

# ClientAlert

## Asset Finance

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## Mexicana Airlines Files for Bankruptcy

Mexicana Airlines has reported that it has filed for bankruptcy protection in Mexico and will seek to reorganize. What does this mean for aircraft lessors and other creditors of Mexicana Airlines?

### The Mexican Business Reorganization Act

The Mexican Business Reorganization Act (Ley de Concursos Mercantiles), enacted in 2000, regulates court-supervised business reorganizations and liquidations in Mexico. Its stated purpose is to preserve companies and to prevent payment defaults from jeopardizing their survival and the survival of the companies with whom they do business.

The Act provides for insolvency proceedings in two successive stages, workout (conciliación) and liquidation (quiebra). In the case of voluntary filings, insolvency proceedings may commence either in the workout stage or the debtor may opt for direct liquidation of its assets.

The workout stage commences when the debtor is declared insolvent by way of a voluntary or involuntary petition of concurso mercantil. That stage ordinarily lasts 185 calendar days, but may, under certain conditions, be extended by the court up to a maximum of 365 calendar days. During this period, the debtor generally continues to operate its business and, with the help of a mediator (a "conciliador"), tries to restructure its obligations. In the case of the Mexicana Airlines workout, inasmuch as it is a holder of a concession granted by the Mexican Government, the conciliador should be appointed at the request and nomination of the Ministry of Communications and Transportation (as in the case with all Mexican airlines).

The liquidation stage commences if the debtor files for it or if the debtor is unable to reach an agreement with the majority of its creditors, primarily the unsecured creditors (which agreement, in the case of an airline, is subject to veto by the Ministry of Communications and Transportation) during the workout stage, whereupon the debtor is declared bankrupt. During the liquidation stage, the court will oversee the liquidation of the debtor's assets and use the proceeds to pay recognized claims in accordance with their amount, status and priority. The sale of any enterprise as an ongoing business is generally preferred over the sale of its assets piecemeal.



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## Implications of an Airline Declaration of Insolvency on Leased Aircraft

As a general principle, during the workout stage, a debtor airline must perform its obligations under the aircraft leases essential to its ongoing business unless (i) it is not possible for the debtor to continue performing and/or (ii) the conciliador objects to a particular lease on the grounds that non-performance would be in the best interest of the bankruptcy estate. Any lease to which the conciliador objects would terminate without the need for prior court approval required, noting, however, that an interested party may challenge such objection by petitioning the court.

Any aircraft lessor may demand that the conciliador declare whether he will object to the debtor airline's performance. If the conciliador declares that he will not object, the lease would continue in accordance with its terms and the debtor airline would have to perform or guarantee the performance of its obligations.

On the other hand, if the conciliador objects to an aircraft lease, the lease will, as noted above, thereupon be terminated. If the conciliador simply does not respond to the demand within 20 business days, the lessor may at its election terminate the lease by way of notice to the conciliador.

Any lease provision providing for the termination thereof upon the filing of a petition of concurso mercantil would be ineffective. A lessor may, however, otherwise terminate its lease in accordance with its terms (for example, following a payment default) or through the declaration/rejection process described above.

If the conciliador does not object to an aircraft lease and the airline subsequently defaults, the lessor may thereafter terminate the lease in accordance with its terms.

In the case of any of the above types of termination, the lessor would be entitled to recover possession of its aircraft in accordance with the terms of its lease. In this regard, it is important to note that the judge presiding over the concurso mercantil may, upon the termination of a lease (a) approve the immediate repossession of the leased aircraft by its lessor, or (b) require the lessor to commence an ancillary proceeding (incidente de separación de bienes) to seek an order requiring the airline to turn over the possession of the aircraft to its lessor and permitting the lessor to take possession of the aircraft. In

the absence of an order, the lessor should request the court to expressly allow the repossession of the aircraft. Any court order affecting a lessor's right to repossess its aircraft would be communicated to the lessor by (a) written notification delivered in the domicile appointed by the lessor either in the lease agreement or, if the lessor has appeared before the court, in the filings made by the lessor with the court, or (b) by publication in the court's public lists or records.

From a Mexican law perspective, no consent, approval or license from any governmental or regulatory authority of Mexico will be required for the termination of the lease or for the removal of the aircraft from Mexico, except for an export certificate from the Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público), a notice on the ferry flight given to the Ministry of Communications and Transportation (Secretaría de Comunicaciones y Transportes) and, possibly, satisfaction of any requirements imposed in connection with the issuance of the prior import authorization. A lessor would not be entitled to recover possession of its aircraft until its lease was so terminated by way of objection to the lease by the conciliador or failure of the conciliador to respond to the lessor's demand regarding objection, or otherwise pursuant to its own terms (excepting any termination based on the filing of a petition of concurso mercantil, as previously mentioned).

Although claim recognition in Mexican insolvency proceedings occurs by operation of law, lessors and/or creditors of Mexican Airlines should nonetheless file proof of their claims with the conciliador including claims for principal, interest, rent, maintenance reserves, recoverable expenses and security interests. In the case of a lease or mortgage claim, the action should be based on the lease agreement and/or the mortgage agreement filed with the Mexican Civil Aviation General Bureau when the aircraft was registered.

Employees of a debtor airline would have a first super-priority claim against any operating assets of the debtor airline. In our experience, creditors should expect the employees and/or their unions to attempt to interfere with the repossession of aircraft even if they are leased or mortgaged, until severance and other labor claims are fully addressed. These attempts should ultimately prove futile, but may nonetheless complicate the repossession process.

It is important to bear in mind that the concession title granted to Mexicana Airlines by the Mexican Government might include provisions that override or otherwise modify the general treatment described above under the Bankruptcy Act. Although, under the Civil Aviation Act and the Regulations of the Aeronautical Registry, the concession titles of Mexican airlines are to be registered in the Mexican Aeronautical Registry (organized by the Mexican Civil Aviation General Bureau) with copies publicly available, in our experience the Mexican Civil Aviation General Bureau has been very reluctant to make copies widely available, and, in fact, delivers copies of such concessions and/or allows review thereof onsite, only if sufficient “legal standing” is evidenced. In practice, access to an airline’s concession generally requires the express consent of such airline.

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