Hearing Date and Time: April 21, 2016, 9:00 a.m. (EST)
Objection Deadline: April 14, 4:00 p.m. (EST)

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	Chapter 11
REPUBLIC AIRWAYS HOLDINGS INC., *et al.*,	16-10429 (SHL) **(Jointly Administered)**
Debtors.	

OBJECTION OF THE UNITED STATES OF AMERICA TO DEBTORS' MOTION FOR ENTRY OF AN ORDER PURSUANT TO 11 U.S.C. §§ 105, 361, 362(d)(1), 363(b), 364(c)(1), 364(c)(2), 364(c)(3), 364(d), 364(e), 503(b)(1) AND 507(b)AND FED. R. BANKR. P. 4001 and 6004 (I) AUTHORIZING DEBTORS TO OBTAIN POSTPETITION FINANCING, (II) GRANTING LIENS AND PROVIDING SUPERPRIORITY ADMINISTRATIVE EXPENSE STATUS, (III) MODIFYING THE AUTOMATIC STAY AND (IV) GRANTING RELATED RELIEF

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—Of Counsel —

The United States of America (the "United States" or the "Government"), by its attorney Preet Bharara, United States Attorney for the Southern District of New York, respectfully submits this objection to Debtors' Motion For Entry of an Order Pursuant to 11 U.S.C. §§ 105, 361, 362(d)(1), 363(b), 364(c)(1), 364(c)(2), 364(c)(3), 364(d), 364(e), 503(b)(1) and 507(b), and Fed. R. Bankr. P. 4001 and 6004: (I) Authorizing Debtors to Obtain Postpetition Financing, (II) Granting Liens and Providing Superpriority Administrative Expense Status, (III) Modifying the Automatic Say and (IV) Granting Related Relief (Dkt. No. 246) (the "DIP Financing Motion").

The relief sought by the DIP Financing Motion would impermissibly protect Delta Air Lines, Inc. ("Delta")—both as DIP lender and as lessee of certain property of the estate—from liabilities that Delta may have or come to have under applicable non-bankruptcy law, such as the United States Comprehensive Environmental Response, Compensation and Liability Act, 29 U.S.C. §§ 9601 *et seq.* ("CERCLA"). Moreover, the budgeting provisions of the DIP Credit Agreement could be read to limit the Debtors' ability to expend funds on environmental and other matters to the extent required to manage and operate the Debtors' property in compliance with law as required by 28 U.S.C. § 959(b). Because the Bankruptcy Code does not authorize Delta to be protected from the consequences of its status and actions under non-bankruptcy law, and does not authorize DIP financing arrangements to limit the Debtors' compliance with law under § 959(b), the DIP Financing Motion should be denied.

BACKGROUND

1. On February 25, 2016 (the "Commencement Date"), Debtor Republic Airways Holdings Inc. ("RAH"), and certain of its wholly-owned direct and indirect subsidiaries (collectively with RAH, the "Debtors") filed voluntary petitions for relief under Title 11, Chapter 11 of the United States Code (the "Bankruptcy Code"). By Order dated February 29, 2016, the

Debtors' petitions are being jointly administered. The Debtors are presently operating as debtors-in-possession. No trustee or examiner has been appointed.

2. The Debtors filed the DIP Financing Motion on March 24, 2016, and later filed a Notice of Correction related to the DIP Financing Motion on March 27, 2016 (Dkt. No. 255).

3. The DIP Financing Motion seeks the entry of an order, which is attached as Exhibit A to the DIP Financing Motion (the "DIP Financing Order"), authorizing the Debtors, *inter alia*, to: (1) obtain postpetition financing up to the aggregate principal amount of $75 million, pursuant to the terms of a proposed financing agreement between the Debtors and Delta, which was itself filed with notice on April 6, 2016 (Dkt. No. 308) (the "DIP Credit Agreement"); (2) grant first priority liens on certain aircraft and other unencumbered assets of the Debtors; (3) grant a first priority priming lien on fifteen (15) specified individual LaGuardia Airport arrival and departure slots (the "Slots"); (4) grant junior liens on all tangible and intangible property of the Debtors that is subject to valid, perfect and unavoidable liens in existence on the Commencement Date; (5) use proceeds of the financing for certain enumerated purposes; (6) grant superpriority administrative expense claims to Delta, subject to certain carveouts; and (7) modify the automatic stay imposed by section 362 of the Bankruptcy Code to the extent necessary to implement and effectuate the terms of the DIP Credit Agreement and DIP Financing Order.

4. The DIP Credit Agreement itself arguably limits the ability of the Debtors to expend funds other than pursuant to a budget approved by Delta. *See, e.g.*, DIP Credit Agreement § 5.17 (prohibiting use of the term loan proceeds other than pursuant to a budget approved by the lenders, or for payment of the lenders' fees and expenses); *id.* § 6.18(c)

(prohibiting the Debtors from even seeking the Court's authorization to take actions inconsistent with the DIP Credit Agreement).

5. Related agreements between the Debtors and Delta provide for Delta to lease the Slots, which are property of the estate. A parallel motion by the Debtors seeking authorization to assume one lease with Delta and enter into an amended and restated lease agreement with Delta is pending before the Court. (Dkt. No. 244).

6. The DIP Financing Order sought pursuant to the DIP Financing Motion includes a "Limitation of Liability" provision that purports to provide Delta protection from applicable non-bankruptcy law in both its capacities as lender and as lessee:

> *Nothing in this Order, the Agreements or any other documents related to these transactions shall in any way be construed or interpreted to impose or allow the imposition upon the Lender or the Lessee of any liability for any claims arising from the prepetition or postpetition activities of the Debtors in the operation of their business, or in connection with their restructuring efforts.* So long as the Lender and the Lessee comply with their obligations under the Agreements and its obligations, if any, under applicable law (including the Bankruptcy Code), (a) the Lender and the Lessee shall not, in any way or manner, be liable or responsible for (i) the safekeeping of the Collateral, (ii) any loss or damage thereto occurring or arising in any manner or fashion from any cause, (iii) any diminution in the value thereof or (iv) any act or default of any carrier, servicer, bailee, custodian, forwarding agency or other person, and (b) all risk of loss, damage or destruction of the Collateral shall be borne by the Debtors. *The Lender and the Lessee shall not be deemed to be in control of the operations of the Debtors or to be acting as a "responsible person" or "owner or operator" with respect to the operation or management of the Debtors (as such terms, or any similar terms, are used in the United States Comprehensive Environmental Response, Compensation and Liability Act, 29 U.S.C. §§ 9601 et seq. as amended, or any similar federal or state statute).*

See DIP Financing Order ¶ 18 (emphasis added).

7. This Limitation of Liability is made retroactively effective through the DIP Financing Order's language that the order, "shall constitute findings of fact and conclusions of

law and shall take effect and be fully enforceable nunc pro tunc to the Commencement Date immediately upon entry hereof." *Id.* at ¶ 19.

ARGUMENT

I. The DIP Financing Motion Impermissibly Seeks to Protect Delta from Obligations Under Non-Bankruptcy Law

8. The proposed DIP Financing Order would impermissibly protect Delta, as lender, from liability in those circumstances where the law authorizes lender liability for the conduct of the borrower. It also goes beyond that and would protect Delta from liability it might face as a result of having the status of lessee of property. Neither is proper.

9. Although the Bankruptcy Code provides specific incentives for DIP lenders, such incentives do not include protection from potential liability. *See, e.g.*, 11 U.S.C. § 364. Moreover, while section 105(a) of the Bankruptcy Code gives this Court equitable power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title," 11 U.S.C. § 105(a), the Second Circuit has made clear that this Court's equitable powers "must and can only be exercised within the confines of the Bankruptcy Code." *In re Dairy Mart Convenience Stores, Inc.*, 351 F.3d 86, 92 (2d Cir. 2002) (quoting *FDIC v. Colonial Realty Co.*, 966 F.2d 57, 59 (2d Cir. 1992)) (emphasis added). Section 105(a) "does not 'authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity.'" *Id.* (quoting *United States v. Sutton*, 786 F.2d 1305, 1308 (5th Cir. 1986)).

10. Under some circumstances, a lender may be liable for the acts of its borrower. For example, CERCLA—which generally imposes strict liability for the cleanup costs of an environmental hazard, even if the person did not contribute to the contamination, on four categories of potentially responsible parties, including the current "owners" and "operators" of a

vessel or facility, 42 U.S.C. § 9607(a)—contains specific provisions governing when a secured lender would or would not fall within the statutory definitions. It provides that the term "owner or operator" would not include a person who holds "indicia of ownership" primarily to protect its security interest but does not "participat[e] in management of a vessel or facility." *Id.* § 9601(20)(A). The statute then describes in detail conduct that may qualify as "participation in management." *Id.* § 9601(20)(F). Accordingly, the proposed DIP Financing Order, which purports to find that Delta shall not be deemed a "responsible person" or "owner or operator" is, with respect to the operations or management of the Debtors, contrary to CERCLA itself.

11. Moreover, outside of CERCLA or environmental affairs, other provisions of federal law may place responsibility on responsible persons or controlling parties, including tax law. *See e.g.* 26 U.S.C. § 3505. *See cf. In re Brandt-Airflex Corp.*, 843 F.2d 90 (2d Cir. 1988). In addition, no basis exists to limit Delta's potential liability as a lessee under non-bankruptcy law. Under CERCLA, for example, lessees "may frequently be liable as operators," *Commander Oil Corp. v. Barlo Equip. Corp.*, 215 F.3d 321, 329 (2d Cir. 2000), and there also "may be circumstances when owner liability for a lessee would be appropriate." *Id.* There is no basis in the Bankruptcy Code for a lessee to be relieved of any responsibilities it may be subject to, simply because the lessor is a debtor. *See generally, e.g., Ohio v. Kovacs*, 469 U.S. 274, 285 (1985) ("We do not question that anyone in possession of the site . . . . must comply with the environmental laws of the State of Ohio. Plainly, that person or firm may not maintain a nuisance, pollute the waters of the State, or refuse to remove the source of such conditions."). Indeed, the amended and restated lease agreement that the Debtors seek to enter into is subject to 11 U.S.C. § 363, *see* (Dkt. No. 244), and it is well established that the recipient of a property interest pursuant to § 363—even when subject to 363(f)'s "free and clear" provisions, which is

not the case here—is subject to all environmental responsibilities that a person acquiring the property interest outside of bankruptcy would be subject to. *See generally, In re General Motors Corp.*, 407 B.R. 463, 508 (Bankr. S.D.N.Y. 2009) (holding that after a 363 sale from the debtor to New GM, ". . . New GM will be liable from the day it gets any such properties for its environmental responsibilities going forward."); *In re Blockbuster, Inc.*, No. 10-14997 (Bankr. S.D.N.Y. Mar. 10, 2011), Transcript of Hr'g at 12:14 - 13:6 (citing as an example of "overzealousness and aggression," the debtors' attempt to cut off the enforcement of environmental liabilities through a free and clear sale) (Lifland, J.); *Zerand-Bernal, Inc. v. Cox*, 23 F.3d 159, 163 (7th Cir. 1994) ("[N]o one believes . . . that a bankruptcy court enjoys a blanket power to enjoin all future lawsuits against a buyer at a bankruptcy sale [or] . . . immunize such buyer from all state and federal laws that might reduce the value of the assets bought from the bankrupt.")

12. Nothing in the Bankruptcy Code authorizes the Court to immunize Delta, in advance, from any such liabilities. To the extent that Delta may argue that these provisions do not in fact provide a "limitation of liability" (although that is the heading in the proposed order) but instead amount to an adjudication of their lack of liability under applicable law, that argument should be rejected as well. As described above, in at least some circumstances, Delta may have such liability, and the Court simply cannot reasonably make an advance determination of Delta's potential liability in theoretical but unripe disputes not even specified in the DIP Financing Motion. Moreover, in at least some potentially applicable areas of law there are statutory prohibitions on advance adjudication of potential liability by the Courts. *See e.g. In re Prudential Lines Inc.*, 928 F.2d 565, 574-75 (2d Cir. 1991) (section 505(a) of the Bankruptcy

Code, which gives this Court the authority to "determine the amount or legality of any tax," does not give this Court jurisdiction "to adjudicate the tax liability of non-debtors.").

13. Accordingly, paragraph 18 of the proposed order is unlawful.

II. The DIP Financing Motion Impermissibly Restricts the Debtors' Ability to Comply with the Law.

14. A Debtor-in-Possession must "manage and operate the property in his possession . . . according to the requirements of the valid laws of the State in which the property is located." 28 U.S.C. § 959(b). This obligation requires compliance with applicable federal law, as well as state law. *See, e.g.*, *In re American Coastal Energy Inc.*, 399 B.R. 805 (Bankr. S.D. Tex. 2009); *U.S. v. Wheeling-Pittsburgh Steel Corp.*, 818 F.2d 1077 (3d Cir. 1987). In environmental matters, Section 959(b) reflects the more general principle that "a person or firm in possession of a site 'may not maintain a nuisance, pollute the waters of the State, or refuse to remove the source of such conditions.'" *In re Chateaugay Corp.*, 944 F.2d 997, 1009 (2d Cir. 1991) (quoting *Ohio v. Kovacs*, 469 U.S. 274, 285 (1984)). Section 959(b) applies more generally, however, than the environmental context to require the trustee to comply with *all* valid legal obligations. *See e.g.*, *In re Old Carco LLC*, 424 B.R. 633, 637 (Bankr. S.D.N.Y. 2010); *In re REA Express, Inc.*, 2 B.R. 730 (Bankr. S.D.N.Y. 1980); *Fed. Home Loan Mortg. Corp. v. 550 Riverside Owners Corp.*, No. 90 Civ. 7873 (RLC), 1991 WL 258779, *1 (S.D.N.Y. Nov. 25, 1991).

15. The DIP Credit Agreement precludes the Debtors from expending funds other than pursuant to a budget approved by Delta—except, of course, for payments that the Debtors may owe Delta, which can be extra-budgetary. *See, e.g.*, DIP Credit Agreement § 5.17. It also broadly prohibits the Debtors even from seeking the Court's leave to expend money

inconsistently with the budget. *See id.* § 6.18(c) (prohibiting Debtors from even seeking the Court's authorization to take actions inconsistent with the DIP Credit Agreement).

16. These restrictions arguably restrict the Debtors' ability to expect funds to address legal obligations that may exist under nonbankruptcy law and that the Debtors may be obliged to comply with pursuant to 28 U.S.C. § 959(b). This arrangement allows Delta to take from the Debtors and the Court the authority to determine whether expenditures by the estate are necessary pursuant to Section 959(b), and as such may improperly serve to immunize the Debtors from their obligations under non-bankruptcy law.

CONCLUSION

For the stated reasons, the United States respectfully objects to the DIP Financing Motion and requests that the Court deny the motion.

Dated: New York, New York
April 14, 2016

Respectfully submitted,

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