

## Aviation - USA

TIA victory for owner participants in Second Circuit *Delta* ruling

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### Introduction

On June 22 2010 the US Court of Appeals for the Second Circuit handed down a decision which has important implications for the holders of tax indemnification agreement (TIA) claims arising from aircraft leveraged leasing transactions. The court allowed the claims of certain owner participant creditors in the Delta Air Lines, Inc bankruptcy case<sup>(1)</sup> (for further background on other TIAs please see "[Applicability of tax indemnification agreements after Chapter 11 reorganization](#)") under tax indemnification agreements (TIAs) reversing the rejection of such claims by the US Bankruptcy Court for the Southern District of New York, as affirmed on appeal to the US District Court for the Southern District of New York.

### Facts

The TIA claims of owner participants in the Delta bankruptcy case had been rejected by the bankruptcy and district courts because of certain exclusions to recovery set forth in the TIA. One such exclusion prohibited the owner participant from recovery under the TIA when the lessee airline 'pays' an amount determined by reference to stipulated loss value. In the Second Circuit appeal, the court reviewed three TIAs relating to different owner participants with variations of the language used to describe the exclusion.

In stark contrast to the earlier decision, the court held, with respect to all three variations of the exclusion, that only payment by the lessee debtor of the whole stipulated loss value amount, resulting in recovery by the owner participant through the waterfall, should trigger the exclusion. Therefore, since Delta 'paid' to the security trustee for the benefit of the indenture trustee an amount significantly less than stipulated loss value in connection with the lease rejection damages, and the owner participant did not recover any such proceeds from the waterfall, Delta was still liable to the owner participant under the TIA. The court recognized that the TIA was designed to remedy the tax loss that an owner participant suffers when a lessee defaults, and that the exclusion served only to prevent the owner participant from double recovery. However, in the context of bankruptcy there is no double recovery by the owner participant, since the amount of the lease rejection damages was less than stipulated loss value, and none of those proceeds were distributed to the owner participant.

Furthermore, the court acknowledged that the lessee airline had entered into the TIA, a separate agreement with the owner participant, giving the owner participant a right to direct recovery from the lessee airline. The court held that when Delta agreed to pay the security trustee lease rejection damages in a certain amount, Delta should have considered its other obligations to the owner participants; and if its payment to the security trustee (when added to amounts it was obliged to pay the owner participant), resulted in 'overpayment' by Delta, it was Delta's own fault because of the separate contractual agreements running to the security trustee and the owner participant. To the extent that Delta was being required to pay duplicative amounts, the court held that "the proper remedy was disallowance of the claims of the [security trustee] to the extent [that such amounts] were predicated on the owner participant's TIA entitlements".

### Comment

The Second Circuit's decision is a victory for owner participants. The court took a big-picture view of the situation and understood the importance of recovery by owner

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participants under TIAs as a basic part of the leveraged lease structure. For owner participants pursuing TIA claims in current lessee airline bankruptcies, this decision gives owner participants greater leverage in settling TIA claims, as lessee airlines will be less motivated to litigate these claims with this precedent against them. Furthermore, while this may be of assistance to owner participants, it may have a dampening effect on the amount for which indenture trustees can settle lease rejection claims.

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#### Endnotes

(1) In re *Delta Air Lines, Inc*, No 08-5002-bk, F3d, 2010 WL 2490021 (2nd Cir June 22 2010).

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