

By JASON W. BANK

Navigating Financial Turbulence

Preserving Air Carrier Certificates in Chapter 11

The aviation industry has endured a significant amount of financial distress since the Sept. 11, 2001, terrorist attacks. In recent years, regional air carriers, a once-profitable segment of the airline industry, have experienced a bumpy ride due to a decreased demand in military spending, wildly fluctuating fuel costs and an overall weakness in the global economic markets. Several regional airlines have recently filed for bankruptcy to pursue mergers, sales or other restructurings of their operations.¹

In order to acquire certificates from federal agencies authorizing them to fly, airlines are subject to extensive regulations based on the inherent safety concerns that are associated with air travel, and air carriers that are filing for chapter 11 face enhanced scrutiny. This article discusses the regulations governing air carrier operating certificates and addresses the challenges that are encountered by financially troubled regional air carriers seeking to preserve or transfer their certificates through the chapter 11 process.



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Overview: DOT and FAA Regulations

National aviation law is regulated by the U.S. Department of Transportation (DOT) and the Federal Aviation Administration (FAA) pursuant to title 49 of the U.S. Code and title 14 of the Code of Federal Regulations. These sections regulate aviation safety and commercial airline operations, including the issuance, suspension and revocation of airline operating licenses and consumer protection matters.

In order to provide air-transportation service as a common carrier, an air carrier must first obtain the following separate authorizations: (1) *economic authority* from the DOT in the form of a certificate for interstate and/or foreign passenger and/or cargo authority issued under 49 U.S.C. § 41102 or an exemption from the certificate requirement, and (2) *safety authority* in the form of an Air Carrier Certificate and Operations Specifications from the FAA.²

DOT Certificate of Public Convenience and Necessity

In order to obtain economic authority, an air carrier must obtain one of the following types of licenses: (1) a certificate of public convenience and

necessity (CPCN) for scheduled or charter operations carrying persons, property and mail (the “combination certificate”); (2) a CPCN for scheduled or charter operations carrying property and mail only (the “all-cargo certificate”); (3) a commuter air carrier authority; (4) an air taxi authority conferred by blanket exemption; or (5) an individual exemption authority.³ The carrier must demonstrate to the DOT that it satisfies the statutory criteria for the fitness, willingness and ability to comply with all pertinent laws and regulations, or meets the applicable criteria for exemption.⁴ Commuter air carriers and air taxis are limited to aircraft that are originally designed for 60 or fewer passengers.⁵ The criteria for commonly issued CPCNs includes the following:

- (1) an examination of the managerial competence of the applicant’s key personnel to determine whether they have sufficient business and aviation experience to operate an airline in the manner proposed;
- (2) a review of an applicant’s financial plans to determine whether the applicant has a reasonable understanding of the costs of commencing operations and a plan for raising the necessary capital to commence operations (the applicant must submit third-party verification that it has acquired the necessary capital to conduct its operations); and
- (3) an examination of whether the owners and managers have a history of safety violations or consumer fraud activities that would pose a risk to the traveling public, or whether other factors indicate that the applicant or its key personnel are unlikely to comply with government laws, rules and directives.⁶

The applicant must also establish that he/she is a U.S. citizen.⁷

Air carriers who obtain certificates have continuing obligations to provide updated “fitness” information to the DOT as set forth in 14 C.F.R. § 204.3. Once a company has initially been found to be fit, it becomes subject to the requirements of 49 U.S.C. § 41110(e), which provides that the company must remain fit in order to continue to hold its authority to provide air transportation services.

3 See Economic Authority: DOT Certificates and Exemptions, available at www.faa.gov/licenses_certificates/airline_certification/media/DOTEATHY.doc (last visited May 7, 2014).

4 49 U.S.C. § 41102.

5 See *supra* n.3.

6 See DOT, “U.S. Air Carriers, Overview,” available at www.dot.gov/policy/aviation-policy/licensing/US-carriers (last visited May 7, 2014); see also ATX Inc. Fitness Investigation, D.O.T. Order 94-4-8, 1994 WL 113077 (D.O.T. 1994).

7 *Id.*; 49 U.S.C. § 40102(a)(15).

1 Evergreen International Airlines, Pinnacle Airlines, Mesaba, Comair (a wholly owned subsidiary of Delta), Mesa Air Group, American Eagle (a wholly owned regional carrier affiliate of American Airlines), Ryan International, Southern Air Holdings and Freedom Air are among the regional air carriers that have filed for bankruptcy in recent years.

2 See DOT, www.dot.gov/policy/aviation-policy/licensing/US-carriers (last visited May 7, 2014).

The DOT will assess significant changes that may affect an air carrier's continuing fitness since its initial DOT authorization and last fitness review. If there are substantial changes anticipated after the commencement of the air service, such as a change in ownership, a major change in the management team, a major expansion in operations (e.g., going from a small to large aircraft), or a filing for chapter 11 protection, the Air Carrier Fitness Division must be promptly notified so that it can determine whether the company will remain fit to operate.

FAA Air Carrier Operating Certificate

An air carrier is also required to obtain safety authority (commonly referred to as a Part 121 or Part 135 Certificate and Operations Specifications) from the FAA by applying to and interacting with the appropriate FAA flight standards district office based on the air carrier's geographical location.⁸ The application process is complex, time-consuming and costly.

The FAA evaluates an applicant's qualifications, including whether it has the experience, skill, capability and resources to operate an air carrier with the highest degree of safety.⁹ The FAA will examine the pilots' skills and training, as well as the operating procedures, maintenance and airworthiness of the aircrafts.¹⁰ When the FAA is satisfied that an airline organization is capable of operating safely, it will issue the Air Carrier Certificate and Operations Specifications.¹¹

Transferring Operating Certificates

A carrier may not transfer its CPCN without the prior approval of the DOT and findings by the DOT that the transfer is consistent with the public interest.¹² The DOT must determine that the transferee is fit to conduct the proposed operations under the same aforementioned three-part test that the carrier had to undergo in order to initially obtain the certificate.¹³ The DOT must also analyze the effects of the transfer on the (1) viability of each carrier involved in the transfer, (2) competition in the domestic airline industry and (3) trade position of the U.S. in the international air transportation market.¹⁴

DOT guidance provides that applications for the transfer of certificate authority should be jointly filed by the transferor and the transferee with the DOT's Dockets Section at least three months in advance of the proposed effective date of the transfer. In extenuating circumstances, some of which have involved carriers in chapter 11, the DOT has expedited this process.¹⁵

Each FAA-issued air carrier operating certificate on its face notifies its holder and any entity that seeks to acquire the certificate holder that the certificate may not be trans-

ferred.¹⁶ Failure to obtain timely approval for the transfer of operating certificates might ground an air carrier's fleet and upset a potential merger or sale. In 2010, Pinnacle Airlines purchased Mesaba Airlines, a former regional shuttle partner of Northwest Airlines and Delta Air Lines. Pinnacle planned to move Mesaba's jet operations under Pinnacle's operating certificate, but due to various issues associated with the merger, FAA approval for the transfer was delayed until January 2012. The delay resulted in significant additional costs that precipitated Pinnacle Airlines Corp.'s chapter 11 filing in April 2012.¹⁷

Preserving Operating Certificates in Chapter 11 and § 363 Sales

Section 363 sales have dominated the chapter 11 landscape over the past decade, enabling debtors to sell assets free and clear of all liens, claims or encumbrances, and permitting buyers to acquire business assets and maintain operations without any interruption. It is widely accepted that the § 363 sale process is the most efficient means to achieve an orderly and relatively speedy transfer of value when compared to the lengthier, more involved chapter 11 plan process.

Section 363 sales typically share a common goal with the aviation industry: the need for speed. Creditor pressures, a lack of funding for ongoing operations or the "melting ice cube" phenomenon often require that expedited sale procedures be used to preserve value and close quickly on a sale. In air carrier restructurings, the preservation of the operating certificates and the ability to transfer the certificates are critical factors in determining whether a § 363 going-concern sale might be achieved. Where the certificates cannot be preserved, a debtor's fleet will likely be grounded and the company will face liquidation.

An expedited § 363 sale process presents a special challenge for air carriers. The operating certificates are typically held in the name of the bankrupt debtor and intertwined with the stock of the debtor. To consummate a potential transfer of assets of an air carrier business to a buyer without an existing certificate,¹⁸ the buyer will be required to satisfy the various tests in order to obtain operating certificates from the DOT and FAA. This means that a potential buyer will have to commence the approval process from the beginning as if it were a new carrier, which may take up to three months.

Debtors should be wary of seeking expedited sale procedures that do not provide sufficient time for potential buyers to complete the DOT/FAA approval process. The U.S., on behalf of the DOT and FAA, has filed objections to motions to sell assets or approve transactions in bankruptcy proceedings where debtors sought to sell or transfer operating certificates without the necessary approval from these agencies.¹⁹ In addition, these agencies have denied transfers of certificates where their statutory requirements were not met.

8 See *supra* n.6.

9 49 U.S.C. §§ 44705, 44702(b)(1); 14 C.F.R. § 119.39; U.S.'s Objection and Reservation of Rights at 2-3, *In re ATA Airlines Inc.*, No. 08-03675 (Bankr. S.D. Ind. Oct. 3, 2008), ECF No. 862.

10 See 49 U.S.C. §§ 44702, 44705.

11 49 U.S.C. § 44702(a)(4).

12 49 U.S.C. § 41105.

13 49 U.S.C. § 41102.

14 See "How to Become a Certificated Air Carrier," Air Carrier Fitness Division, Office of the Secretary, U.S. Department of Transportation (September 2012).

15 For example, the DOT has expedited the approval process in cases where a smaller community or region might be impacted by an airline's closure and leave the community without reasonable access to air travel.

16 U.S.'s Objection and Reservation of Rights at 2-3, *In re ATA Airlines Inc.*, No. 08-03675 (Bankr. S.D. Ind. Oct. 3, 2008), ECF No. 862.

17 Declaration of John Spanjers, Pursuant to Local Bankr. R. 1007-2 at 7-8, *In re Pinnacle Airlines Corp.*, No. 12-11343 (Bankr. S.D.N.Y. April 1, 2012), ECF No. 3.

18 A buyer that seeks to purchase assets in connection with its existing certificate will still face scrutiny under the continuing-fitness criteria.

19 U.S.'s Objection and Reservation of Rights, *In re ATA Airlines Inc.*, No. 08-03675 (Bankr. S.D. Ind. Oct. 3, 2008), ECF No. 862.; U.S.'s Response to Statements Made by Debtor in Motion to Approve Settlement, *In re Ozark Air Lines Inc., d/b/a Great Plains Airlines*, No. 04-10361 (Bankr. D. Okla. Oct. 13, 2004), ECF No. 260.

continued on page 94

Navigating Financial Turbulence: Air Carrier Certificates in Chapter 11

from page 33

In *Ryan International Airlines*, Ryan International Airlines (“Ryan”) filed for chapter 11 on March 6, 2012.²⁰ On Jan. 11, 2013, Ryan ceased operations. On Jan. 16, 2013, the DOT advised Ryan that its operating authority was suspended and that it could not resume air transportation operations until the DOT had confirmed its fitness to resume operations. As a result, the operating certificate became dormant. In February 2013, AJet Holdings LLC purchased certain assets of Ryan, including its common stock. Subsequently, an involuntary bankruptcy petition was filed against AJet Holdings.²¹ The AJet Holdings bankruptcy trustee filed a motion to sell the estate’s interest in common stock and certain assets of Ryan International Airlines Inc.²² and filed a notice of intent to resume operations with the DOT so that the buyer could use the Ryan certificate.²³ The AJet Holdings trustee sought authority to sell the Ryan assets to American West Jets LLC.

The DOT determined that it had insufficient evidence that Ryan had maintained the necessary personnel, ownership and financial results to confirm the fitness of the air carrier. As a result, AJet Holdings or any purchaser of the stock or assets of Ryan would not be in a position to recommence operations without a full departmental review to confirm the air carrier’s fitness. The DOT would be required to analyze new owner’s fitness based on the same criteria as if it were a new applicant. As a result, the certificate authority that was held by Ryan was revoked, without prejudice to any future applications that the new owners may file for a new air carrier authority.²⁴

The disposition of the Ryan certificate and the active role of the DOT and FAA in bankruptcy proceedings demonstrates that the difficult issues that a bankruptcy estate seeking to sell assets faces in maximizing value from air carrier certificates. Unless a potential buyer has its own FAA and DOT approved certifications, the purchaser might be required to start the application process from scratch in order to obtain the required certificates to fly a commercial airline. Such delays may not be conducive to the traditional § 363 sale process and the substantial costs associated with an ongoing chapter 11 proceeding.

As a result, conventional wisdom, which provides that § 363 sales are faster and more efficient when compared to traditional plans, might not apply in air carrier bankruptcies. Where the stock in a debtor airline is tied to the operating certificates, it may be more efficient to proceed with a plan that keeps the stock and certificates intact. Furthermore, the plan process, and in particular, § 1123(a)(5), provides more tools for an air carrier debtor to restructure its indebtedness. In the case of air carrier restructurings, when comparing a plan confirmation process to a § 363 sale process, the tortoise might be preferable to the hare.

Conclusion

The inherent pitfalls surrounding the preservation and potential transfer of § 363 sales means that a debtor must be aware of all of the federal regulations surrounding air carrier certificates when filing for chapter 11. Lenders or creditors that insist on unrealistic time frames in connection with a § 363 sale process may place a debtor and its certificates in a precarious position. A debtor and its creditors should work together in advance of a chapter 11 filing toward a prepackaged plan/bankruptcy process in order to ensure that all DOT and FAA requirements have been addressed. **abi**

²⁰ *In re Ryan International Airlines Inc.*, No. 12-80802 (Bankr. N.D. Ill. 2012).

²¹ *In re AJet Holdings LLC*, No. 13-18933 (D. Nev. 2013).

²² Motion to Sell Estate’s Interest in Common Stock and Certain Assets of Ryan International Airlines Inc., *In re AJet Holdings LLC*, No. 13-18933 (D. Nev. Feb. 6, 2014), ECF 44.

²³ See Order Denying Waiver from Dormancy, Dismissing Notice to Resume Operations and Revoking Certificate Authority, D.O.T. Order 2014-2-8 (Feb. 11, 2014) (notice of AJet Holdings LLC of intent to resume operations under 14 C.F.R. § 204.7; in matter of revocation of certificate authority issued to Ryan International Airlines Inc. pursuant to provisions of 14 C.F.R. § 204.7).

²⁴ *Id.* American West Jets LLC has filed a petition for review of the DOT’s order.

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