

## ANALYSIS OF IBC IN AVIATION INDUSTRY IN INDIA

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### ABSTRACT

*Go Airlines (India) Ltd., a subsidiary of Go Air, filed for insolvency on May 10, 2023, despite the lessors' strong objections. The Special Bench of the NCLT in New Delhi accepted the application, despite the lessors' strongest objections. The lessors appealed to the Appellate Tribunal, which rejected their claims of malicious intent. The Delhi High Court upheld the order, partially providing relief to the lessors on aircraft maintenance. However, the law regarding insolvency in the aviation industry is not clear and needs more attention. The Cape Town Convention (CTC) makes India a preferred jurisdiction for aircraft leasing, allowing the lessor to exercise their rights to leased aircraft in case of default. This raises questions about the legal stand on suspending the lessor's right during the moratorium period in the insolvency settlement. The Aircraft Rules, 1937, post-CTC, were amended to allow the Civil Aviation Ministry to make changes in accordance with the CT Convention and Protocol, enabling aircraft deregistration and export. The Ministry also advocated for the Cape Town Convention Bill to resolve contradictions between legislation and the CT Convention and Protocol. Despite being proposed in 2018, the bill has not been passed. Discussion between policymakers and lawmakers is crucial for addressing aviation sector challenges.*

**Keywords:** *Capetown Convention, Go First, Indian Bankruptcy Code, Lessor and NCLT.*

## 1. INTRODUCTION

On May 10, 2023, the Special Bench of the NCLT in New Delhi accepted the insolvency application of Go Airlines (India) Ltd., also known as Go Air. The insolvency application was moved to safeguard the financial interests of the lessors, viz., aircraft lessors at Rs. 2660 crore and suppliers at Rs. 1202 crore, aggregating the total obligation of Rs. 11.03 crore of Go Air. The NCLT accepted the aviation company's application despite the lessor's strongest objection against it. Aggrieved by the decision of the Ld. NCLT, the lessors preferred an appeal before the Appellate Tribunal to quash the NCLT's order. The Ld. NCLAT, in its speaking order, rejected the appeal of the lessors, contending before the Hon. Tribunal that the aviation company has applied for insolvency with a malicious intention. In further appeal before the Hon. Delhi High Court preferred by the lessors against the appellate order, the Hon. Delhi High Court upheld the order of the NCLAT, partially giving relief to the lessors on one of their issues amongst many with respect to the maintenance of the aircraft periodically to keep the aircraft in operational condition. However, the law with respect to insolvency in the aviation industry is not vocal, and it requires more to be done to appreciate the Cape Town Convention (CTC) to make India a preferred jurisdiction for aircraft leasing. As laid down in the CTC, the lessor can very well exercise its rights to the leased aircraft in the event of the lessee's default. In the backdrop of the above explanation, now the question arises and clarification is sought on the legal stand on suspension of the lessor's right during the moratorium period in the insolvency settlement, if India is already a contracting party to the Convention.

## 2. KEY ISSUES IN AIRLINE INSOLVENCY

Problems that contribute to resolving insolvency in the aviation industry range from operational difficulties to financial and asset preservation<sup>1</sup>.

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<sup>1</sup> Akshaya Kamalnath, Hitoishi Sarkar, *Airline Insolvencies*, SSRN ELEC. J. (2020)

## 2.1 Aircraft Financing

As we are aware, aircraft are a primary and essential asset in the aviation industry. However, the Aviation Company needs to own a fleet of aircraft for its survival. Aviation companies with limited resources will either bridge the working capital requirement for the operational needs of financial institutions or lease aircraft from lessors or manufacturers<sup>2</sup>. When aviation companies enter into agreements with financial institutions to cater to their financial requirements and/or with lessors or manufacturers to lease aircraft, airlines tend to give heavy guarantees to these business allies, which increases the burden on the aviation companies with limited resources. It is very pertinent to note that the passing of the aircraft to the airlines on completion or termination of the lease depends upon the terms and conditions of the financial lease agreement entered into by and between the parties to the agreement. In the event of the default of the aviation company, the execution of the transfer clause of the agreement, whether to take over the aircraft from the aviation company or not, depends upon the discretion of the lessor. Under a given situation, if the lessor takes over the aircraft hitherto in operation with the lessee, it will impair the lessor's contractual rights, wherein the question of the application of IBC remains unanswered.

## 2.2 Legal pre-requisites for operating airlines.

The aviation industry requires a definite set of skills, training, rules, regulations, and other mandatory requirements for operational airlines to function in the industry. To illustrate, Aircraft Rules requires an airline to obtain an airline operator certificate that complies with the Aircraft Rules. When the permission to operate the airline is forfeited, the DGCA, exercising its sole discretion, may cancel the requisite certificate to operate the airline. Adding a little further, the appointment of an Accountable Manager (AM) is mandatory for the airline company to take care of its financial rights and obligations. During insolvency proceedings, the company ought to appoint a Resolution Professional (RP), who enters into the shoes of the AM and ensures that the rules and duties laid down by the DGCA are strictly followed and compliances are made adhering to the byelaws. Simultaneously, the RP also has to remain in loop with the company's

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<sup>2</sup> Gregory P. Ripple, *Special Protection in the Air[Line Industry]: The Historical Development of Section 1110 of the Bankruptcy Code*, 78 NOTRE DAME L. REV. (2002)

senior management, ensuring that the business of the company is not adversely affected or disturbed during the insolvency proceedings.

### **2.3 Cross-Border Implications**

Because of the nature of an airline's business, its assets may be located in multiple jurisdictions. In this circumstance, bankruptcy proceedings may be initiated in multiple jurisdictions. Such was the situation with Jet Airways' bankruptcy. It will be easier to identify how to handle these concerns if the relevant nations have a regulatory framework for dealing with cross-border insolvency. This will, however, be dependent on the reciprocal connection between these jurisdictions. In the absence of a cross-border insolvency regulatory framework in both jurisdictions, the procedure is highly reliant on voluntary collaboration between PRs, regulators, and judicial forums in those jurisdictions. Things become more problematic when the airline's plane is involved. Not only will the company's operations suffer in this circumstance, but creditors in the jurisdiction where the aircraft is immobilised are likely to profit from the sale or auction of the proceeds from that jurisdiction while the successor remains bankrupt.

### **2.4 Time-sensitive necessities**

It is no secret that the value and goodwill of the airline are mitigated if the airline fails to maintain its time discipline in flying schedules and maintains its aircraft for the customers' safety and security. It is no secret that pilots with technical expertise in flying aircraft are obviously in high demand in the industry. Thus, delay in passing the insolvency resolution results in the migration of the pilots owing to the hunt by competing airlines in the industry. Therefore, the management of the airlines ought to take care of these two critical components to survive in the aviation business.

## **3. THE CAPETOWN CONVENTION**

Given that cross-border leasing includes the interplay of many different jurisdictions, conventions like UNIDROIT advocate for the adoption of fundamental rules to protect the lessor's interests in the event of a transaction. One of these conventions is the UNIDROIT Convention on Cross-Border Leasing.

In 2001, the Cape Town Convention (CTC)<sup>3</sup> was signed by a number of certifying parties for aircraft leasing. Payment terms are included in the CTC and the Aircraft Equipment Protocol. These clauses are intended to provide lessors with clarity and protection in the event of a debtor's insolvency. Here are a few crucial points:

- Recognition of bankruptcy proceedings: The Convention recognises insolvent parties' right to control and manage aviation objects under current bankruptcy law, like waiting periods, remedies, etc.
- The Convention specifies a 60-day waiting period during which lessors cannot exercise their claim to delist or repossess the aircraft. This delay gives the lessee or bankrupt administrator the opportunity to decide the fate of the airplane.

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- The Convention specifies two options for lessors rights in bankruptcy proceedings.

- 1) Method A: This option offers lessors a default remedy, allowing them to take ownership of the aircraft subject matter when the waiting period expires if certain conditions are met. Lessors can also request an expedited settlement from the court if the lessee fails to fix the breach or agree to alternative arrangements.
- 2) Method B: An insolvent professional can choose whether to unlease the aircraft or continue to use it and pay under the lease or warranty agreement. Lessors' rights are safeguarded, and they have the right to seek restitution if their obligations are not honoured.

#### **4. THE IMPACT OF GO AIR'S INSOLVENCY ON INDIA'S STANDING IN THE AIRCRAFT LEASING SECTOR**

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<sup>3</sup> Jolyn Ang, *Rationalising the Cape Town Convention & Aircraft Protocol's First-to-Register Rule and Its Exceptions in the Context of Aviation Finance*, 79 J. AIR L. & COMMERCE (2014)

“Go Airlines,” which operates under the name Go First, has a fleet of 54 aircraft, of which the majority are obtained through lease agreements with various aircraft leasing companies. In the insolvency proceedings, the moratorium period substantiates that the lessor’s will be unable to retrieve the aircraft for 6 months, wherein the extension can be given for another 3 months if the situation warrants. It has the potential to have far-reaching consequences for the entire aviation industry, especially considering the Indian government's efforts to encourage aircraft leasing in the country. This decision is likely to stymie progress in this area, resulting in some lessor’s connected with other suffering carriers (like Spice Jet) having been reported to have made an attempt to deregister their aircraft. This demonstrates international lenders' growing scepticism about the Indian market. In fact, this is not the first time that multinational leasing companies have encountered difficulties in collecting leased aircraft from Indian Airlines. Lessors have even suffered with other Indian airlines, viz., Jet Airways and Kingfisher Airlines. It is also alleged that the Aviation Working Group, a UK-based agency that supervises aircraft leasing and financing legislation for manufacturers, has given India a poor outlook, which is likely to affect overseas lessors trust and confidence in the Indian aviation industry. Overseas Lessor’s deteriorated trust and confidence in the Indian aviation industry may result in enforcing strict terms and conditions for leasing aircraft. This might make it more difficult for Indian airlines to operate economically in the given situation, stifling the company’s growth and leading to a possible rise in operation costs and a spike in tariffs, which affects passengers' potential to travel by air.

## 5. HOW IS THIS ISSUE DEALT BY OTHER NATIONS?

The insolvency of airlines is not a subject concerning only India; it is a subject of global concern. To address this menacing problem, some countries have enacted specific rules and regulations in the statute governing aircraft leasing, whereas others have adhered to the standard bankruptcy laws. To quote a few, the United States Bankruptcy Code's Chapter 11 includes regulations pertaining to ships and aircraft<sup>4</sup> automatically sojourning lessors from cancelling the lease or

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<sup>4</sup> Ralf Jörg Vogler and Ulrich Stepler, *Airline Insolvency Protection – a justified form of relief or the next level of “consumerism”*, 37 AIR & SPACE L. (2012)

retrieving the aircraft or ships. It is provided in the statute that enforcement of suspension is legally void, and the lessor will have to face penalties and/or damages for violations of the law, and, thereby, the lessees will continue to own and manage the business under judicial supervision. To safeguard the financial interests of the lessors, Section 1110 provides a window for the lessors to seek redress in case the lessees fail to treat their defaults within 60 days. However, Section 1110 provides a restriction that the lessor will not have any rights or remedies and cannot claim possession of leased aircraft or vessels during the moratorium period of insolvency.

It has been made amply clear that the above-explained protection provided by Section 1110 of the United States Code is restricted to insolvency procedures under US law and is not applicable to non-US entities. The USA did not ratify Cape Town for want of acceptance of "Option A" as specified in Article XI of the Aircraft Protocol since the US code's restrictions are stronger than what the CTC had anticipated.

The Aircraft Equipment Protocol and the CTC were both ratified by the UK in 2015, resulting in certain enactments into UK law<sup>5</sup>, i.e., the creation of a legal repatriation protection scheme to safeguard any passenger whose flight commences in the United Kingdom, as well as holders of a return ticket on an airline who become insolvent while already overseas, improving the availability of rescue tariffs and passenger claim ability, and introducing a broader set of management tools that will include:

- 1) Annual certification to check the company's financial position,
- 2) Require the board of directors of a UK airline to notify the Civil Aviation Authority of any major adverse change in the airline's financial position;<sup>6</sup> and enhance current refund protection by raising consumer knowledge and instituting refund protection; reducing unneeded duplicate protection; and assisting travellers in filing claims swiftly and easily.

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<sup>5</sup> *The UK Corporate Insolvency and Governance Act 2020: A move to a more debtor-friendly restructuring regime?*, NORTON ROSE FULBRIGHT (Dec. 2, 2023, 6:00 PM), <https://www.nortonrosefulbright.com/en/knowledge/publications/5ac21a15/the-uk-corporate-insolvency-and-governance-%20act-2020>

<sup>6</sup> Prof. (Dr.) V. Balakista Reddy, *Aviation Corporate Laws*, CENTRE FOR AEROSPACE & DEFENCE LAWS (Dec. 1, 2023, 5:00 PM), [nalsarpro.org/Portals/23/Aviation%20corporate%20laws-2020.pdf](https://nalsarpro.org/Portals/23/Aviation%20corporate%20laws-2020.pdf)

The bankruptcy of Ocean Air Line, formerly known as Avianca Brazil, is a glaring case that highlights the distinction between CTC and local bankruptcy laws. Avianca Brazil declared bankruptcy in December 2018, resulting in a protracted court struggle over aircraft repossession, wherein if the lessee neglects to fulfil his CTC duty, a registered lessor can claim repossession of his leased aircraft. However, the bankruptcy legislation in Brazil protects the lessor's interest, providing in the statute that the lessee cannot declare bankruptcy during the moratorium period. In the Avianca Brazil case, lessors, viz., GECAS and Avolon, requested to regain possession of their aircraft seeking shelter under CTC, ignoring the Brazilian bankruptcy laws. The Brazilian court has done away with the CTC, categorically forbidding the lessors to take control of the aircraft during the moratorium period.

## **6. FUTURE COURSE OF ACTION**

Despite being a signatory to the CTC, India's existing Insolvency and Bankruptcy Code (IBC) contradicts the terms of the CTC. It is high time that India acknowledge the CTC as having legitimate status. However, the matter was taken up in 2018 by the Department of Civil Aviation, which sought an opinion on the Cape Town Convention Bill. The bill is likely to be discussed in the House of Parliament in the coming monsoon session. Passing the CTC bill is necessary in the interest of the nation and to restore the international aviation community's trust in the Indian aviation industry. Till then, the judiciary must treat these insolvency cases more rationally. By virtue of provisions in the CTC bill, the assets will be transferred to the lessor at the discretion of NCLT, and the lessee may utilise them to restore and stabilise its operations. Presently, the damage that is incurred by the lessors can be reduced if NCLT insists on the lessee keeping the property with revised payment terms. Needless to say, the CTC law has taken a more pragmatic approach to protecting the interests of both parties, viz., the lessor and the lessee. This enables the lessee to continue revenue generation from the leased fleets, providing financial security and prospects of a return on investment to the lessor as well.

## **7. CONCLUSION**



The amendment was made in the Aircraft Rules, 1937, post-CTC, empowering the Civil Aviation Ministry to make suitable changes in conformity with the CT Convention and Protocol, enabling aircraft deregistration and export in accordance with the CT Convention and Protocol. Additionally, the Ministry of Civil Aviation advocated for the passage of the Cape Town Convention Bill to do away with the contradictions that persisted between present legislation and the CT Convention and Protocol. Despite being proposed in 2018, the bill has yet to be passed. Discussion and deliberation between the policymakers and the lawmakers with respect to the insolvency of an airline will be of great help in dealing with the challenges posed in the aviation sector. However, the present IBC law has provided that the provisions of the IBC will prevail in cases where they clash with any other legislation.

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