

CLIENT UPDATE

SECOND CIRCUIT AFFIRMS BANKRUPTCY COURT RULING AUTHORIZING AMERICAN AIRLINES TO REPAY \$1.3 BILLION DEBT WITHOUT MAKE-WHOLE

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On September 12, 2013, the United States Court of Appeals for the Second Circuit held that American Airlines, Inc. (“American”) had the right to repay \$1.3 billion in debt (“Notes”) without payment of a make-whole amount.¹ The Second Circuit dismissed all of the arguments raised by U.S. Bank Trust National Association (“U.S. Bank”), the trustee for the Noteholders, on appeal, and affirmed the decision of Judge Sean Lane of the Bankruptcy Court for the Southern District of New York in all respects.² The Second Circuit’s ruling is grounded in a straightforward contractual interpretation of the specific indentures at issue and reaffirms the importance of properly documenting the parties’ intentions at the time of drafting.³

BACKGROUND

On November 29, 2011, AMR Corp. and a number of its subsidiaries, including American, filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code. At the time of the filing, American was party to three separate aircraft financing transactions, each of which was secured by a different pool of aircraft.

¹ *U.S. Bank Trust National Association, et al. v. American Airlines, Inc., et al. (In re AMR Corp.)*, Nos. 13-1204-cv, 13-1207-cv, 13-1208-cv (2d Cir. Sept. 12, 2013).

² Our Client Update dated January 29, 2013, “Bankruptcy Court Authorizes American Airlines to Repay \$1.3 Billion Debt Without Make-Whole,” described Judge Lane’s ruling.

³ Debevoise & Plimpton LLP is counsel to American Airlines, Inc. in this matter.

On October 9, 2012, American filed a motion seeking the Bankruptcy Court's authorization (i) to obtain new financing in an amount of up to \$1.5 billion, secured by the aircraft that served as collateral for the prior financings, and (ii) to use cash on hand, including the proceeds of the new financing, to repay the outstanding principal and interest owed under those financings, without the payment of any make-whole. A make-whole is an amount that may be due under the terms of a debt agreement if debt is paid before it matures. The Bankruptcy Court granted American's motion in its entirety, ruling that American was entitled to repay the prior financings without payment of a make-whole and was authorized to enter into the new financing.

U.S. Bank appealed, and the Bankruptcy Court certified the appeals for direct appeal to the Second Circuit, a procedure by which the parties may bypass appeal to the district court. The Second Circuit authorized the direct appeals on April 2, 2013.

THE TERMS OF THE CONTRACT WILL CONTROL

On appeal, U.S. Bank advanced the same arguments that it had raised in the Bankruptcy Court; primarily that American's repayment of the Notes was a voluntary prepayment under the terms of the indentures governing the Notes, which required payment of a make-whole. In opposition, American pointed to language in the indentures that provided for the automatic acceleration of the Notes upon a bankruptcy filing and noted that under the terms of the indentures, in the event of an acceleration, "the unpaid principal of the Notes then outstanding, together with accrued but unpaid interest thereon and all other amounts due thereunder (but for the avoidance of doubt, without Make-Whole Amount)" would become immediately due and owing.

Based on this language, the Second Circuit observed that under the terms of the indentures, American's bankruptcy filing constituted an event of default that automatically accelerated the Notes, making them immediately due and payable. The Second Circuit further noted that the indentures explicitly stated that the make-whole would not be due in the event of such an automatic acceleration. In light of these provisions, the Second Circuit agreed with the Bankruptcy Court that American's repayment of the Notes after such an automatic acceleration was not a voluntary redemption, but rather a post-maturity date repayment, for which no make-whole was due.

The Second Circuit rejected U.S. Bank's argument that under New York law, acceleration is a remedy that must be affirmatively invoked by lenders. Specifically, the Court stated that provisions providing for automatic acceleration upon the filing of a voluntary bankruptcy petition are common and acceptable under New York law. The Court further reasoned

that, contrary to U.S. Bank's argument, the automatic acceleration provision in the indentures benefited both the Noteholders (by accelerating outstanding debt in the event of American's bankruptcy) and American (by excluding any make-whole from American's obligation to pay the Notes in full after a bankruptcy filing).

The Second Circuit further held that the Bankruptcy Court did not abuse its discretion in ruling that any attempt to waive the event of default or to decelerate the Notes would be an attempt to modify American's contractual rights under the indentures in violation of the automatic stay. Although the terms of the indentures permitted U.S. Bank to waive an event of default or rescind an acceleration, under the clear terms of the indentures, once American filed its bankruptcy petition, it had the contractual right to repay the accelerated Notes without a make-whole. Thus, any attempt to modify American's contractual rights was an attempt to get more property from the debtor and the estate, barred by the automatic stay.

SECTION 1110 DOES NOT MODIFY CONTRACTUAL RIGHTS

The Court also addressed U.S. Bank's arguments regarding Section 1110(a) of the Bankruptcy Code. Section 1110 of the Bankruptcy Code applies to leased or financed aircraft and related equipment. Section 1110 states that the automatic stay does not apply to such transactions and that lenders and lessors may enforce their contractual remedies against the debtor, unless, before the date that is 60 days after the commencement of the case, the debtor cures outstanding defaults and agrees to continue to perform its obligations under the applicable lease or loan documents. U.S. Bank argued that American's election to perform its obligations under the Notes decelerated the Notes, such that the Notes were no longer due and payable (and thus, a make-whole would be due if American repaid the Notes). The Court rejected this argument, noting that Section 1110(a)(2) does not modify the parties' contractual relationship but merely provides a mechanism by which the debtor can take advantage of the automatic stay.

U.S. Bank next argued that, if the Notes were accelerated by the bankruptcy filing, American's election to perform its obligations under the Notes pursuant to Section 1110 required American to repay the Notes in full, immediately. The Court rejected this argument because Section 1110 explicitly provides that a debtor need not cure any default relating to the commencement of a bankruptcy case. The accelerated debt was due only as a result of American's bankruptcy filing, and thus did not need to be cured.

IMPLICATIONS

Like the Bankruptcy Court's earlier ruling, the Second Circuit's decision makes clear that courts will enforce the clear and unambiguous terms of contracts. If the parties to a financing wish to receive a make-whole upon the repayment of accelerated debt, they must draft their agreements to explicitly provide for such payment.

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Please do not hesitate to contact us with any questions.

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