

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

In re Delta Air Lines, Inc.

608 F.3d 139 (2d Cir. 2010) · No. 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk · Decided July 13, 2010

SUMMARY

Claimants who were owner participants in leveraged aircraft leases appealed the disallowance of their tax indemnification claims against Delta Air Lines in bankruptcy. The Second Circuit held that the contractual exclusion provisions did not bar the claims merely because Delta's obligations were discharged in bankruptcy or because payment of stipulated loss value was demanded or partially made. The court vacated the district court's judgment and remanded with instructions to overrule Delta's objections.

CASE DETAILS

COURT	United States Court of Appeals for the Second Circuit
WRITING FOR THE COURT	Pierre N. Leval; Robert A. Katzmann; Debra Ann Livingston
JURISDICTION	Federal
DECIDED	July 13, 2010
DOCKET	08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk
DISPOSITION	vacated
PROCEDURAL POSTURE	Claimants in Delta's Chapter 11 bankruptcy appealed from a Southern District of New York decision affirming Bankruptcy Court orders that sustained Delta's objections to approximately \$1 billion in tax-indemnification claims arising under leveraged-aircraft-lease agreements.
STANDARD OF REVIEW	De novo review of contract-interpretation issues.
PRECEDENTIAL VALUE	published and precedential
PARTIES	The Northwestern Mutual Life Insurance Company, DFO Partnership, AT&T Credit Holdings, Inc. v. Delta Air Lines, Inc., Bank of New York, as Indenture Trustee and Pass Through Trustee, Bank of America, N.A., Strategic Value Partners, LLC

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QUESTIONS PRESENTED

1. Whether the tax-indemnification agreements' references to Delta having paid stipulated loss value included the bankruptcy discharge of Delta's obligations.
2. Whether the phrase requiring Delta to be required to pay stipulated loss value was satisfied merely by a demand for payment, without payment being made.
3. Whether payment of a percentage of stipulated loss value or lease-rejection damages calculated by reference to stipulated loss value discharged Delta's tax-indemnification obligations.
4. Whether the Owner Participants' tax-indemnification claims were barred because allowing them would create duplicative recovery for a single loss or violate bankruptcy equality-of-distribution principles.

HOLDINGS

1. The contractual reference to Delta having paid stipulated loss value was not satisfied by the discharge in bankruptcy of Delta's obligation to pay stipulated loss value. The bankruptcy court's interpretation was unreasonable because it nullified the tax-indemnification obligation in the very insolvency circumstances for which the agreements were designed to provide protection.
2. A demand by an Indenture Trustee that Delta pay stipulated loss value did not, without more, establish that Delta was required to pay stipulated loss value so as to trigger the DFO tax-indemnity exclusion. In any event, the record showed that the DFO Indenture Trustee filed claims for stipulated lease-rejection damages rather than stipulated loss value.
3. Payment of a percentage of stipulated loss value, or of lease-rejection damages calculated by starting with stipulated loss value, did not satisfy the Northwestern exclusion provision. The court did not definitively resolve every possible meaning of the phrase, but held that the parties could not have intended any partial payment, however small, to discharge the tax-indemnity obligation.
4. The Owner Participants' tax-indemnity claims were not barred merely because the Indenture Trustees also held stipulated-loss-value or lease-related claims. Separate obligations owed under separate contracts to different parties could coexist, particularly where the Owner Participants had suffered an uncompensated actual loss.

KEY QUOTATIONS

“Adoption of the bankruptcy court’s construction of “pay” nullified Delta’s obligation to pay the Owner Participant under the TIA upon the occurrence most likely to call its provisions into play – Delta’s insolvency.” (608 F.3d at 145)

“By ruling that partial payment of the Lease claims, in however small an amount, satisfied the exclusion, the bankruptcy court effectively nullified the TIAs by stripping them of their ability to protect the Owner Participant in the event of Delta’s default.” (608 F.3d at 148)

“If Delta has contracted to pay duplicative claims, then it must pay both—it cannot repudiate its duty to party A under contract A by asserting that it contracted to pay the same amount to party B under contract B.” (608 F.3d at 150)

FACTUAL BACKGROUND

Delta entered into leveraged aircraft leases in which Owner Participants contributed equity and claimed accelerated depreciation deductions, while lenders financed the remainder of the aircraft purchases. The tax indemnification agreements required Delta to compensate the Owner Participants for tax losses caused by depreciation recapture, while the leases separately required stipulated-loss-value payments to the Indenture Trustees upon default. After Delta's bankruptcy, aircraft foreclosures and lease restructurings caused the Owner Participants to incur depreciation-recapture losses, and they filed tax-indemnification claims that Delta opposed on the ground that the contractual exclusion provisions had been triggered by payment, discharge, or partial payment of stipulated loss value.

PROCEDURAL HISTORY

Delta filed for Chapter 11 bankruptcy on September 14, 2005. After the bankruptcy court confirmed Delta's plan of reorganization, the bankruptcy court designated objections to selected tax-indemnification claims as test cases and disallowed the claims of Northwestern, DFO, and AT&T. The United States District Court for the Southern District of New York affirmed, and the Second Circuit vacated the district court's judgment and remanded with instructions to overrule Delta's objections.

DISPOSITION

vacated

REMAND INSTRUCTIONS

Remand to the district court with instructions that Delta's objections to the Appellants' tax-indemnification claims be overruled.

CASES CITED

- *Fin. One Pub. Co. v. Lehman Bros. Special Fin., Inc.*, 414 F.3d 325, 339 (2d Cir. 2005)
- *Butner v. United States*, 440 U.S. 48 (1979)
- *Greenfield v. Philles Records, Inc.*, 780 N.E.2d 166, 170 (N.Y. 2002)
- *Aron v. Gillman*, 128 N.E.2d 284, 288 (N.Y. 1955)
- *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 448 (2007)
- *Musso v. Ostashko*, 468 F.3d 99, 104 (2d Cir. 2006)
- *In re Delta Air Lines, Inc.*, 381 B.R. 57, 68-69, 71, 82 (Bankr. S.D.N.Y. 2008)
- *In re Delta Air Lines, Inc.*, 370 B.R. 552, 557, 559, 562 (Bankr. S.D.N.Y. 2007)

OPINION

PER CURIAM.

08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 UNITED STATES
COURT OF APPEALS 2 FOR THE SECOND CIRCUIT 3 August Term, 2009 4 (Argued:
September 21, 2009 Decided: June 22, 2010 5 Errata filed: July 13, 2010) 6 Docket Nos. 08-5002-
bk, 08-5230-bk, 08-5236-bk1 7 -----X 8 IN RE: DELTA
AIR LINES, INC., 9 Debtor.

10 -----X 11 The Northwestern Mutual Life Insurance
Company, 12 Appellant, 13 v. 14 Delta Air Lines, Inc., Bank of New York, as Indenture Trustee
and Pass Through Trustee, and 15 Bank of America, N.A.,2 16 Appellees. 17 -----
-----X 1 On October 23, 2009, after we heard oral argument in these cases, appellants Bell
Atlantic Tricon Leasing Corporation and Verizon Capital Corp. withdrew their appeal docketed at
No. 08-5296-bk.

2 Pursuant to the parties’ notice of the dissipation of the Post-Effective Date Committee, The Clerk
of Court is directed to amend the official captions in these cases to conform to the listing of the
parties above. 1 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1
DFO Partnership, 2 Appellant, 3 v. 4 Delta Air Lines, Inc., and Strategic Value Partners, LLC, 5
Appellees, 6 Wilmington Trust Company, as Owner Trustee, and Cargill Financial Services
International, 7 Inc., 8 Interested-Parties Appellees.

9 -----X 10 AT&T Credit Holdings, Inc., 11 Appellant, 12 v. 13 Delta Air
Lines, Inc., and Bank of America, N.A., 14 Appellees, 15 Bank of New York, as Indenture Trustee,
16 Interested-Party Appellee. 17 -----X 18 Before: LEVAL, RAGGI, and
LIVINGSTON, Circuit Judges. 19 Claimants in the bankruptcy proceedings of debtor Delta Air
Lines, Inc., who are Owner 20 Participants in leveraged leases of aircraft to Delta, appeal from the
judgment of the United 21 States District Court for the Southern District of New York (Berman,
J.), affirming final orders 22 of the United States Bankruptcy Court for the Southern District of
New York (Hardin, J.), which 23 upheld Delta’s objections to their claims under tax
indemnification agreements.

The Court of 2 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1
Appeals (Leval, J.) vacates the ruling of the district court, and remands with instructions to 2
overrule Delta’s objections. 3 LISA HILL FENNING, Arnold & Porter LLP, Los 4 Angeles, CA,
for Appellant The Northwestern 5 Mutual Life Insurance Company. 6 RICHARD G. SMOLEV,
Kaye Scholer LLP, New 7 York, NY (Piper A. Brock, on the brief), for 8 Appellants DFO
Partnership and AT&T Credit 9 Holdings, Inc. 10 Stephen Sanders, Mayer Brown LLP, Chicago,
IL, 11 and Andrew H. Schapiro, David F. Abbott, and 12 John M. Conlon, Mayer Brown LLP,
New York, 13 NY, for Amicus Curiae General Foods Credit 14 Corporation in Support of
Reversal.

15 LAWRENCE M. HANDELSMAN, Stroock & Stroock & 16 Lavan LLP, New York, NY (Kristopher M. Hansen 17 and Jayme T. Goldstein, Stroock & Stroock & 18 Lavan LLP, New York, NY, and Michael E. Wiles 19 and Jessica R. Simonoff, Debevoise & Plimpton, 20 LLP, New York, NY, on the brief), for Appellee 21 Delta Air Lines, Inc. 22 LEO T. CROWLEY, Pillsbury Winthrop Shaw 23 Pittman LLP, New York, NY (Eric Fishman and 24 Margot P. Erlich, on the brief), for Appellee the 25 Bank of New York Mellon, f/k/a the Bank of New 26 York, as Indenture Trustee and Pass Through 27 Trustee.

28 MICHAEL J. EDELMAN, Vedder Price, P.C., New 29 York, NY (Douglas J. Lipke, on the brief), for 30 Appellees Bank of America, N.A., and Strategic 31 Value Partners, LLC. 32 MARK M. ELLIOTT, Bingham McCutchen LLP, 33 New York, NY (Michael J. Reilly and Joshua 3 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 Dorchak, on the brief), for Interested-Party 2 Appellees Wilmington Trust Company, as Owner 3 Trustee, Cargill Financial Services International, 4 Inc., Bank of New York, as Indenture Trustee, and 5 The Bank of New York Mellon.

6 LEVAL, Circuit Judge. 7 Northwestern Mutual Life Insurance Company, Inc. (“Northwestern”), DFO Partnership 8 (“DFO”), and AT&T Credit Holdings (“AT&T”) (collectively, the “Appellants” or 9 “Claimants”), who are claimants in the bankruptcy proceedings of Delta Air Lines, Inc. 10 (“Delta”), appeal from a ruling of the United States District Court for the Southern District of 11 New York (Berman, J.) affirming final orders of the United States Bankruptcy Court for the 12 Southern District of New York (Hardin, J.) (the “Bankruptcy Court Orders”).

The bankruptcy 13 court upheld Delta’s objections to Appellants’ claims for approximately \$1 billion under tax 14 indemnity agreements. For the reasons discussed herein, the judgment is VACATED, and the 15 cases are REMANDED with instructions to reject Delta’s objections. 16 BACKGROUND 17 I. Underlying Agreements 18 Each of these three appeals requires that we construe a set of agreements governing a 19 leveraged lease, a financing structure commonly employed by airlines to fund the acquisition of 20 aircraft.

Because of its chronic unprofitability, Delta was unable to benefit from the right to take 21 accelerated depreciation deductions accorded by the Internal Revenue Code to the owner of 22 equipment used in business. See 26 U.S.C. §§ 167(a), 168.

The purpose of the leveraged lease 4 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 was to place ownership of the aircraft in a profitable entity – the Owner Participant – which 2 would put up a portion of the acquisition cost and take accelerated depreciation against its own 3 profits; the aircraft would be leased to Delta.

The Owner Participant’s bearing of a portion of the 4 purchase price of the aircraft as an equity investor (in order to obtain the benefits of accelerated 5 depreciation) reduced the percentage of

acquisition cost that needed to be financed by debt, thus 6 reducing the interest cost of the acquisition. 7 A. The Leveraged Leases 8 In each of these leveraged lease transactions, the parties entered into a master agreement 9 (the “Participation Agreement”), which specified the roles of the parties and identified the 10 various constituent agreements.

An “Owner Trust” was established to purchase aircraft with 11 funds provided by (i) an equity contribution (of approximately 20%) from the Owner Trust’s 12 beneficiary (the “Owner Participant”) and (ii) non-recourse borrowings (of approximately 80%) 13 from lenders (the “Lenders”). Each Claimant was the Owner Participant and beneficiary of such 14 an Owner Trust.

15 In each transaction, the Owner Trust leased the aircraft to Delta pursuant to a “net” lease 16 (the “Lease”) that required Delta to pay all operating expenses. Basic rent payments were 17 calculated to amortize the debt due to the Lenders and in some cases to provide a cash return to 18 the Owner Participant.

In each case, in order to provide security for the borrowed funds, the 19 Owner Trust granted a security interest in the aircraft and assigned its interest in the Lease 20 (subject to certain exceptions) to an “Indenture Trustee” acting for the Lenders, pursuant to an 5 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 indenture agreement (the “Indenture”).

The Indenture Trustee was charged with making debt 2 payments from the Lease rentals and distributing the excess, if any, to the Owner Trust. As 3 assignee of the lessor’s interest, the Indenture Trustee was entitled to control the exercise of 4 remedies if Delta defaulted under the Lease. 5 B. Tax Indemnity Agreements and Stipulated Loss Value 6 The primary incentive of the Owner Participant in advancing 20% of the purchase price 7 of the aircraft was to obtain the benefits of accelerated depreciation.

That interest, or in any 8 event its economic value to the Owner Participant, was protected by two mechanisms against 9 events that would prevent the Owner Participant from taking full advantage of the deductions, 10 including Delta’s default under the Lease (which might result in the Indenture Trustees’ 11 foreclosing on the aircraft).

The first form of protection for the Owner Participant was a Tax 12 Indemnity Agreement (“TIA”), which required Delta to compensate the Owner Participant in the 13 event that, upon a foreclosure on the aircraft, the Internal Revenue Service required the Owner 14 Participant to “recapture” deductions it had taken for accelerated depreciation.

The second was a 15 provision of each Lease that permitted the lessor (or the Indenture Trustee, as assignee) to 16 demand that Delta pay “stipulated loss value” (“SLV”) if Delta defaulted under the Lease. SLV 17 (the precise amount of which was fixed by an appendix to the Lease and was tied to the date of 18 the default) was calculated to provide for (i) the payment of the remaining debt with

all interest 19 due and (ii) the agreed-upon return to the Owner Participant through the date of termination, 20 taking into account all adverse tax consequences that would result from the default.

6 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 In each case, the rights assigned to the Indenture Trustee as security for the loan to the 2 Owner Trust included the right to demand payment of SLV.

The terms of the Indenture provided 3 that, upon the Indenture Trustee's collection of SLV, the funds would first be applied to the 4 parties' expenses, and then to any outstanding balance on the loan. Remaining funds would be 5 paid over to the Owner Trust, and ultimately to the Owner Participant. This sequence of 6 payments was known as the "Indenture waterfall." 7 Because SLV was calculated to be sufficient to compensate the Owner Participant for all 8 adverse tax consequences of a Lease default, if Delta were to make a full payment of SLV and a 9 full payment under the TIA, the Owner Participant would receive double compensation, at least 10 to the extent of the tax losses indemnified by the TIA.

Accordingly, each TIA contained an 11 exclusionary provision, which stipulated in some form that, in the event that Delta paid SLV 12 under the Lease, the Owner Participant was not entitled to collect under the TIA. (For the same 13 reason – i.e., to protect against the Owner Participant's receipt of double payment – the 14 Participation Agreements contained provisions requiring reduction of the SLV to account for any 15 amount paid by Delta to the Owner Participant under a TIA.)

16 The precise language employed in the exclusionary provisions of the TIAs is not 17 standardized, but varies slightly as among the three sets of leveraged lease transactions involved 18 in these appeals. DFO's TIAs provide that no amount is due under the TIAs where Delta is 19 "required to pay" SLV. AT&T's agreements provide that it is not entitled to anything under the 20 TIAs where Delta "pays an amount equal to" SLV.

Northwestern's TIAs provide that it is not 7 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 entitled to "any payment... in respect of any Loss... arising as a result of... [a]ny event 2 whereby [Delta] pays Stipulated Loss Value... or an amount determined by reference thereto." 3 DFO TIA § 7c; AT&T TIA §6c; Northwestern TIA § 6c.

4 II. Procedural History 5 A. Bankruptcy Filing and Exercise of Remedies by Indenture Trustees 6 On September 14, 2005, Delta filed a voluntary Chapter 11 petition. On September 28, 7 2005, the Office of the United States Trustee appointed an Official Committee of Unsecured 8 Creditors.

On April 25, 2007, the bankruptcy court confirmed Delta's Joint Plan of 9 Reorganization, which became effective on April 30, 2007. Delta's bankruptcy filing was an 10 event of default under all of the Leases and Indentures, and entitled the Indenture Trustees to 11 exercise the remedies

provided under the Leases. 12 Many of the aircraft at issue were disposed of pursuant to a term sheet (the “Bingham 13 Term Sheet”) negotiated among Delta and an ad-hoc committee of debtholders and approved by 14 the bankruptcy court on February 15, 2006.

The Bingham Term Sheet authorized and directed a 15 series of transactions, consisting of (1) foreclosure upon the collateral, including the aircraft, by 16 the Indenture Trustees, (2) rejection of the applicable Leases, and (3) execution of new, post- 17 petition leases.

The Owner Participants did not participate in the new leases. The Bingham 18 Term Sheet set forth a formula to determine the amount of the Indenture Trustees’ claims for 19 rejection damages, roughly: SLV (calculated as of the date of Delta’s filing), less the aggregate 20 rent payments to be received under the restructured leases, less the expected residual value of the 8 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 aircraft at the end of the restructured lease terms.

2 Northwestern was the Owner Participant in leveraged leases of three aircraft (tail 3 numbers N182DN, N803DE, and N804DE). Early in the bankruptcy, Delta rejected its leases 4 with respect to airplanes N803DE and N804DE, whereupon the Indenture Trustee repossessed 5 and sold the aircraft.

The Indenture Trustee foreclosed on Northwestern’s remaining plane and 6 re-leased it to Delta pursuant to the Bingham Term Sheet. The Indenture Trustee filed three 7 proofs of claim arising from Delta’s default under the Northwestern Leases.

The claims for 8 N803DE and N804DE were for SLV less sale proceeds, and the claim for N182DN was for the 9 lease rejection damages stipulated in the Bingham Term Sheet. 10 DFO was the Owner Participant in leveraged leases of eight aircraft (tail numbers 11 N914DL, N915DL, N916DL, N954DL, N955DL, N956DL, N957DL, and N958DL).

The 12 Indenture Trustee foreclosed on three of DFO’s aircraft and re-leased them to Delta pursuant to 13 the Bingham Term Sheet (N914DL, N915DL, and N916DL). With respect to the other five 14 aircraft, Delta and the Indenture Trustee entered into restructuring agreements under which 15 DFO’s interest in the aircraft was foreclosed out.

The restructuring agreements (as under the 16 Bingham Term Sheet) provided for new leases and stipulated lease rejection damages (calculated 17 by reducing SLV by the present value of the restructured lease and the residual value of the 18 aircraft). 19 AT&T was the Owner Participant in leveraged leases involving seven aircraft (tail 20 numbers N131DN, N178DN, N660DL, N962DL, N963DL, N964DL, and N965DL).

The 9 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 Indenture Trustee foreclosed on all of AT&T’s aircraft and re-leased them to Delta pursuant to 2 the

Bingham Term Sheet. 3 B. Objections to TIA Claims of Owner Participants 4 Appellants filed claims under their TIAs for tax losses that arose when the Indenture 5 Trustees foreclosed on the aircraft, forcing Appellants to recapture prior accelerated depreciation 6 deductions.

See 26 U.S.C. § 1245(a). Delta decided to object to such tax indemnification claims 7 brought by leveraged lease Owner Participants. Because Delta faced hundreds of such claims, 8 totaling over \$1.5 billion in aggregate, the bankruptcy court approved procedures permitting 9 Delta to designate objections to selected sets of TIA claims, which would serve as “test cases” 10 governing the disposition of similar claims.

The bankruptcy court upheld the objections of Delta 11 and the official committee to the claims of DFO, Northwestern, and AT&T. 12 The objection to DFO’s claims, designated “TIA/SLV Objection 1,” addressed TIAs 13 providing that no payment would be due if a loss arose as a result of “any event whereby a party 14 to any of the Operative Documents is required to pay” SLV.

The objection to Northwestern’s 15 claims, designated “TIA/SLV Objection 2,” addressed TIAs providing that no payment would be 16 due if a loss arose as a result of “any event whereby the Lessee pays [SLV] or an amount 17 determined by reference [to SLV].” The objection to AT&T’s claims, designated “TIA/SLV 18 Objection 5I,” addressed TIAs providing that no payment would be due if a loss arose as a result 19 of “[a]ny event whereby the Lessee pays an amount equal to Stipulated Loss Value.” 20 C. The Bankruptcy Court’s Ruling 10 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 The bankruptcy court upheld each of the three categories of objections on the following 2 reasoning.

First, the court reasoned that discharge of a debt in bankruptcy is effectively payment 3 of the debt. The court reviewed dictionary definitions of “pay” and “paid,” which provided that 4 a payment is an event that “discharge[s]” a debt.

In re Delta Air Lines, Inc., 381 B.R. 57, 68-69 5 (Bankr. S.D.N.Y. 2008). The court reasoned that “[t]he only meaning of pay/paid/pays which 6 can rationally be ascribed to such terminology in the context of an insolvent and bankrupt 7 airline/lessee is the common dictionary meaning of payment in the sense of discharge of the 8 indebtedness.” Id. at 82. (The court rejected Claimants’ argument that, in light of the purpose of 9 the exclusionary provisions, “pays SLV” could only refer to payment of the full amount of SLV, 10 as depending on a “narrow and eccentric meaning of ‘pay.’” Id. at 69.)

Because each Indenture 11 Trustee’s claim for SLV would be discharged in Delta’s bankruptcy, each SLV had been “paid” 12 within the meaning of the TIA, with the consequence that a TIA claim could not be asserted. Id. 13 at 71. 14 The court found additional basis for rejecting DFO’s claims in the specification of DFO’s 15 exclusionary language that Delta would not be obligated to

make a payment under the TIA as a result of “any event whereby [Delta was] required to pay” SLV.

The court reasoned that, in each case, it was undisputed that such an “‘event’ has happened—by reason of Delta’s [default], the indenture trustee has demanded that Delta pay, and Delta ‘is required to pay,’ SLV under... the Lease.” *In re Delta Air Lines, Inc.*, 370 B.R. 552, 559 (Bankr. S.D.N.Y. 2007).

The court thus found that in any case where the Indenture Trustee had demanded payment of SLV, Delta had been “required to pay” SLV, with the consequence that the Owner Participant was barred from asserting a claim under a TIA containing such a carveout. Finally, the court focused on the language in Northwestern’s agreements that Delta would not be obligated to make a payment under a TIA if it paid the Indenture Trustee “an amount determined by reference [to SLV].” It concluded that the distribution to an Indenture Trustee of a pro rata share of its SLV claim was such an amount, as the amount of the distribution would be determined as a percentage of the full SLV claim.

Id. at 562. The court also concluded that payments to the Indenture Trustee for stipulated lease rejection damages (as described in the Bingham Term Sheet and similar agreements) were “amount[s] determined by reference” to SLV, because the damages were calculated using SLV as a starting point.

The court thus held that in any case where Delta had paid a percentage of (1) SLV or (2) the lease rejection damages specified in the Bingham Term Sheet and similar agreements, Delta had paid “an amount determined by reference [to SLV],” and the Owner Participant would not be permitted to recover under a TIA containing such a carveout. D. District Court Decision and Appeals to this Court Each of the Claimants appealed to the United States District Court for the Southern District of New York from the bankruptcy court order disallowing its claims.

On September 29, 2008, the district court issued a decision on all appeals affirming the rulings below, and generally adopting verbatim the reasoning of the Bankruptcy Court Orders. *In re Delta Air Lines, Inc.*, No. 07-cv-7745, 07-cv-11437, 08-cv-2411, 08-cv-2449, 08-cv-6879, 2008 WL 12 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk *In re: Delta Air Lines, Inc.* 14444001 (S.D.N.Y.

Sept. 29, 2008). These related appeals followed. 2 DISCUSSION 3 All issues on appeal involve contract interpretation, and are thus subject to de novo 4 review. *Fin. One Corp. v. Lehman Bros. Special Fin., Inc.*, 414 F.3d 325, 339 (2d Cir. 2005). 5 Under the doctrine of *Butner v. United States*, 440 U.S. 48 (1979), principles of state law govern 6 the interpretation of contractual provisions in bankruptcy.

Under New York law, which governs 7 by reason of the choice of law clauses in the TIAs, “[t]he fundamental, neutral precept of 8 contract interpretation is that agreements are construed in accord with the parties’ intent.” 9 *Greenfield v. Philles Records, Inc.*, 780 N.E.2d 166, 170 (N.Y. 2002). While “[t]he best 10 evidence of what parties to a written agreement intend is what they say in their writing,” *id.* 11 (internal quotation marks omitted), “[e]ach word must be considered along with not only all the 12 other words that surround it, but also the history and education of the parties, the nature of the 13 contract, the purposes of the parties, and all other relevant circumstances.” 5 *Corbin on 14 Contracts* § 24.21 (Joseph M. Perillo ed., 2009); accord *Aron v. Gillman*, 128 N.E.2d 284, 288 15 (N.Y.

1955). 16 I. Purpose of Tax Indemnification Agreements and Their Exclusionary Provisions 17 To understand the Tax Indemnification Agreements at issue, it is necessary to take into 18 account their purpose in the leveraged leases and the purpose of their exclusionary provisions. 19 The purpose of each TIA was to compensate the Owner Participant in the event it was required 20 to recapture accelerated depreciation it had taken.

The Owner Participant’s primary motivation 13 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 in putting up 20% of the purchase price of the aircraft was to obtain the benefits of accelerated 2 depreciation.

The circumstance most likely to deprive the Owner Participant of that benefit was 3 Delta’s falling into insolvency. If Delta were forced by insolvency to declare bankruptcy or to 4 default on its rent payments under a leveraged lease, in all likelihood the Indenture Trustee 5 would foreclose on the aircraft, and the Owner Participant would be required to recapture 6 accelerated depreciation it had taken.

The TIA was designed to remedy that loss by obligating 7 Delta to compensate the Owner Participant for it. 8 The purpose of the exclusionary provisions was simply to ensure that an Owner 9 Participant not receive double compensation for depreciation recapture. Delta’s default might 10 give rise to two obligations – one to pay the Owner Participant as provided in the TIA, and a 11 second to pay SLV to the Indenture Trustee.

SLV was calculated to include an amount to 12 compensate the Owner Participant for loss of accelerated depreciation. It was therefore 13 theoretically possible, although as a practical matter highly improbable, that an Owner 14 Participant might recover twice for the loss occasioned by its depreciation recapture.

The 15 improbability of such double recovery resulted from the terms of the Indenture waterfall, which 16 provided that no portion of SLV collected by the Indenture Trustee would go to the Owner 17 Participant until the Lenders had been paid in full.

Thus, only in the unlikely event that Delta, 18 after its default, paid virtually the entirety of SLV would the Owner Participant receive any 19 portion of it. The purpose of the exclusionary provision was to eliminate any such double 20 compensation, leaving the Owner Participant with a one-time compensation (a protection further 14 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 provided in the terms of the Lease, which required that SLV be diminished to reflect any 2 amounts paid by Delta under the TIA).

3 II. The Bankruptcy Court's Interpretation of the Agreements 4 Upon recognition of the purpose of the TIA and the function of its exclusionary 5 provision, it becomes apparent that the bankruptcy court's interpretation, far from reflecting the 6 intentions of the contracting parties, was virtually certain to defeat those intentions. 7 A. Meaning of "Pay" 8 The bankruptcy court's rejection of the Owner Participants' claims was based on its 9 ruling that an exclusionary clause, which canceled Delta's obligation to pay under the TIA if it 10 "paid" SLV, was satisfied by the discharge in bankruptcy of Delta's obligation to pay SLV.

The 11 court's reasoning was based in part on alternative dictionary definitions of "pay" to the effect 12 that an obligation is deemed "paid" once the obligation has been discharged. 13 We find this reasoning erroneous. Assuming that the reference, in the exclusionary 14 clauses, to "payment" of SLV is ambiguous, the court's interpretation depended on a strained 15 and improbable reading, which inevitably defeated the intentions of the contracting parties.

16 Adoption of the bankruptcy court's construction of "pay" nullified Delta's obligation to pay the 17 Owner Participant under the TIA upon the occurrence most likely to call its provisions into play 18 – Delta's insolvency. Delta's insolvency would predictably at once bring about (1) the 19 foreclosure of the aircraft, causing the loss to the Owner Participant for which Delta promised 20 compensation, and (2) Delta's bankruptcy and discharge, causing (under the bankruptcy court's 15 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 interpretation) nullification of Delta's obligation to compensate the Owner Participant under the 2 TIA.

This interpretation of "pay" rendered the agreement nonsensical and self-defeating, by 3 making it inoperative in the very circumstance for which it was designed. 4 Delta's obligation to pay compensation under the TIA, of course, did not provide the 5 Owner Participant with complete protection. Since the Owner Participant's loss of tax benefits 6 would likely come about as a result of Delta's insolvency and consequent bankruptcy, the Owner 7 Participant could not realistically expect to collect 100% of what Delta would owe it under the 8 TIA.

What the Owner Participant could reasonably expect to receive was a claim against Delta 9 in bankruptcy for the amount due to it under the TIA, and to recover ratably for that claim along 10 with the other creditors. This contractual expectation was defeated by the bankruptcy court's 11 interpretation, which treated Delta's bankruptcy as simultaneously causing the Owner 12

Participant's loss for which Delta owed compensation under the TIA and nullifying Delta's obligation to compensate the Owner Participants for that loss.

This was not a reasonable interpretation of the contract. Nor is it an answer that, notwithstanding the cancellation of Delta's obligation to pay under the TIA, the Owner Participant retained the opportunity to recover for its loss of depreciation by way of SLV.

As noted, under the terms of the Indenture waterfall, the Owner Participant would receive no part of SLV until the Lenders were fully compensated. By giving the Owner Participant a right to recover directly from Delta, the TIA placed the Owner Participant in equal status with other unsecured creditors, to the extent of its claim for 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. depreciation recapture.

Relegating it to recover only indirectly through the indenture waterfall, from payment of SLV, deprived the Owner Participant of that contractual entitlement and defeated the purpose of the contract. Notwithstanding that dictionary definitions of "pay" include this strained alternative, the bankruptcy court was not at liberty to adopt it as the meaning of the contractual term, when that was plainly not the understanding of the contracting parties.³⁷ B. Meaning of "Required to Pay" The bankruptcy court's interpretation of the "required to pay" language in DFO's TIAs was no less flawed.

The court found that "[t]here can be no dispute that [an excluded event] has happened—by reason of Delta's [Lease default], the indenture trustee has demanded that Delta pay, and Delta 'is required to pay,' SLV under Section 15(e) of the Lease." In re Delta Air Lines, Inc., 370 B.R. at 559. Though it is not entirely clear, the court's reasoning seems to be that Delta is "required to pay" SLV whenever an Indenture Trustee makes a legally supported demand for payment of SLV, whether or not that demand is met.

In other words, the bankruptcy court held that whenever an Indenture Trustee properly demands of Delta that it pay SLV, Delta The bankruptcy court characterized "full payment" as a "narrow and eccentric" definition of the term "payment." In re Delta Air Lines, Inc., 381 B.R. at 69.

In our view, however, that interpretation is consistent with common usage and understanding. By contrast, a definition of "payment" which permits the obligee to receive nothing, while the obligor is excused from the obligation by virtue of a grace conferred by law so as to enable insolvent debtors to get a fresh start, is not. If asked whether a creditor had received "payment" of a debt owed to him, in circumstances where the creditor received nothing and the debtor was discharged from the obligation by a bankruptcy court, we think that most persons would answer that it had not.

17 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 is released from its obligation under the TIA to indemnify the Owner Participant for its tax 2 losses, regardless of whether Delta ever pays any part of SLV to the Indenture Trustee.

For all 3 the reasons just discussed, that interpretation is patently at odds with the intent of the parties in 4 contracting for the TIAs.^{4 5 C. Meaning of “Pay SLV or an Amount Determined by Reference Thereto”} 6 Northwestern’s agreements, which provide that Delta is excused from paying anything 7 under the TIA where it “pays [SLV]... or an amount determined by reference thereto,” present 8 a closer question – but only marginally so – as such language arguably contemplates 9 circumstances in which payment of an amount other than SLV will satisfy Delta’s obligation to 10 the Owner Participant.

Delta argues that, pursuant to this language, it owes nothing to 11 Northwestern, because in each case it paid the Indenture Trustee either (1) a percentage of SLV 12 net of the proceeds of the sale of the aircraft, or (2) a percentage of the stipulated lease rejection 13 damages calculated under the Bingham Term Sheet using a formula that started from SLV.

14 Delta argues that in each case it thus literally paid “an amount determined by reference [to 15 SLV].” 16 In context and in light of the purpose of the agreements, we think it likely that the phrase 4 Moreover, the bankruptcy court’s finding that “the [I]ndenture [T]rustee [for DFO’s leveraged leases] has demanded that Delta pay... SLV,” 370 B.R. at 559, is unsupported by the record.

The Indenture Trustee foreclosed on all eight of DFO’s aircraft after Delta’s default under the Leases, but re-leased each of them to Delta pursuant to a renegotiated lease. In each case, the Indenture Trustee filed a claim for stipulated lease rejection damages – not SLV.

Accordingly, Delta was not “required to pay” SLV in even the barest sense applied by the bankruptcy court. 18 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 “an amount determined by reference thereto” was intended to indicate that Delta could discharge 2 its obligation under the TIAs by payment of the amount of SLV, reduced in accordance with 3 certain Lease-sanctioned offsets, such as those for fair market value, sale proceeds, insurance 4 revenues, and government receipts, in a manner that would result in realization of the full value 5 of SLV.

However, we need not definitively resolve the meaning of the phrase; we need only 6 decide, as above, that, as among the various possible meanings of an ambiguous contract term, 7 the parties could not have intended that payment of any percentage of SLV would discharge 8 Delta’s obligations under the TIAs. By ruling that partial payment of the Lease claims, in 9 however small an amount, satisfied the exclusion, the bankruptcy court effectively nullified the 10 TIAs by stripping them of their ability to protect the Owner Participant in the event of Delta’s 11 default.

12 The problem with the interpretation urged by Delta is even clearer if one considers its 13 consequences in a non-bankruptcy context. The tax benefits secured by the TIAs were crucial to 14 the Owner Participants' agreement to enter into the leveraged leases. It cannot possibly be that 15 the parties understood that those benefits could be eliminated as the result of any Delta payment 16 to the Indenture Trustee, so long as it was determined by reference to SLV, notwithstanding that 17 such payment would in no way benefit the Owner Participant.

Delta and the Indenture Trustee 18 could not, consistent with the parties' contractual intent, discharge Delta's obligations to the 19 Owner Participants under the TIAs by agreeing to cancel its SLV liabilities for ten cents on the 20 dollar, of which no portion would go to the Owner Participants. Absent an understanding that 19 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 the agreements would operate differently in bankruptcy, or a specific statute authorizing 2 different treatment in bankruptcy, see *Travelers Cas. & Sur.*

Co. of Am. v. Pac. Gas & Elec. Co., 3 549 U.S. 443, 448 (2007), they cannot do so here. 4 III. Delta's Other Arguments for Affirmance 5 As an alternative basis for affirmance, Delta argues that a single loss can only give rise to 6 a single claim in bankruptcy, and that Appellants seek to be compensated for losses on account 7 of which another set of claims – the SLV claims – has already been allowed.

Delta presses this 8 argument notwithstanding that the TIA claims and SLV claims arise under agreements (1) 9 between different parties, (2) addressing different events, and (3) providing for different 10 remedies. In light of these facts, we agree with the bankruptcy court that: 11 Each agreement was freely negotiated and fully supported by fair consideration on 12 both sides.

If a component of the SLV claim under the Lease is calculated by 13 reference to the owner participant's tax consequences which are indemnified under 14 the TIA (the "overlap" Delta objects to), so be it. That is what Delta agreed to and 15 what both the owner participant and the indenture trustee relied upon in negotiating 16 the agreements. If Delta has contracted to pay duplicative claims, then it must pay 17 both—it cannot repudiate its duty to party A under contract A by asserting that it 18 contracted to pay the same amount to party B under contract B. 19 In re Delta Air Lines, Inc., 370 B.R. at 557.

20 Delta argues that the bankruptcy court's decision in this respect "rested on three errors of 21 law." Delta Br. at 21. First, Delta argues that the court failed to appreciate that "[a]n agreement 22 to pay an amount, upon default, that is not based on the other party's actual loss is contrary to 23 public policy and void as a penalty." *Id.* However, as the bankruptcy court noted, "the general 20 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 legal principle that precludes double liability for a single injury or loss has never been applied by 2 any court to void separate contract obligations owed to different parties under different 3 contracts." In re Delta Air Lines, Inc., 370 B.R. at 557.

Moreover, even if it were true as a 4 general principle that “[a]n agreement to pay an amount... that is not based on the other party’s 5 actual loss is... void as a penalty,” Delta Br. at 21, that principle would be of limited 6 applicability in the instant case (to bar Appellants’ claims), where it is uncontested that 7 Appellants have suffered an actual loss that has not been compensated.

8 Next, Delta argues that the bankruptcy court erred in finding that its obligations under the 9 TIAs and Leases were owed to different parties, because the Indenture Trustees are mere 10 assignees of the Owner Trusts’ interests in the Leases, and “[f]or tax purposes, the Owner Trust[] 11 has no separate existence; the Owner Trust[] and Owner Participant are the same entity.” Delta 12 Br. at 22 (emphasis added).

As Appellants point out, this argument is unavailing because the tax 13 regulations specify that the tax treatment of single-member entities is independent of their 14 corporate separateness for all other purposes, including entry into and enforcement of contracts. 15 See, e.g., Treas. Regs. §§ 301.7701-1 to -3. 16 Finally, Delta argues that the claims asserted against a debtor in bankruptcy are 17 “supposed to equal the out-of-bankruptcy right of payment.” Delta Br. at 23.

In effect, Delta 18 argues that allowing Appellants’ claims would violate the bankruptcy policy of equality of 19 distribution among creditors, see, e.g., *Musso v. Ostashko*, 468 F.3d 99, 104 (2d Cir. 2006), 20 because the collective recovery of the Appellants and Indenture Trustees would exceed their pro 21 08-5002-bk, 08-5230-bk, 08-5236-bk, 08-5239-bk In re: Delta Air Lines, Inc. 1 rata share of entitlements.

To the extent that this is true, it is Delta’s own fault: the problem 2 exists because Delta (and the creditors’ committee) agreed, under the Bingham Term Sheet, the 3 other restructured lease agreements, and Delta’s plan of reorganization, to pay the Indenture 4 Trustees more than they were entitled to – namely, their share and the Owner Participants’ share.

5 While Delta is correct that the aggregate amounts claimed by the Owner Participants and the 6 Indenture Trustees exceeded their proper aggregate share to the extent of the duplication of the 7 Owner Participants’ claims under the TIAs, the proper remedy was disallowance of the claims of 8 the Indenture Trustees to the extent they were predicated on the Owner Participants’ TIA 9 entitlements.

10 CONCLUSION 11 For the foregoing reasons, the ruling of the district court is VACATED, and the cases are 12 REMANDED with instructions that Delta’s objections to Appellants’ claims be overruled. 22