bankr. W.D. Mo.), Order Granting Motion to Approve Settlement with PFC and Security Fee Claimants, June 18, 2004.

[446] In re Delta Airlines, Inc., Case No. 05-17923-ASH (Bankr. S.D.N.Y. Sept. 14, 2005) [Docket No. 29].

[447] *See, e.g.,* In re US Airways Group, Inc., et al., Case No. 04-13819-SSM (Bankr. E.D. Va., Oct. 15, 2004); In re Aloha Airgroup, Inc., et al., Case No. 04-03063 (Bankr. D. Haw. Feb. 10, 2005); In re ATA Holdings Corp., et al., Case Nos. 04-19866 and 04-19868–74 (Bankr. S.D. Ind. Nov. 1, 2004).

[448] FAA, Discussion of comments received in response to *Federal Register* Notice in *Federal Register* Vol. 68, No. 123, 38108, at 5, *available at* www.regulations.gov/fdmspublic/component/main?main=DocumentDetail&o=0900006480313b4f (Last visited Dec. 17, 2008).

[449] In re Markair, Inc., 5 ABR [Alaska Bankruptcy Reports] 277 (Bankr. D. Alaska 1998), *available at*

trustee agreed to apply a portion of MarkAir's multimillion-dollar settlement from an antitrust action against Alaska Airlines[450] to the PFC claims, resulting in partial payment of prepetition PFCs and close to full payment of postpetition PFCs. The MarkAir case illustrates the danger of failing to aggressively follow up on collection of PFC funds pre-bankruptcy and earlyon in the bankruptcy process: the longer the process goes on, the greater the likelihood that sufficient funds will not remain to cover the PFC obligation and/or that a Chapter 7 court will find that the obligation to remit no longer exists.

Another Chapter 7 airline, Transmeridian Airlines, recently settled its PFC claims with 14 airports, resulting in the airports receiving 10 percent of their outstanding PFCs in cash and retaining an allowed, general unsecured claim for the remaining 90 percent.[451]

DOT and FAA take the position that PFCs are not property of the estate and therefore cannot be recoverable as preferences.[452]

3. Acceptance or Rejection (by the Debtor) of Leases for Real Property and Improvements at Airports

Airports could have found themselves in limbo as they waited for airlines to assume or reject their leases. In particular, many airports considered extensions to the period in which the debtor might continue to occupy the premises while deciding whether to assume or reject the lease burdensome.[453] The extension issue is less troublesome now than when the AAAE/ACI-NA made their comments in 2003, given the 2005 amendment to the Bankruptcy Code that put an end to routine extensions to the 60-day consideration period. *See* discussion of § 365 in Section II.B.1, *supra*. Nonetheless, Chapter 11 airlines continue to receive § 365(d)(4) extensions, although presumably with the airports' consent. For example, Delta Air Lines received the following extensions: order dated November 10, 2005, extending time through May 15, 2006; order dated May 1, 2006, extending time through October 16, 2006; order dated October 10, 2006, extending time through April 16, 2007; with further extensions possible.[454] In addition to refusing to provide consent to extensions, the airport may seek to compel the airline to assume or reject the leases within a time certain.[455]

In order to assume a lease, the airline in bankruptcy must have the bankruptcy court's approval, must cure any defaults, and may have to provide adequate assurance of future performance. For example, in order to obtain court approval of assumption of a sublease, Belize Airlines, a sublessee to Pan Am—under the facts standing in much the same position as an airport—was required to pay all past due and current rent within 15 days after entry of the court's order, and was required to put up a security deposit of approximately 3 months' rent.[456]

Before emerging from Chapter 11, US Airways rejected all of its leases and contractual agreements with the Allegheny County Airport Authority, effective January 5, 2004, subject to renegotiation of a new long-term lease agreement.[457] At that time such a move was unprecedented.[458] Fitch Ratings considered the potential lease rejection to be a "material negative event," which resulted in downgrading of the airport's credit rating from A- to BBB. The PNC Bank also withdrew the airport's line of credit.[459]

While rejecting all leases at an airport was viewed as unprecedented, that was not the first lease that US Airways had rejected.[460] Moreover, examples abound of bankrupt airlines that have rejected leases, or used the threat of rejection to renegotiate leases under more favorable terms. For example, after filing for bankruptcy protection, United Airlines rejected its lease for a maintenance center at the Indianapolis International Airport. While the airport was able to subsequently lease out portions of the facility, it was forced to incur some expenses for operation and maintenance, a portion of which were reimbursed under a settlement between the airport and the bankruptcy trustee. Interestingly, it appears that United Airlines did not attempt to rechar-

www.akb.uscourts.gov/5abr277.htm#5abr277 (Last visited Dec. 17, 2008).

[450] *MarkAir Calls $19 Million Alaska Airline Settlement Mixed Victory*, BUSINESS WIRE, July 23, 1998, *available at* http://findarticles.com/p/articles/mi_m0EIN/is_1998_July_23/ai_50191764 (Last visited Dec. 17, 2008).

[451] Order Granting Motion (as Amended) to Settle with Airport Defendants ABE, ATL, BQN, CLT, CVG, IAD, JFK, MDT, OKC, RFD, SFB, SJU, SYR, and TOL In Adversary Proceeding No. 07-06617, in re Transmeridian Airlines, Inc., Case No. 05-83284-jb, ch. 7 (Bankr., N.D. Ga. May 2, 2008).

[452] Author's June 27, 2008, telephone conversation with Bernard F. Diederich, Senior Attorney, Office of General Counsel, U.S. Dep't of Transp.

[453] *See* AAAE and ACI-NA comments in response to the June 26, 2003, *Federal Register* Notice titled, "Request for Public Comment on the Impact of Airlines Emerging From Bankruptcy on Hub Airports, Airport Systems and U.S. Capital Bond Markets," 68 Fed. Reg. 38108 (June 26, 2003), at 2, available at www.regulations.gov/fdmspublic/component/main?main=DocumentDetail&o=0900006480313b58 (Last visited Dec. 17, 2008).

[454] Delta Air Lines Form 8-K, Airports/Facilities Restructuring, at 63 (SEC Form 8-K available at http://www.sec.gov/answers/form8k.htm (Jan. 2, 2009).

[455] Braniff Airways, 783 F.2d at 1283.

[456] Pan American World Airways, Inc. v. Belize Airways, Ltd. (In re Belize Airways, Ltd.), 5 B.R. 152 (Bankr. S.D. Fla. 1980).

[457] U.S. DEP'T OF TRANSP., IMPACT OF AIR CARRIERS EMERGING FROM BANKRUPTCY ON HUB AIRPORTS, AIRPORT SYSTEMS AND U.S. CAPITAL MARKETS (2003), http://ostpxweb.dot.gov/aviation/domav/dotspecterstudy.pdf.

[458] Brown Company, *supra* note 13, at 1.

[459] Brown Company, *supra* note 13, at 3–4.

[460] TAMPA INT'L AIRPORT, ANNUAL REPORT 2006, at 45, www.tampaairport.com/about/facts/financials/hcaa_ann_rpt_2006.pdf.

acterize its lease for this facility, choosing instead to merely reject the lease and abandon the facility.[461]

In 2005, Delta Air Lines rejected its special facility bond lease for certain facilities at the Cincinnati/Northern Kentucky Airport.[462] The lease rejection led to a settlement that provided the Bond Trustee a $260,000,000 prepetition, nonpriority, unsecured claim against the airline. In addition, Delta and the Kenton County Airport Board (KCAB) entered into a new lease for the facilities in question under a smaller bond indenture. Delta also amended and restated leases with Massachusetts Port Authority for Logan Airport;[463] rejected a lease for a maintenance hangar at Tampa International Airport;[464] and rejected its lease at the Greater Orlando Airport Authority, negotiating a new lease with fewer gates.[465] In Tampa's situation, both ground rent payments and bondholder payments were lost; the bond indenture required that the lease and debt service agreement remain in place until the bondholders were paid in full; the lease agreement requires that the airport not recognize any ground rent payments until the bondholders are paid.[466] Note that when the defaulting airline reaches a settlement agreement with the bond trustee that allows the parties to enter a new lease agreement, dissenting bondholders may challenge the settlement agreement, although in KCAB's case, the challenge was unsuccessful. The bankruptcy court upheld the trustee's right to negotiate the settlement and the district court held the bondholders' appeal was equitably moot.[467]

As noted in Section II.D.1, *Lease Recharacterization*, *supra*, an airline may attempt to reject its leases but still retain use of the property. Even when the airline rejects leases and agrees to abandon the property, the amount of damages owed, and when they must be paid, can be a subject of dispute. *See* Sections II.D.4, *Stub Period Rent*, and II.D.5, *Other* (Lease rejection), *supra*.

Regardless of the exact circumstances, lease rejection or lease renegotiation is likely to result in some loss of airport revenue that the airport must attempt to recoup. Redeploying the gates or facility in question, whether by release or assignment, should mitigate the loss, although new leases may be at lower rates. Also, assumption of a Chapter 11 airline's gate leases and other airport assets must be approved by the bankruptcy court.[468] Beyond redeploying, the airport's ability to recoup lost revenue depends to some extent on the structure of the use agreement in effect. Under residual agreements the airport can generally increase fees charged to its remaining airlines; under compensatory agreements the airport must absorb the loss.[469] In addition, any new leases must comport with the FAA's nondiscrimination requirement.

Because of the leverage afforded by potential lease rejections, airlines may request lease modifications before deciding which leases and contracts to accept or reject under bankruptcy. For example, the SFO Airport Commission approved a modification to its lease with US Airways resulting in an annual $1.6 million reduction in rent to the airport, rather than risk having the airline reject its lease outright during the Chapter 11 proceedings.[470] Once a lease is rejected, the airline is free to negotiate a new lease with the airport, subject to the approval of the bankruptcy court.

In many cases, negotiations following the commencement of lease rejection proceedings—which proceedings must be approved by the court to be effective—substitute for litigation. The Delta special facility lease with KCAB, noted above, provides a good illustration. Following its Chapter 11 filing, Delta Air Lines issued notice to KCAB and the Bond Trustee that Delta intended to reject a special facility bond lease supporting improvements at the Cincinnati/Northern Kentucky

[461] Indianapolis Airport Authority, supra note 49, at 11, 57–58.

[462] Delta Air Lines 370 B.R. 537. *See also* CINCINNATI-NORTHERN KENTUCKY INT'L AIRPORT, ANNUAL MARKETING REPORT, 2006 Financial Statements, at 38, www.cvgairport.com/files/files/CVG_2006.pdf; Delta Air Lines Form 8-K, Feb. 7, 2007, Airports/Facilities Restructuring, at 54–59 (Discussion of special facilities restructuring at Boston/Logan, Cincinnati, Atlanta, Dallas, Tampa, Portland, Los Angeles, Chicago, and New York/LaGuardia Airports), *available at* http://pcquote.brand.edgar-online.com/EFX_dll/EDGARpro.dll?FetchFilingHTML1?SessionID=gMXgCgomAhfWRT_&ID=4936650 (Last visited Dec. 17, 2008).

[463] Massport 2007 bond issuance, *supra* note 38, at 68.

[464] TAMPA INT'L AIRPORT, *supra* note 460, at 45; Tampa International Airport, Agenda for Aviation Authority Regular Board Meeting, Dec. 14, 2006, at 37.

[465] Delta Air Lines Form 8-K, Airports/Facilities Restructuring, at 59; Beth Kassab, *Delta Signs New Lease Deal with OIA as Song Fades Away*, ORLANDO SENTINEL, May 2, 2006. (SEC Form 8-K available at http://www.sec.gov/answers/form8k.htm (Jan. 2, 2009)).

[466] TAMPA INT'L AIRPORT, *supra* note 460, at 45; Tampa Agenda, *supra* note 464, at 37.

[467] Delta Air Lines 370 B.R. at 537.

[468] *E.g.* ATA AIRLINE BANKRUPTCY NEWS (Bankruptcy Creditors' Service, Inc.), Oct. 27, 2004, *available at* http://bankrupt.com/ata.txt (Last visited Dec. 17, 2008). *See* Commitment Letter from AirTrans, http://bankrupt.com/misc/AirTranCommitmentLetter.pdf. At least in some instances the airport itself will be able to exert some control over lease assignments.

[469] AAAE and ACI-NA comments in response to Request for Public Comment on the Impact of Airlines Emerging From Bankruptcy on Hub Airports, Airport Systems and U.S. Capital Bond Markets, 68 Fed. Reg. 38108 (June 26, 2003), at 2 *available at* www.regulations.gov/fdmspublic/component/main?main=DocumentDetail&o=0900006480313b58 (Last visited Dec. 17, 2008).

[470] Minutes of the Airport Commission [SFO] Special Meeting of March 25, 2003, Modification No. 9 to Lease and Use Agreement No. 82-0120–US Airways, Inc., at 12–13, www.sfoairport.com/web/export/sites/default/download/about/commission/agenda/pdf/minutes/M032503.pdf; San Francisco International Airport Competition Plan Update, Dec. 10, 2003, at 4, www.flysfo.com/web/export/sites/default/download/about/competition/pdf/Competition_Plan_Update_Final_-_121003.pdf.

Airport. Negotiations followed Delta's motion for approval of rejection of the lease. The issues that were covered during the negotiations and resolved by the settlement agreement rather than by litigation included:

- Delta's ability to reject the Facilities Agreement.
- Whether the obligations under the Guaranty were capped under § 502(b)(6) of the Bankruptcy Code.
- Whether the Facilities Agreement itself was a disguised financing transaction.
- Whether the Indenture Trustee had a claim to "relet proceeds" to the extent that the Facilities Agreement was rejected.
- Whether Kentucky law was an obstacle to Delta's plans to reject the Facilities Agreement or otherwise occupy the Facilities at a reduced rental rate even if the Rejection Motion was approved.
- The viability of the Indenture Trustee's claims against KCAB.[471]

The negotiations ultimately resulted in a settlement agreement under which the original lease was terminated and replaced with a new lease at a fixed interest rate. The settlement agreement also provided the Bond Trustee a $260 million allowed prepetition, nonpriority, unsecured claim against Delta.[472]

The airport associations have suggested that airlines may use bankruptcy to discharge their obligations for cleaning up environmental contamination at an airport, shifting those costs to the airport itself and/or other carriers,[473] although debtors may not abandon hazardous waste and appear to be subject to strict penalties for violating other environmental laws.[474] In any event, there do not appear to be any reported cases that have involved Chapter 11 airlines filing for bankruptcy to avoid environmental obligations.

Current FAA regulations do not address assignment of airport leases in bankruptcy proceedings.

B. Under 49 U.S.C. § 40117/FAA Regulations

49 U.S.C. § 40117/14 C.F.R. Part 158 require that all airlines operating regularly: collect PFCs;[475] record PFC activities and compensation retained;[476] establish and maintain a financial management system that accounts for PFC revenues separately and discloses them as trust funds in airline financial statements;[477] file quarterly reports with airports for which PFCs are collected;[478] conduct a CPA procedural audit if more than 50,000 PFCs are collected annually;[479] and remit PFCs to airports monthly.[480] Both statute and regulation specify that PFC revenues are trust funds held for the beneficial interest of the airports for which they are collected.[481]

The Vision 100—Century of Aviation Reauthorization Act (Vision 100)[482] amended 49 U.S.C. § 40117 by adding a provision on financial management of fees for "covered" airlines (essentially those entering bankruptcy proceedings after December 12, 2003). Although the new statutory requirements for covered airlines went into effect as of December 12, 2003, the implementing regulations were not finally promulgated until June 22, 2007.[483] In the interim FAA notified airlines entering bankruptcy—and their bankruptcy courts—of the statutory requirements and recommended procedures for the airlines to follow in order to be in compliance with likely regulatory requirements.[484]

The additional requirements for covered airlines include:[485] establishing a separate segregated account for PFCs that includes and maintains a PFC reserve as specified by law and FAA regulation; putting any existing commingled PFC revenues into the PFC account; using that PFC account for all PFC transactions during the airline's bankruptcy, thus no longer commingling PFC revenues with other corporate revenues (funds deposited in operating accounts must be transferred to the PFC account); compensating an airport for costs incurred to recover PFCs in the event the airline fails to comply with 14 C.F.R. 158.49(c) or causes that airport to incur costs to recover or retain PFC revenue; and not pledging PFC revenues as collateral. The covered airlines are not required to create a separate account for each airport for which they collect PFCs. In addition, covered airlines that do not segregate PFC revenues as required are prohibited from collecting interest on their PFC revenues.[486] Finally, covered airlines must provide the FAA with copies of the quarterly reports provided to airports and must also file monthly PFC account statements with the FAA.[487] The FAA made clear that subaccounts within existing accounts do not meet the PFC account requirement and that 49 U.S.C. § 40117(m)(3)

[471] Delta Airlines, 370 B.R. 543.

[472] Delta Airlines, 374 B.R. 520.

[473] AAAE/ACI-NA, *supra* note 469, at 3.

[474] LYNN, *supra* note 2, ¶ 21.03[9], Exceptions to the Automatic Stay; ¶ 21.06[2], Environmental Claims.

[475] 49 U.S.C. § 40117(i)(2)(A); 14 C.F.R. § 158.45(a)(3).

[476] 14 C.F.R. § 158.69(a).

[477] 14 C.F.R. § 158.49.

[478] 14 C.F.R. § 158.65(a).

[479] 14 C.F.R. § 158.69(b).

[480] 49 U.S.C. § 40117(i)(2)(B) requires Secretary to establish remittance procedures; 14 C.F.R. § 158.51 requires monthly remittance.

[481] 49 U.S.C. § 40117(g)(4); 14 CFR § 158.49(b).

[482] Sect. 124, 108 Pub. L. No. 176, 117 Stat. 2502 (Dec. 12, 2003).

[483] Passenger Facility Charge Program, Debt Service, Air Carrier Bankruptcy, and Miscellaneous Changes: Final Rule, 72 Fed. Reg. 28837 (May 23, 2007).

[484] *E.g.,* a Dec. 15, 2005, letter from Catherine M. Lang, Acting Associate Administrator for Airports, was sent to Neal S. Cohen, Executive Vice President and Chief Financial Officer, Northwest Airlines.

[485] 49 U.S.C. § 40117(m); 14 C.F.R. § 158.49.

[486] 49 U.S.C. § 40117(m)(5); 14 C.F.R. § 158.53(b).

[487] 14 C.F.R. § 158.65(b).

prohibits a carrier from granting an interest in PFCs to a third party.[488]

Enforcement of § 40117(m) has been raised in at least one proceeding where the Chapter 11 airline took the position that the airports could not bring a motion to compel during the bankruptcy proceeding, arguing that action remained the sole purview of the FAA and USDOT.[489] Although this issue was not fully litigated, the motions to compel were in effect granted via a consent order issued by the bankruptcy court.[490] Nonetheless, the statute and implementing regulations do not describe any enforcement responsibilities, and the FAA has taken the position that it cannot address this issue in its regulations without additional legislative authority.[491] Thus far it appears that the issue of how the compensation requirements of 49 U.S.C. § 40117(m)(4)/14 C.F.R. § 158.49(c)(4) will work has not been litigated. However, several consent orders resolving motions to compel debtors to segregate and remit PFCs have addressed the issue, albeit obliquely. The issue had been addressed by providing that in the event of failure to cure a default of the obligation to pay PFCs, the airport operator will be entitled to request an expedited hearing to compel payment of PFCs and all costs incurred.[492] As to the priority of such airport compensation, the FAA noted that "Bankruptcy law makes participation in a bankruptcy proceeding unavoidable for public agencies seeking to assure a carrier implements the PFC financial management requirements of Vision 100. Participation may be necessary even when the air carrier is willing to implement the provision."[493]

This statement may lend support for the argument that such expenses should be considered a postpetition claim treated as an administrative expense entitled to priority under § 503(b),[494] but the issue has apparently not been litigated.

Prior to enactment of 49 U.S.C. § 40117(m), airline associations raised the issue of airlines using PFCs as subjects of liquidity covenants with creditors.[495] Doing so following that enactment would violate the statutory provision and its implementing regulations. At least one airport operator expressed concern that airports not be considered third parties for purposes of § 158.49(c)(3).[496] Although the FAA did not address this concern directly, it did state that air carriers and public agencies are the only authorized holders of PFC revenue,[497] from which point it follows that airports are not third parties.

IV. CONCLUSIONS

Once an airline files for bankruptcy protection, its ability to pay debts is constrained by the bankruptcy court's determination of the best interests of the estate and the rights of other creditors (secured, priority, and general unsecured). Even certain payments made prepetition may be subject to recovery by the DIP/trustee. In addition, and key for airports dealing with airlines in bankruptcy, executory contracts and unexpired leases may be assumed or rejected, sometimes over an extended period of time.

This section: 1) reviews the major legal issues at play under the Bankruptcy Code and under federal law and regulation that should be of greatest concern to airport counsel; 2) offers some points for airports to consider in order to mitigate losses due to airline bankruptcy, both before and after airlines file for bankruptcy protection; and 3) sounds a cautionary note about steps that appear helpful, but in fact may not be.

A. Summary of Legal Issues

1. Lease Recharacterization

Recharacterizing a lease as a "disguised financing" allows a Chapter 11 airline to continue using the facility in question without assuming the lease under § 365, thus avoiding paying at least some of the amounts owed until the end of the bankruptcy proceeding—and possibly avoiding some payment altogether. Since generally bond repayment is not owed to the airport, the financial effect on the airport is indirect: failure to pay on bonds reduces the market for such bonds, thereby reducing financing available for airport improvements.

A key distinction between a true lease and a loan is that under a true lease the amount of payment is tied to the rental value of the premises and under a loan the amount of payment is tied to the funds borrowed. Another way of looking at it is that the lease is based on current consumption and the loan is based on extension

[488] FAA Final Rule, 72 Fed. Reg. at 28841.

[489] In re Northwest Airlines Corp., Chapter 11, Case No. 05-17930 ALG (Bankr. S.D.N.Y.), *Denver International Airport's Reply and Joinder with the Consortium of Airports' Reply to Debtors' Consolidated Opposition to Motion to Compel Debtors to Segregate and Remit Passenger Facility Charges*, Sept. 16, 2005, at 4, par. 5, citing Debtor's Motion, ¶ 23.

[490] Consent Order Resolving Multiple Motions to Compel Debtors to Segregate and Remit Passenger Facility Charges and Consolidated Opposition of Debtors, In re Northwest Airlines Corp., Chapter 11, Case No. 05-17930 (ALG), Jointly Administered (Oct. 28, 2005).

[491] Preamble to final rule, 42 Fed. Reg. 28837, 28841.

[492] *E.g.*, Consent Order Resolving Multiple Motions to Compel Debtors to Segregate and Remit Passenger Facility Charges and Consolidated Opposition of Debtors, In re Northwest Airlines Corp., Chapter 11, Case No. 05-17930 (ALG), Jointly Administered (Oct. 28, 2005), at 5, par. 7.

[493] FAA Final Rule, 72 Fed. Reg. at 28842.

[494] Denver raised this issue in its request that the FAA provide a cost recovery procedure. FAA Final Rule, 72 Fed. Reg. at 28841.

[495] AAAE/ACI-NA, *supra* note 469, at 5.

[496] City of St. Louis, FAA-2006-23730-0014, Comments to NPRM on Passenger Facility Charge Program, Debt Service, Air Carrier Bankruptcy, and Miscellaneous Changes, *available at* www.regulations.gov/fdmspublic/component/main?main=DocketDetail&d=FAA-2006-23730 (Last visited Dec. 16, 2008).

[497] 72 Fed. Reg. at 28841.

of credit. There are a number of specific factors leading to a finding of no true lease in bankruptcy. The one court that has recharacterized an airport lease as a disguised financing has identified the following factors:

> (1) the fact that debtor airline's "rental" payments were tied to the amount borrowed from the bondholders;
>
> (2) the presence of a balloon payment;
>
> (3) the presence of a "hell or high water" clause, meaning the debtor had to pay the full "rental" amount if even the property became unusable;
>
> (4) the fact that prepayment of the debtor's obligations would end the arrangement; and
>
> (5) the fact that creditor did not have a remaining interest in the property at the end of the transaction.

Being a lease under federal tax standards is not necessarily sufficient to be considered a true lease under § 365, as both the DEN and LAX leases were leases for purposes of receiving federal tax exemptions.[498]

2. Relationship Between Multiple Agreements

The contexts in which a court may need to analyze whether multiple agreements must be construed together or separately include: whether multiple leases are severable, so that the trustee may assume some and reject others; whether agreements linked by a cross-default clause are substantially connected; whether an agreement found to be "disguised financing" is severable from a "true lease" agreement (recharacterization cases). Where the nondebtor party seeks to construe multiple agreements together, a significant concern for the bankruptcy court is ensuring that the nondebtor does not require the Chapter 11 estate to bear the costs of substantially unrelated agreements. To conduct the cross-default analysis, bankruptcy courts will generally look to whether the nondebtor party is being deprived of an essential part of its bargain.[499] If two agreements (or two parts of a single agreement) are such that the party would not have entered into one without the other, the agreements should stand together.

Severability is determined under state law. Often the test is intent, not form. The parties may have intended separate agreements to be a single contract or may have intended agreements bundled together to be treated separately. A key factor is an assessment of the underlying economic interests: economic dependence is a factor for reading agreements together; the existence of unrelated consideration in parallel agreements is a factor for construing the agreements separately.[500] It appears that a mere statement of intent, not supported by actual economic effect, is not sufficient to establish that one agreement was essential to entering into another.[501] Apportionability of payment, in and of itself, is not necessarily sufficient grounds for severing a lease.

3. Stub Period Rent

Many leases require that rent be paid in advance.[502] The "stub period" is "the time remaining after the entry of an order for bankruptcy relief, in a period for which rent was payable prior to the entry of the order for relief."[503] The existence of an obligation to pay this rent, and the standard for measuring the amount owed, is likely to turn on the application of § 365(d)(3). A key question in construing § 365(d)(3) is when the payment obligation arose, and, as noted below, courts are split over the correct standard to apply. At least one commentator flatly states that "a landlord is entitled to the rent provided for in the lease from the petition date through the date the lease is rejected; all such rent is accorded administrative expense priority status."[504] However, while the provision itself may seem straightforward, if the debtor does not actually "timely perform all the obligations of the debtor…arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title," results may differ on how the subsequent claim will be treated. It seems courts are split over whether a lessor is automatically entitled to administrative expense priority if § 365(d)(3) does apply, or whether the lessor must establish its administrative claim status under § 503(b)(1)(A) ["actual, necessary costs and expenses of preserving the estate"].

It is also possible, but not certain, that if on the facts of the case § 365(d)(3) does not apply, the lessor may nonetheless have an administrative claim under § 503. Issues concerning the amount of administrative rent owed—in the negotiation arena if not in actual litigation—include whether there is a presumption in favor of using the lease rate to set the rent; if so, what is the burden of proof—and which party has it—on what the presumption should be; and whether the administrative rent should be tied to the fair market value of the property or to the lessee's actual use of the property; and whether the lessor can receive more than the lease rate. Disputes over stub period rent illustrate the importance of whether facilities rentals owed are categorized as prepetition (which helps the airline) or postpetition (which helps the airport).

4. State Law Issues

A number of substantive issues in bankruptcy proceedings are decided under state law. These include:

- Whether the failure to perform the remaining obligations of an executory contract would constitute a material breach excusing performance of the other party

[498] *See, e.g.*, Jessop, *supra* note 134.

[499] United Air Lines, 346 B.R. at 468–69.

[500] *Id.* at 469–70.

[501] *Id.* at 471.

[502] In re UAL Corp., Case No. 02-B-48191, Debtors' Motion for an Order Approving and Authorizing Payment Under the Agreed-Upon Stub Rent Procedures, at 2. (Bankr. N.D. Ill., filed July 28, 2003).

[503] United Air Lines, 291 B.R. at 123.

[504] SALERNO, *supra* note 2, § 4.11[A][7], Administrative Rent.

(important if there is a question of whether a contract exists and so can be assumed or rejected under § 365).

- Whether executory contract was terminated prepetition (and therefore cannot be assumed).
  - e.g., state contract law construction of forfeiture clauses.[505]
- Whether an agreement is a lease or a loan; Seventh Circuit Court of Appeals has held that as a matter of federal law, economic substance governs in this determination, while state law determines which aspects are important in determining whether a transaction is a lease.
- Contract severability: the question is often the intent of the parties, and then how state law requires determining that intent (contract interpretation principles).
- Determination of what constitutes repossession or surrender for purposes of § 502(b)(6).
- Whether the debtor holds a property interest under § 541.
- The extent of the right of set-off under § 553.

5. PFC Enforcement/Treatment of PFCs

While it is arguable that the bankruptcy court's approval is not needed in order for the airline to set up the separate PFC account required under § 40117(m), it may be in the interest of both airports and compliant airlines to cover such accounts in first day orders or similar motions. Even if not required, the bankruptcy court's imprimatur should deflect challenges to the PFC account by other creditors.

At least one air carrier—Northwest Airlines—has argued in court that only USDOT and FAA have the authority to compel compliance with § 40117(m). The case settled, so the standing issue has not been litigated. Nonetheless, the settlement agreement required the airline to set up a separate account for PFCs and stipulated the trust fund nature of the PFC funds. The USDOT and FAA's pursuit of PFC compliance may mitigate the importance of the enforcement issue. However, if airlines do not comply with their PFC remittance requirements, the possibility still exists that bankruptcy will result in insufficient funds being available to remit to the airports on whose behalf the PFCs were collected. USDOT, FAA, and airports all have a strong interest in maintaining that PFCs cannot become property of the bankrupt estate under § 541. If not property of the estate, PFCs cannot constitute cash collateral under § 363(a) and cannot be subject to preference actions under §§ 547 and 550.

6. Removing Unwanted Tenants

Lessees may attempt to use bankruptcy proceedings to maintain leases that the airport wished to terminate. Section 541 of the Bankruptcy Code should preclude such efforts, provided that the lease in question is terminated before Chapter 11 is filed. Determination of termination is made under state law and so may vary, but providing prompt notice of defaults is generally a key factor. Once the lessee has filed for bankruptcy, the airport can no longer stop the lessee from assuming or assigning the lease. Although § 365(c) provides that the debtor may not assume or assign any executory contract or unexpired lease if applicable law excuses the airport from accepting performance from or rendering performance to an entity other than the debtor or DIP *and* the airport does not consent, there does not appear to be any applicable law that would excuse performance. It has been suggested, but not determined, that USDOT could provide such excuse by regulation.

7. Treatment of Gates

Two issues are of particular importance: the time allowed for assuming/rejecting the leases and assignment of leases. Recent changes under BAPCPA to the time allowed for assuming/rejecting leases may ease the hardship to the airport in terms of having gates unavailable due to the bankruptcy process. As to assignments, § 365 generally favors them. While § 365(c) theoretically offers a possible means to object to assignments, thus far it does not appear that any court has agreed with an argument that DOT's competition policy is "applicable law" for purposes of that provision. Moreover, a general lease provision allowing assignment of agreements may support the Chapter 11 carrier being able to assign its gate leases regardless of the airport's preferences.[506]

8. Federal Splits in Authority

There are a number of issues that have come up in airline bankruptcy cases (or in other bankruptcy cases that seem relevant to airline bankruptcy) on which federal courts are split as to the appropriate legal standard. These include: the performance date (billing) approach and the proration (accrual) approach to determine the amount and timing of payments under § 365(d)(3); whether § 365(d)(3) can apply to obligations that come due prepetition; whether § 365(d)(3) establishes an administrative priority claim without the need to establish such a claim under § 503(b); whether stub period rent, if coming due prepetition, can nonetheless be accorded administrative claim status; whether the nondebtor party must show more than a hypothetical possibility that the contract will be assigned before the exception under § 365(e)(2)(A) will apply; whether the "15 percent" in § 502(b)(6)(A) refers to 15 percent of the time left on the lease, measured from the date of surrender, or to 15 percent of the rent that would have become due after the date of surrender; and whether a debtor is precluded from pursuing a preference avoidance action under 11 U.S.C. § 547 once a claim has been allowed under § 502(d).

[505] Belize Airways, 5 B.R. 152 (Florida law disfavors forfeiture clauses in leases, tender of payment should be allowed to cure default).

[506] Midway Airlines, 6 F.3d 492.

B. Mitigating Losses

It is advisable to conduct a prebankruptcy assessment; that is, to evaluate all airport agreements to determine the effect that airline bankruptcies would have on those agreements. Airport counsel, in consultation with bankruptcy counsel (or airline operating agreement consultants), can then consider changes in leases/operating permits that may reduce exposure in future bankruptcies.[507] In addition, it may be useful to compile a checklist of issues to track in the event of actual airline bankruptcies. This section provides a number of examples of issues that airport counsel, directly or through bankruptcy counsel, may be advised to monitor.

1. Prebankruptcy

In drafting new airport operating agreements and leases, and in reviewing existing agreements for renegotiation, a number of issues may limit the airport's exposure in the event of bankruptcy. These include, but are not limited to:

Multiple leases.—As noted above, airlines in Chapter 11 have the option of assuming or rejecting executory contracts and unexpired leases. To the extent that the airline can pick and choose among multiple leases, it is more likely that the airline will be able to shed less desirable leases. Depending on state law concerning severability of contracts, it may be feasible to structure leases for multiple facilities as one lease, which may make it more difficult to reject only a few facilities.[508] A key factor is whether the multiple agreements are economically interdependent, as opposed to independent agreements merely bundled together. See Sections II.D.2, *Severability,* and II.D.3, *Cross-Default Clauses*, *supra*. Evaluate the possibility of keeping the flexibility to terminate one or all of the leases upon the lessee's default under one lease, without being obligated to terminate all of the leases.

The results may vary depending on state contract law, but generally transactions that are integrated bargains are more likely to hold together than multiple transactions dropped into one document. A mere statement of reliance that the parties would not have entered into one of the leases without the other(s) may not be enough to find that agreements are integrated. The assertion should be supported by underlying economic reality.

Structuring payments.—To the extent that agreements cover obligations that could be billed monthly or annually, it may be advisable to evaluate how the billing structure could affect collection in the event of bankruptcy.[509] Consider whether steps can be taken to reduce the likelihood of payments being recovered as avoidable preferences. Take into account whether the airport is in a payment date or proration jurisdiction, as well as how the jurisdiction treats other questions of receiving payment under § 365(d)(3)/§ 503(b). Try to get landing fees covered in an agreement, even if the airport sets fees under an ordinance.[510]

Keep on top of debts.—Remember, the airport cannot let payments go unpaid and then suddenly rush to collect when it looks like the airline is in trouble. Aside from practical problems, *i.e.*, refusal to pay, payments made within 90 days of a bankruptcy filing may be recoverable by the DIP as avoidable preferences. Therefore, waiting to collect debts from airlines or to enforce contractual terms may result in a loss or impairment of the ability to collect such debts once a bankruptcy petition is filed.[511] While probably not an option in the case of major airlines, consider whether to file for involuntary bankruptcy of smaller tenants that look like they are wasting their estates.

Perfecting security interests.[512]—The benefit of perfecting is to protect claims that would otherwise not receive priority. It is advisable to have bankruptcy counsel consider whether in an airport's particular circumstances there are any downsides to perfecting its security interest in the property leased to an airline, and if so to take another tack, for example by obtaining a letter of credit.[513] (See 11 U.S.C. § 502, *supra*.)

Danger of cash collateral.—Evaluate whether cash deposits are at risk in the airport's particular jurisdiction, which determination may be affected by wording of the deposit agreement. Consider whether to use a letter of credit, which—if properly drawn—as an agreement between the airport and the bank should not be property of the bankruptcy estate[514] and therefore should not be subject to the automatic stay or constitute an avoidable preference. However, also keep in mind that under § 503(b)(7), it appears that surety bonds and letters of credit may decrease the payment owed the airport, while cash security deposits may increase it.[515] In addition, it is possible that prepetition draws on a letter of credit serving as a security deposit will be held

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[507] *See generally* Adam Lewis, Brian Busey & Bill McCarron, *Bankruptcy, Inc.*, AIRPORT BUSINESS MAGAZINE, June 2003, *available at* www.airportbusiness.com/print/Airport-Business-Magazine/Bankruptcy--Inc/1$1126 (Last visited Dec. 17, 2008).

[508] *See id*.

[509] *See* In Re Handy Andy Home Improvement Ctrs., Inc., 196 B.R. 87, 93 (Bankr. N.D. Ill. 1996) (by not requiring monthly payments of real estate taxes, landlord extended credit to lessee, which debt arose prepetition).

[510] Lewis, *supra* note 507.

[511] Even if the airport is diligent in pursuing overdue amounts, it may be prudent to put in allowances for uncollectible debts in landing fees and terminal rental rates. *See* Massport 2007 Bond Issuance, *supra* note 38, at 58–59, A-7.

[512] *See* Carragher, *supra* note 336.

[513] *See, e.g.*, SAN DIEGO COUNTY REGIONAL AIRPORT AUTHORITY, SAN DIEGO, CALIFORNIA, COMPREHENSIVE ANNUAL FINANCIAL REPORT, FISCAL YEAR ENDED JUNE 30, 2006, at 47, www.san.org/documents/airport_authority/financials/CAFR_v3.5_finalPrint.pdf.

[514] In Re ITXS, Inc., 318 B.R. 85, 87 (Bankr. W.D. Pa. 2004).

[515] *See* Jessop, *supra* note 134.

under § 502(b)(6) to reduce the landlord's allowable claim in bankruptcy.[516]

Lease options: Airport counsel, in conjunction with bankruptcy counsel, may want to consider under which circumstances the airport would benefit if the Chapter 11 airline were held to its leases and under which circumstances the airport would benefit if the Chapter 11 airline were prevented from assuming its leases, and then explore whether leases can be constructed accordingly. For example, including provisions that allow the airport to terminate the lease for late payment or similar breaches, rather than relying on *ipso facto* clauses (discussed below), may provide the ability to terminate unwanted leases.

To the extent that the airport is party to a transaction with financing aspects, consider the ramifications if that part of the transaction were held to be a secured loan and plan accordingly. To decrease the odds of having a transaction with financing aspects be held to be a disguised financing rather than a true lease, emphasize the current consumption rather than credit components; to the extent possible make the financing part of the ground lease (taking state law into consideration); if possible have the facility revert to the airport or other public authority; and be aware of the ramifications of "hell or high water" clauses, particularly if they conflict with provisions in an accompanying ground lease. Combining leases may be easier to do if the facilities to be financed are built on the ground being leased (DEN) as opposed to being separate (SFO). State law on contract construction should be carefully reviewed.

The use of short-term gate leases rather than long-term exclusive leases will optimize opportunities to recapture the gates of a Chapter 11 airline.[517] In fact, such leases can be advantageous regardless of the presence of bankruptcies, provided they are negotiated to allow the airport more control over gate utilization.[518]

Lease valuation.—It may be advisable to consider how a lease should be valued if it is rejected. Depending on the factual situation, in the event of bankruptcy the airport may need to establish the value of the premises in order to establish a priority administrative claim. There may be advantages to doing so before bankruptcy actually ensues.

PFCs.—Monitor PFC reports to ensure that airlines are keeping current. Follow up with the airlines and, if necessary, USDOT and FAA if airlines fall behind. USDOT and FAA do try to get airlines to pay late remittances.[519]

2. Postbankruptcy

Bankruptcy can be a squeaky wheel operation. The nondebtor party rarely benefits by sitting on its rights. While it is particularly important to remember substantial consummation (once a reorganization plan is substantially consummated, the court will be reluctant to disrupt it), there are many steps along the way to plan confirmation at which the nondebtor who hesitates may lose—Big. With that in mind, the following are examples, not a completely exhaustive list, of points to consider.

Read the Chapter 11 disclosure statement: How are the airport's claims classified? How will they be treated? Is it necessary to file any proofs of claim? Be mindful of the airport's voting rights if the airport will get less than the full value of its claims or if the leases will be rejected or otherwise modified under the airport's reorganization plan. Consider what the airport would like to see in the reorganization plan and be prepared to offer input in time to influence the Chapter 11 airline. Consider whether to seek to reduce the period of exclusivity, object to the reorganization plan, or propose an alternative plan.

Stay on top of:

- *Procedural issues, especially first day motions*. In particular it is important to monitor proposed case management procedures. These procedural rules may have substantive implications, as they will establish notice periods and other matters that can influence outcomes. Specific procedural orders may also establish legal standards for resolving disputes in the bankruptcy case. In addition, when a court fails to rule on a motion—such as a motion for adequate protection—in a timely fashion, the unfolding of events during the pendency of the motion may affect the outcome of the motion.[520] Therefore, if a motion is pending, do not assume that if the court does not rule the problem will go away. If the airline does not on its own address setting up a separate PFC account, consider remedies, *infra*.
- *Bankruptcy dates*. Pay close attention to the Bar Date, which is so named for a reason. Keep track of the period available to the Chapter 11 airline for assuming or rejecting leases. It is also advisable to stay on top of dates to ensure accurate accounting of rent owed for computing damages. The effective date of rejection may substantially affect the character and amount of the resulting claims: be alert for motions requesting that rejection be made retroactive to the petition date.
- *Cash collateral, postpetition financing, and other motions*. Requests by the airline for authorization to

[516] Connectix Corp., 372 B.R. at 494–95.

[517] Bernard F. Diederich, *Federal Government Updates: PFCs (DOT White Paper—Airline Bankruptcy Issues)*, presented at ACI-NA 2008 Spring Legal Affairs Committee Conference, Session II: Current Airport Legal Issues, Apr. 18, 2008.

[518] For example, the Philadelphia International Airport replaced expiring 32-year leases with 5-year leases that allow the airport to require airlines to share partially used gates or return unused gates to the airport. Tom Belden, *New Gate-Lease Deals Mark the End of an Airport Era: The Old 32-Year Regulation-Era Leases Are Out; Five-Year Deals Are In. Two Airlines Will Likely Wind Up with More Gates*, THE PHILADELPHIA INQUIRER, July 1, 2006, *available at* http://findarticles.com/p/articles/mi_kmtpi/is_200607/ai_n16566977 (Last visited Jan. 2, 2009).

[519] Diederich, *supra* note 28.

[520] Continental Airlines, 91 F.3d 553.

use cash collateral, receive an extension of time to assume a lease, etc., may be challenged on the ground that the debtor has failed in some obligation, such as paying postpetition rent. Also, look out for motions that could include PFCs.

• *Potential remedies*. A number of remedies may be appropriate, including: motion for relief from automatic stay; objection to airline's request for authorization to use cash collateral; motion to compel airline to assume or reject an unexpired lease; motion to compel airline to segregate and remit PFCs;[521] and request for adequate protection. In the event of an adequate protection motion, take care not to raise an administrative rent claim prematurely. In particular consider requesting adequate protection in the event of lease assignment. Remember that adequate protection is likely to be unavailable once the reorganization plan is confirmed.

• *FAA reporting requirements*. An airline that has entered bankruptcy must file monthly PFC account statements with the FAA and quarterly PFC reports with each airport for which it collects PFCs. Being alert to failure to file required reports or discrepancies in reporting may afford an opportunity to press the delinquent airline to adhere to its responsibilities, rather than waiting and discovering that the funds have been spent elsewhere. *See* discussion of Vanguard, MarkAir *supra*.

• *Notices*, particularly of the Chapter 11 airline's statements of amounts owed. If the airline alleges an inaccurate amount owed and the airport does not dispute in a timely fashion, the bankruptcy court may adopt the amount asserted by the airline.

• *Claims and objections*. Be timely. This is particularly important for Chapter 7 unsecured claims; see Section II.C, *Bankruptcy Process*, *supra*. Once the reorganization plan is substantially consummated, the court will be loath to do anything to upset it. [522] Try to recover claims as soon as possible, while there is still recovery to be had.

Work with other creditors: Depending on the airport's particular circumstances, it may be advantageous to enter a workout settlement with the bondholders. Settlement elements may include: "entering into hangar operational maintenance and marketing agreements, purchasing and/or selling unsecured bankruptcy claims, prosecuting collection of unsecured bankruptcy claims and potentially acquiring some or all of the bondholders' rights in the bonds."[523]

C. Sounds Good, But…

There are a number of measures that may appear helpful but are in fact unlikely to hold up. While there may be strategic reasons for including such provisions in airline agreements and leases, the airport relies solely on them to protect its interests at its peril. These include:

1. *Anti-assignment clauses*: Given the sensitivity of having gates or other facilities assigned in contravention of the airport's competition plan or other imperatives, it is tempting to want to control the assignment process. Unfortunately, the Bankruptcy Code puts the debtor's need to dispose of assets ahead of such concerns.

2. *Clauses waiving rights under § 365 to reject executory contracts*: When an airport invests significant resources in a single-tenant facility, it is also tempting to want to hold the airline to the lease. However, much as is the case for anti-assignment clauses, the Bankruptcy Code puts the debtor's need to dispose of obligations ahead of such concerns.

3. *Ipso facto clauses*: Depending on the facts, the airport may wish to prevent an airline from assuming a lease or contract. The strongest ground for doing so is to be able to establish that the lease was not unexpired/the contract was not executory. Thus it may seem prudent to include contractual clauses purporting to affect the airline's interest upon filing for bankruptcy

[521] The facts of a particular situation, e.g., whether the airline has failed to remit some or all PFCs to date, will dictate specific points that must be covered. However, there are certain general points advisable to include in any proposed order to compel:

- Reference to statutory and regulatory requirement to collect and remit PFCs.
- Reference to statutory and regulatory requirements for airlines in bankruptcy regarding PFCs.
- Statement that the airline holds the PFCs in trust for the airports and has no legal nor equitable interest in the PFCs. Statement that the PFCs are not property of the estate under 11 U.S.C. § 541.
- Establishment of segregated account for establishing minimum reserve and depositing and remitting PFCs to airport operator(s); terms of account will comply with 49 U.S.C. § 40117 and 14 C.F.R. pt. 158.
- Specific statement of how amount in reserve account is to be calculated.
- Specific statement of deposit obligations to ensure PFC account is kept current, including daily deposit and monthly reconciliation obligations.
- Statement that as required by § 40117(m)(3), the airline has not and will not grant security interest in the PFCs to any third party.
- Statement of default notice and cure, including airport's right to expedited hearing to compel payment and for all costs incurred.
- Statement that nothing in the order changes the PFC trust fund status.

Depending on the circumstances it may also be advisable to include a statement that the order does not cover any other claims that the airport may have against the airline and reserve the right of setoff and/or recoupment. Motions/orders that can be used as models can be located through Pacer, *see* note 402, *supra*.

[522] Continental Airlines, 91 F.3d at 560.

[523] Tampa Agenda, *supra* note 464, at 38.

protection. However, provisions purporting to terminate or modify an airline's interest in property because of bankruptcy filing are likely to be held to violate § 363(l). Provisions that waive the automatic stay may be less vulnerable depending on the specific circumstances, but are by no means certain to hold up.

4. *Grouping unrelated leases*: State law should govern. However, even if state law takes a completely formulistic approach, a bankruptcy court may look at the underlying economic reality to allow the airline in bankruptcy to accept beneficial leases and reject those that do not benefit the bankruptcy estate.

5. *Statements in an agreement that the airport relied upon payment in a bond agreement in order to enter into an Airport Use Agreement:* Not likely to work without support from underlying economic circumstances. At least it didn't work for Chicago. Similar results are likely for unsupported statements of reliance in an attempt to tie together unrelated agreements.

Appendix A—Bankruptcy Code Provisions

- 11 U.S.C. § 105, Power of court, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC105
- 11 U.S.C. § 361, Adequate protection, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC361
- 11 U.S.C. § 362, Automatic stay, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC362
- 11 U.S.C. § 363, Use, sale, or lease of property, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC363
- 11 U.S.C. § 365, Executory contracts and unexpired leases, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC365
- 11 U.S.C. § 366, Utility service, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC366
- 11 U.S.C. § 502, Allowance of claims or interests, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC502
- 11 U.S.C. § 503, Allowance of administrative expenses, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC503
- 11 U.S.C. § 506, Determination of secured status: (a), http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC506
- 11 U.S.C. § 507, Priorities, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC507
- 11 U.S.C. § 511, Rate of interest on tax claims, www.abiworld.org/wiki/usc_sec_11_00000511----000-.html
- 11 U.S.C. § 541, Property of the estate, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC541
- 11 U.S.C. § 544, Trustee as lien creditor and as successor to certain creditors and purchasers, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC544
- 11 U.S.C. § 547, Preferences, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC547
- 11 U.S.C. § 550, Liability of transferee of avoided transfer, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC550
- 11 U.S.C. § 553, Setoff, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC553
- 11 U.S.C. § 1101(2), Substantial consummation, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC1101
- 11 U.S.C. § 1107, Rights, powers, and duties of debtor in possession, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC1107
- 11 U.S.C. § 1108, Authorization to operate business, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC1108
- 11 U.S.C. § 1109. Right to be heard, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC1109
- 11 U.S.C. § 1110, Aircraft equipment and vessels, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC1110
- 11 U.S.C. § 1121, Who may file a plan, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC1121

- 11 U.S.C. § 1123, Contents of plan, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC1123
- 11 U.S.C. § 1129, Confirmation of plan, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC1129
- 11 U.S.C. § 1141, Effect of confirmation, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+11USC1141

Appendix B—Federal Aviation Provisions

49 U.S.C. 40117. Passenger facility fees. http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+49USC40117.

(m) Financial Management of Fees.—

(1) Handling of fees.—A covered air carrier shall segregate in a separate account passenger facility revenue equal to the average monthly liability for fees collected under this section by such carrier or any of its agents for the benefit of the eligible agencies entitled to such revenue.

(2) Trust fund status.—If a covered air carrier or its agent fails to segregate passenger facility revenue in violation of the subsection, the trust fund status of such revenue shall not be defeated by an inability of any party to identify and trace the precise funds in the accounts of the air carrier.

(3) Prohibition.—A covered air carrier and its agents may not grant to any third party any security or other interest in passenger facility revenue.

(4) Compensation to eligible entities.—A covered air carrier that fails to comply with any requirement of this subsection, or otherwise unnecessarily causes an eligible entity to expend funds, through litigation or otherwise, to recover or retain payment of passenger facility revenue to which the eligible entity is otherwise entitled shall be required to compensate the eligible agency for the costs so incurred.

(5) Interest on amounts.—A covered air carrier that collects passenger facility fees is entitled to receive the interest on passenger facility fee accounts if the accounts are established and maintained in compliance with this subsection.

(6) Existing regulations.—The provisions of section 158.49 of title 14, Code of Federal Regulations, that permit the commingling of passenger facility fees with other air carrier revenue shall not apply to a covered air carrier.

(7) Covered air carrier defined.—In this section, the term "covered air carrier" means an air carrier that files for chapter 7 or chapter 11 of title 11 bankruptcy protection, or has an involuntary chapter 7 of title 11 bankruptcy proceeding commenced against it, after the date of enactment of this subsection.

PART 158—PASSENGER FACILITY CHARGES (PFCs)

www.faa.gov/airports_airtraffic/airports/resources/publications/regulations/media/pfc_14cfr158_062207.pdf

Subpart A—General

Sec.

§ 158.49 Handling of PFCs.
(a) Collecting carriers shall establish and maintain a financial management system to ac-

count for PFCs in accordance with the Department of Transportation's Uniform System of Accounts and Reports (14 C.F.R. part 241). For carriers not subject to 14 C.F.R. part 241, such carriers shall establish and maintain an accounts payable system to handle PFC revenue with subaccounts for each public agency to which such carrier remits PFC revenue.

(b) Collecting carriers must account for PFC revenue separately. PFC revenue may be commingled with the air carrier's other sources of revenue except for covered air carriers discussed in paragraph (c) of this section. PFC revenues held by an air carrier or an agent of the air carrier after collection are held in trust for the beneficial interest of the public agency imposing the PFC. Such air carrier or agent holds neither legal nor equitable interest in the PFC revenues except for any handling fee or interest collected on unremitted proceeds as authorized in § 158.53.

(c)(1) A covered air carrier must segregate PFC revenue in a designated separate PFC account. Regardless of the amount of PFC revenue in the covered air carrier's account at the time the bankruptcy petition is filed, the covered air carrier must deposit into the separate PFC account an amount equal to the average monthly liability for PFCs collected under this section by such air carrier or any of its agents.

(i) The covered air carrier is required to create one PFC account to cover all PFC revenue it collects. The designated PFC account is solely for PFC transactions and the covered air carrier must make all PFC transactions from that PFC account. The covered air carrier is not required to create separate PFC accounts for each airport where a PFC is imposed.

(ii) The covered air carrier must transfer PFCs from its general accounts into the separate PFC account in an amount equal to the average monthly liability for PFCs as the "PFC reserve." The PFC reserve must equal a one-month average of the sum of the total PFCs collected by the covered air carrier, net of any credits or handling fees allowed by law, during the past 12-month period of PFC collections immediately before entering bankruptcy.

(iii) The minimum PFC reserve balance must never fall below the fixed amount defined in paragraph (c)(1)(ii) of this section.

(iv) A covered air carrier may continue to deposit the PFCs it collects into its general operating accounts combined with ticket sales revenue. However, at least once every business day, the covered air carrier must remove all PFC revenue (Daily PFC amount) from those accounts and transfer it to the new PFC account. An estimate based on 1/30 of the PFC reserve balance is permitted in substitution of the Daily PFC amount.

(A) In the event a covered air carrier ceases operations while still owing PFC remittances, the PFC reserve fund may be used to make those remittances. If there is any balance in the PFC reserve fund after all PFC remittances are made, that balance will be returned to the covered air carrier's general account.

(B) In the event a covered air carrier emerges from bankruptcy protection and ceases to be a covered air carrier, any balance remaining in the PFC reserve fund after any outstanding PFC obligations are met will be returned to the air carrier's general account.

(v) If the covered air carrier uses an estimate rather than the daily PFC amount, the covered air carrier shall reconcile the estimated amount with the actual amount of PFCs collected for the prior month (Actual Monthly PFCs). This reconciliation must take place no later than the 20th day of the month (or the next business day if the date is not a business day). In the event the Actual Monthly PFCs are greater than the aggregate estimated PFC amount, the covered air carrier will, within one business day of the reconciliation, deposit the difference into the PFC account. If the Actual Monthly PFCs are less than the aggregate estimated PFC amount, the covered air carrier will be entitled to a credit in the amount of the difference to be applied to the daily PFC amount due.

(vi) The covered air carrier is permitted to recalculate and reset the PFC reserve and daily

PFC amount on each successive anniversary date of its bankruptcy petition using the methodology described above.

(2) If a covered air carrier or its agent fails to segregate PFC revenue in violation of paragraph (c)(1) of this section, the trust fund status of such revenue shall not be defeated by an inability of any party to identify and trace the precise funds in the accounts of the air carrier.

(3) A covered air carrier and its agents may not grant to any third party any security or other interest in PFC revenue.

(4) A covered air carrier that fails to comply with any requirement of paragraph (c) of this section, or causes an eligible public agency to spend funds to recover or retain payment of PFC revenue, must compensate that public agency for those cost incurred to recover the PFCs owed.

(5) The provisions of paragraph (b) of this section that allow the commingling of PFCs with other air carrier revenue do not apply to a covered air carrier.

(d) All collecting carriers must disclose the existence and amount of PFC funds regarded as trust funds in financial statements.

§ 158.53 Collection compensation.

* * *

(b) A covered air carrier that fails to designate a separate PFC account is prohibited from collecting interest on the PFC revenue. Where a covered air carrier maintains a separate PFC account in compliance with § 158.49(c), it will receive the interest on PFC accounts as described in paragraph (a)(2) of this section.

§ 158.65 Reporting requirement: Collecting air carriers.

(b) A covered air carrier must provide the FAA with:

(1) A copy of its quarterly report by the established schedule under paragraph (a) of this section, and

(2) A monthly PFC account statement delivered not later than the fifth day of the following month. This monthly statement must include:

(i) The balance in the account on the first day of the month;

(ii) The total funds deposited during the month;

(iii) The total funds dispersed during the month; and

(iv) The closing balance in the account.

Appendix C—FAA Congestion Provisions

The FAA has had several regulations and orders related to congestion management that are relevant to airline bankruptcy, insofar as they relate to the issue of ownership of takeoff and landing slots. These include:

- Air traffic rules for congestion reduction at Chicago O'Hare International Airport, under which arrival authorizations (slots) could be sold or leased only subject to FAA regulations. This regulation was scheduled to expire on October 31, 2008, and the FAA has confirmed it will not seek to extend flight caps at O'Hare. (14 C.F.R. 93.21-32; 14 C.F.R. 93.21(e); FAA Announces Elimination of Flight Caps at Chicago's O'Hare International Airport, June 16, 2008. Accessed June 23, 2008, at www.faa.gov/news/press_releases/news_story.cfm?newsId=10240.
- FAA order on Operating Limitations at New York LaGuardia Airport, 71 Fed. Reg. 54331-54334 (September 14, 2006).
- The High Density Rule (HDR), which designated LaGuardia, Newark, O'Hare, National, and John F. Kennedy International (JFK) Airports as High Density Traffic Airports with limitations imposed by the FAA on takeoffs and landings at those airports. As of January 1, 2007, the HDR no longer applied to LaGuardia or JFK. (14 C.F.R. part 93, subpart K; Congestion Management Rule for LaGuardia Airport, SNPRM, 73 Fed. Reg. 20846, 20847 (April 17, 2008)).
- Proposed rules for congestion management at LaGuardia, John F. Kennedy International, and Newark International Airports that would allow carriers to purchase a right to slots for up to 10 years without being subject to the minimum usage requirement. (Congestion Management Rule for LaGuardia Airport, SNPRM, 73 Fed. Reg. 20846 (April 17, 2008); Congestion Management Rule for John F. Kennedy International Airport and Newark Liberty International Airport, NPRM, 73 Fed. Reg. 29626 (May 21, 2008). This proposal faces opposition from Congress and at least one airport authority has questioned the FAA's authority to treat slots as property. *See* Sewell Chan, Debate Over Auctioning of Airport Landing Slots, New York Times Blog, June 18, 2008. Accessed June 23, 2008, at http://cityroom.blogs.nytimes.com/2008/06/18/debate-over-auctioning-of-airport-landing-slots/; Alexandra Marks, U.S. Plan to Ease Air Congestion Runs into Head Winds, *The Christian Science Monitor*, June 20, 2008. Accessed June 23, 2008, at www.csmonitor.com/2008/0620/p02s01-usgn.html. See also New York Aviation Rulemaking Committee Report, December 13, 2007. Accessed July 8, 2008, at www.dot.gov/affairs/FinalARCReport.pdf.)

In its proposed congestion management rulemaking for LaGuardia Airport, the FAA took the position that "[c]arriers possess no absolute property interest in slots unless the FAA gives it to them." Moreover, while the FAA acknowledges that airlines will have some property interest in any slots authorized by the FAA under the rulemaking, the FAA asserts "those rights will be limited by the terms of any final rule and any lease terms that the FAA specifies. Ultimately it is the FAA that controls the airspace and controls the rights of carriers to use it." (Congestion Management Rule for LaGuardia Airport, SNPRM, 73 Fed. Reg. 20846, 20853 (April 17, 2008)).

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