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INSOLVENCY IN INDIAN AVIATION: WHAT DOES INDIA'S NEW CAPE TOWN CONVENTION BILL MEAN FOR RECOVERY AND RE-POSSESSION OF LEASED AIRCRAFTS?

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Leasing of aircrafts is a prevalent market practice in the aviation industry, and all existing airline operators in India have currently leased a significant number of aircrafts in their fleet. In fact, a sizeable debt in the books of these operators is in connection with such leasehold arrangements.

Insolvency proceedings in India, including the aviation sector, are governed by the Insolvency and Bankruptcy Code, 2016 (IBC). On 8 October 2018, the Indian government proposed the enactment of the Cape Town Convention Bill, 2018 (Bill), which when enacted will give primacy to the provisions of the Convention on International Interests in Mobile Equipment (Convention) and Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (Protocol), overriding any conflicting provision contained in any other law in force, especially the IBC and its moratorium provisions. Once this Bill is enacted into law, the Convention and the Protocol will become part of Indian law.

While the Bill potentially impacts the aviation insolvency sphere in multiple respects, this update analyses the effect of the Bill on the ability of lessors to re-possess aircrafts leased to Indian airline operators in insolvency under the IBC (corporate debtors) and other practical aspects in relation to this.

Is re-possession of the leased aircraft allowed during the moratorium period under IBC?

Once moratorium under IBC is declared by the bankruptcy court, recovery of any property by an owner or lessor (where such property is occupied by or in the possession of the corporate debtor) is prohibited under Section 14(1)(d) of the IBC for the duration of the moratorium period. However, bankruptcy courts have not yet had an opportunity to interpret this prohibition in the context of aircraft leases. This provision has in the past been applied to protect lessees from eviction in real estate tenancies, and given the wide ambit of Section 14(1)(d), the prohibition is likely to apply to aircraft leases as well. Accordingly, it is likely that the lessors will not be able to regain possession of their aircrafts when moratorium has been imposed.

Can the lessor terminate the lease agreement during the moratorium period under IBC?

Strictly, Section 14(1)(d) of the IBC only prohibits recovery and re-possession and makes no mention of termination of the underlying lease arrangement itself. While there is no judicial precedent as yet, however, given the intrinsic linkage between termination and right to re-possess, a court in India may well find that even termination is prohibited

under Section 14(1)(d) unless egregious circumstances (such as non-maintenance of the aircraft at the risk of substantial risk or damage) otherwise exist.

It is helpful to note that Article 10 of the Convention expressly provides that in the event of default under a lease agreement, the lessor can terminate such agreement and take possession or control of the object to which the agreement relates. This is yet another reason why the enactment of the Bill will be a positive step for lessors.

How does the IBC treat lease rentals that the corporate debtor has defaulted on?

The treatment of lease rental dues depends on whether these relate to the period prior to the moratorium or after. Once insolvency has been initiated, all payments due to lessors for the pre-moratorium period can only be claimed from the corporate debtor as "operational debt", by submitting a claim in the insolvency process. Amounts due to such lessors for the moratorium period form part of "insolvency resolution process costs" (IRP Costs). IRP Costs, under Indian law, are treated as super senior debt and are to be paid prior to any other debts of the corporate debtor under Regulation 31(b) of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations).

Certain judicial decisions suggest that there is no bar on lessors being paid rentals on a current basis during the moratorium period (*Rave Scans Pvt Ltd, Company Petition No. (IB)-01(PB)/2017 (Principal Bench, New Delhi)*). Practically as well, resolution professionals continue to make such payments from the cash flows of the corporate debtor, if these are required to maintain the corporate debtor as a going concern.

Is the aircraft lease a supply of essential goods to the corporate debtor under IBC? If so, what implications does this have?

This question assumes importance because under Section 14(2) of the IBC, the supply of "essential goods or services" to the corporate debtor cannot be terminated, suspended or interrupted during the moratorium period. Amounts due to such a supplier are also treated as part of IRP Costs.

"Essential goods and services" have been defined very specifically and narrowly under Regulation 31 of the CIRP Regulations and clearly do not include aircraft leases. However, there has been a case where the bankruptcy court expanded this definition, even though such an expansive reading is not supported by the IBC (*Canara Bank v Deccan Chronicle Holdings Limited, Company Petition No. IB/41/7/HDB/2017 (National Company Law Tribunal, Hyderabad)*). If this trend continues, the corporate debtor could argue that the lease of aircrafts is an essential good or service and thus cannot be terminated.

In certain cases, the bankruptcy appellate court has held, albeit surprisingly, that a supplier of "essential goods and services" can terminate that contract if its dues during the moratorium period have not been paid despite repeated requests (*Uttarakhand Power Corporation Ltd v M/s ANG Industries Ltd, Company Appeal (AT) (Insolvency) No. 298 of 2017; Innoventive Industries Ltd v Maharashtra State Electricity Distribution Co Ltd, Company Appeal (AT) (Insolvency) No. 156 of 2017; Dakshin Gujarat VIJ Co Ltd v ABG Shipyard Ltd Company Appeal (AT) (Insolvency) No. 334 of 2017*).

Cape Town Bill – What does it change?

The Bill, once enacted into law, will override the moratorium provisions of the IBC. Article XI of the Protocol (read together with the declarations lodged by India at the time of the deposit of its instrument of accession) allows the lessor to take possession of the aircraft if dues are not cleared within 2 months of initiation of insolvency proceedings against the lessee corporate debtor. Until then, the insolvency

administrator must preserve the aircraft and maintain its value in accordance with the lease agreement. The lessor is also entitled to apply for any other interim relief available under Indian law. The insolvency administrator or lessee has the right to retain possession of the aircraft if within 2 months, all defaults under the agreement (other than the default constituted by opening of insolvency proceedings) have been cured and the insolvency administrator or lessee has agreed to perform all future obligations under the lease agreement.

Way forward – Is the Bill the dawn of a new regime?

The Bill is designed to expressly override the IBC on the aspect of moratorium. This is a helpful change, as it takes India back to its avowed position under the Convention and Protocol (which it acceded to in 2008). Prior to the enactment of the IBC, courts in India have applied the Convention and the Protocol (*AWAS 39423 Ireland Ltd & Ors v Directorate General of Civil Aviation & Anr*, WP(C) 871/2015 (High Court of Delhi); *Corporate Aircraft Funding Company LLC v Union of India & Ors*, WP(C)792/2012 (High Court of Delhi)) to allow repossession. However, the IBC appears to have unintentionally contradicted India's agreed position under the Convention and the Protocol, taking away some critical protections given to aircraft lessors. The enactment of the Bill is a crucial change in restoring the *status quo*. In the meanwhile, it remains to be seen whether bankruptcy courts will apply the Convention/Protocol or Section 14(1)(d) of IBC.

That said, there remain some "watch outs" as well. For example, it is yet to be seen how courts will proceed if a lessor gets a decree from a foreign court for recovery of the aircraft in India. This will have to be examined along with Article XII of the Protocol which obligates India to co-operate to the maximum extent with foreign courts and foreign insolvency administrators in carrying out provisions of the Convention or the Protocol.

Practically, there are significant questions that will be answered only once the Convention / Protocol gets implemented post the enactment of the Bill. For instance, what are the documentation requirements and stamp duty implications for making such re-possession applications upon initiation of insolvency proceedings? What are the costs that should be factored by lessors for making such re-possession requests? What exactly is the role of local lawyers in fulfilment of such re-possession requests? With airlines in India facing considerable financial stress and reporting losses, the enactment of the Bill at this juncture would be considered very timely by the aircraft leasing industry.

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