



# Current issues in aircraft repossession in Brazil

Stewart B Herman and Timothy J Lynes, partners of Katten Muchin Rosenman, examine how aircraft repossession could change in Brazil after the country's implementation of the Cape Town Convention.



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In June 2005 Brazil's first airline, Varig, filed for bankruptcy protection in the Brazilian courts, testing the new bankruptcy code that had come into effect in February of that year. Although the letter of the law provided robust protection to lessors, the wide discretion afforded individual judges meant that the code was at times not implemented in practice. Nearly 10 years later, what is the state of the process of repossessing a commercial aircraft in Brazil?

Although there have been no repossessions from a major passenger airline since Varig, Varig's cargo arm, Varig Logistica, had four aircraft repossessed through the Brazilian courts in the course of its bankruptcy.

This article provides an overview of Brazil's bankruptcy law pre-Cape Town in practice with Varig Logistica, as well as some issues that may arise in repossessing aircraft in Brazil and concludes with a look at the future now that the Convention on International Interests in Mobile Equipment, 2001 (the Cape Town Convention) and Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment, 2001 (the Aircraft Protocol) have come into force in Brazil.

## **The Brazilian repossession system – pre-Cape Town**

Although most leases require that the lessee be notified of a default, when facing the prospect of having to engage in a legal action in Brazil to recover the leased

aircraft, it is prudent to provide a second written notice of actual lease termination, even if not required under the terms of the lease. The reason for this is that in the event a court action is filed, the lessee cannot argue that the lease was not properly terminated.

If the lessee has been provided with notice, then the next step is to file a request for ex parte injunctive relief with the court located in the lessee's legal headquarters. The court has a variety of options at its disposal but the most likely is that it will issue a preliminary injunction, allowing the lessor nominally to take possession of the aircraft, within a few days. Once issued, the injunction also provides the lessee an opportunity to file a defence.

In the meantime, the aircraft cannot be taken out of Brazil nor will it be deregistered by the Brazilian authorities. Once the lessee files a defence, the judge will then rule on the claim, likely providing the lessor with the ability to repossess and export the aircraft. There is no self-help remedy under Brazilian law, even with the adoption of Cape Town, and so any repossession must be done through the courts.

It is also important to note that under Brazilian law, filing for bankruptcy protection does not automatically terminate the lease. Even if the lease provisions specify the termination of the lease if there is a bankruptcy filing, it is unlikely that Brazilian courts will enforce it.

In the US, Section 1110 of the Bankruptcy Code provides a 60-day stay for a lessee of aircraft and aircraft equipment that is a commercial airline, after which the airline has a positive obligation to return the aircraft or abide by the lease obligations (as may be renegotiated with the lessor). On the other hand, Brazilian law permits a lessee to continue to fulfil the obligations of all contracts regardless of a bankruptcy filing. However, the lessee is under no positive obligation to do anything, and it falls to the lessor to commence the repossession action.

## **Repossession in action – Varig Logistica**

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**The National Congress of Brazil which has implemented the Cape Town Convention.**

arm of Varig that continued on while Varig's commercial operations were wound down. VarigLog in turn was hard hit by the financial crisis and limped along for a few years before filing for bankruptcy protection after a clash between an American fund and its Brazilian partners. During this time VarigLog defaulted on its lease obligations to Wells Fargo as owner trustee for four Boeing 757s and Wells Fargo sought to repossess the aircraft.

In December 2011 Wells Fargo filed a claim in São Paulo seeking to recover the four 757s and obtained a favourable decision a month later from the lower court. However, VarigLog appealed, seeking to retain the aircraft, and in so doing obtained a stay so that Wells Fargo could not immediately recover the aircraft.

The appeals court also ruled against VarigLog and awarded the aircraft to Wells Fargo, pending a response from VarigLog. When a final decision was issued, VarigLog filed a separate, ultimately unsuccessful, suit to return possession of the aircraft to it. The Wells Fargo suit cleared the courts

in about two months with some additional weeks necessary to deal with the bureaucratic formalities before Wells Fargo could take possession in February 2012 and export the aircraft from the country.

### **Practical obstacles and delays to repossession**

Although the repossession of the aircraft from VarigLog was reasonably quick, especially in relation to other cases that are winding their way through the courts, it does illustrate some of the potential avenues for delay in the Brazilian system.

The most prominent one, shown in the VarigLog case, is that the Brazilian legal system provides for a variety of appeals, including interlocutory appeals and appeals on non-substantive issues. If a lessee wants to delay the recovery process, it may take advantage of these appeals. VarigLog engaged in some of these delay tactics, appealing the court decisions and utilizing the response period to ensure the aircraft were out of the country at the time the final decision was issued, further delaying

the re-acquisition of the aircraft by the lessor. While repeatedly doing so could result in fines for litigating in bad faith, a lessee under a payment default will likely not have the sums to pay any of the fines, rendering them essentially meaningless in many respects.

Other potential delays can vary depending on the region where the repossession suit is filed and the judge to which it is assigned. In locations such as São Paulo or Rio de Janeiro, Brazil's main economic hubs, the courts have more experience with these types of repossession claims and, accordingly, suits filed in these jurisdictions generally move more rapidly. If the lessee's legal headquarters is in a city outside of these business centres, such as Curitiba or Belo Horizonte, the judge to whom the

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case is assigned is less likely to be familiar with the law governing aircraft repossessions and may take more time before issuing a decision.

Additionally, bankruptcy protection in Brazil places the lessor's interest above those of the majority of other creditors but does subordinate it to employee credits, which opens up potential pitfalls depending on whether an employee union decides to bring a suit. In VarigLog, the union brought a suit to freeze all of VarigLog's assets but it was dismissed. However, in a subsequent bankruptcy, this could pose a more formidable obstacle to a lessor's attempt to recover an aircraft.

Finally, it is worth noting that even with a favourable decision from the courts, a lessor may run into problems exporting the aircraft from Brazil. The importation and registration of aircraft, which may be under a temporary admission regime, is taken care of by the Brazilian lessee. Normally, the same lessee would obtain the necessary export paper work; however, this is often not feasible in repossession cases.

Previously, the state court would, in its order, require the customs authorities to provide the lessor the necessary paperwork to export the aircraft. However, recently some courts have ceased to do so, noting that as state courts they do not have jurisdiction over the federal customs authority. In other cases, the customs authority, when presented with the order, has questioned whether they are required to oblige.

### Implementation of Cape Town – impact on aircraft repossession

Since Brazil formally implemented the Cape Town Convention and Aircraft Protocol, effective November 30 2011, there have not yet been any major lease defaults to put Cape Town into practice. However, even without a test case for Cape Town, there are still some things to be gleaned from it.

First, in the declarations that implement Cape Town, Brazil has elected to permit the use of irrevocable deregistration and export request authorizations (Ideras). These potentially mitigate the difficulty of obtaining the necessary export paperwork.



**New rules should mean repossessions like Varig Logistica's should be easier in future.**

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The Brazilian Aeronautical Registry has communicated that it will comply with Ideras within five days, although there is no practical evidence to indicate whether this in fact will occur. Overall, even with some initial delays in implementation, the expectation is that Cape Town will substantially speed up the repossession process.

The one issue that may inhibit a smooth transition is the conflict between Brazil's current bankruptcy law and the provisions it adopted under Cape Town. As mentioned above, Brazil's current bankruptcy provisions do not provide a stay from repossession but rather require that the lessee continue to abide by the lease obligations. In adopting Cape Town, Brazil adopted Alternative A of Article XI, imposing a 30-day stay period. The conflict between the two provisions might lead to initial delays as the Brazilian courts determine which law applies to the transaction.

### Conclusion

The enforcement climate in Brazil for aircraft lessors has improved since the Varig insolvency. The adoption of the Cape Town Convention in Brazil should give aircraft lessors greater certainty as to the ability to repossess from a defaulting airline. Further lessee defaults will be the test. ▲