

CANADA
PROVINCE OF QUEBEC
DISTRICT OF MONTREAL

SUPERIOR COURT
(Commercial Division)

N°: 500-11-039418-104

IN THE MATTER OF THE JUDICIAL
REORGANISATION PROCEEDINGS OF:

COMPANIA MEXICANA DE AVIACION, S.A.
DE C.V.

Insolvent Debtor

-and-

MARU E. JOHANSEN

Foreign Representative

-and-

SAMSON BELAIR DELOITTE & TOUCHE
INC.

Information Officer

-and-

INTERNATIONAL AIR TRANSPORT
ASSOCIATION

Applicant

REPLY OF THE APPLICANT TO THE INSOLVENT DEBTOR'S CONTESTATION

IN REPLY TO CONTESTATION TO THE INSOLVENT DEBTOR'S MOTION FOR AN ODER REGARDING THE FINAL SETTLEMENT OF THE DEBTOR'S OUTSTANDING BALANCE WITH THE IATA CLEARING HOUSE AND FOR THE FINAL DISTRIBUTION OF BSP & CASS PROCEEDS AND CROSS DEMAND, THE APPLICANT STATES AS FOLLOWS:

1. This Reply addresses the allegations contained in the *Insolvent Debtor's Contestation to the Motion for an Oder Regarding the Final Settlement of the Debtor's Outstanding Balance with the IATA Clearing House and for the Final*

Distribution of BSP & CASS Proceeds and Cross Demand, dated April 18, 2013 (the “**Contestation**”).

2. All terms not defined herein will have the same meaning as in the *Motion for an Order Regarding the Final Settlement of the Debtor's outstanding Balance with the IATA Clearing House and for the Final Distribution of BSP & CASS Proceeds* (the “**Reconciliation & Payment Process Motion**”)
3. The Applicant joins issue with respect to paragraphs 1 to 40 of the Contestation.
4. The Applicant denies paragraph 41 of the Contestation and further refers to Section A) of this Reply.
5. The Applicant admits paragraph 42 of the Contestation.
6. The Applicant denies as drafted paragraph 43 of the Contestation, further refers to Exhibit MX-17 and denies anything not in conformity therewith.
7. The Applicant ignores paragraph 44 of the Contestation.
8. The Applicant admits paragraphs 45 to 47 of the Contestation.
9. The Applicant ignores paragraph 48 of the Contestation.
10. The Applicant denies as drafted paragraph 49 of the Contestation.
11. The Applicant denies paragraph 50 of the Contestation,
12. The Applicant denies as drafted paragraphs 51 and 52 of the Contestation.
13. The Applicant denies paragraph 53 of the Contestation.
14. The Applicant denies as drafted paragraph 54 of the Contestation, further refers to Exhibit R-2 in support of Mexicana's *Motion for Partial Distribution of Sums Held by IATA on Behalf of the Insolvent Debtor*, dated April 11, 2013 (the “**Partial Distribution Motion**”) and denies anything not in conformity therewith.
15. The Applicant admits paragraph 55 of the contestation.
16. The Applicant denies as drafted paragraph 56 of the Contestation.
17. The Applicant admits paragraph 57 of the Contestation.
18. The Applicant denies as drafted paragraph 58 of the Contestation further refers to Exhibit R-3 of the Partial Distribution Motion and denies anything not in conformity therewith.
19. The Applicant denies paragraphs 60 to 64 of the Contestation.

20. With respect to paragraph 65 of the Contestation, the Applicant refers to Exhibit MX-2, which speaks for itself, and denies anything not in conformity therewith.
21. The Applicant denies paragraphs 66 to 71 of the Contestation.
22. The Applicant denies as drafted paragraphs 72 and 73 of the Contestation.
23. The Applicant denies paragraph 74 of the Contestation.
24. The Applicant denies as drafted paragraphs 75 and 76 of the Contestation.
25. The Applicant denies paragraphs 77 to 82 of the Contestation.

A) The incorrect qualification of the BSP & CASS Net Proceeds

26. Mexicana pretends at paragraph 2 of the Partial Distribution Motion that IATA would have held the BSP & CASS Net Proceeds as a result of an initial deposit of USD \$ 17,331,771.31 (called by Mexicana the "Reserve").
27. This is incorrect. While there have been discussion about a deposit in the event of the reactivation of Mexicana's operations, there has never been such a deposit and there is no "Reserve".
28. In fact, as appears from the Mexicana (MX-132) Financial Statement as of September 16, 2010 (**Exhibit MX-1**) and from the Agreement on refunds (**Exhibit MX-17**) the BSP & CASS monies held by IATA represent the sale proceeds for sales made by IATA accredited agents that were owing to Mexicana by IATA in the various BSP and CASS services in which it participated into up until its suspension on August 3, 2010.
29. Before these sales proceeds can be remitted to Mexicana (1) the refunds owing to the various passengers left on the ground by Mexicana when it stopped operations must be processed and paid (this was the purpose of the Agreement on refunds, **Exhibit MX-17**), and (2) any and all amounts owing to IATA must be paid, including any and all amounts owing under other IATA financial services, as well as any cost of IATA.

B) The set-off and the currency conversions

30. Contrary to Mexicana's allegations, IATA set-off fully applied between on the one hand the BSP & CASS Net Proceeds and on the other hand, the ICH Balance and the costs incurred by IATA.
31. This is so, firstly as a matter of law (legal set-off), pursuant to Article 1672 of the Quebec Civil Code.

32. Indeed, at the completion of the Reconciliation and Payment Process (the “**Process**”) contemplated by the Agreement on refunds, Mexicana and IATA were reciprocally indebted and the two debts were certain, liquid and exigible.

33. Regarding the ICH Balance, the Clearing House Regulations (**Exhibit I-17**) provide that the members are fully liable to the Clearing House for the balance due on “Call day” (see in particular Sections 9(d) and 28(a)). Moreover Section 24 also stipulates that:

“Members who are not in agreement with the claims raised by other Members shall resolve their differences directly with the Members concerned. Any adjustment arising therefrom may be included in a subsequent Clearance.”

34. Regarding the fees and costs incurred by IATA in connection with the restructuring of Mexicana, Section 40 of the Clearing House Regulations provide:

“(a) Members shall reimburse to the Clearing House any direct charges incurred by the Clearing House on their behalf, including without limitation:

[...]

(ii) legal fees and costs incurred through action taken with regard to bankruptcy reorganization under bankruptcy and/or insolvency laws, court-appointed (or otherwise) administration, receivership, insolvency or liquidation of a Member.”

35. In addition to the legal set-off mentioned above, IATA also had a clear right to operate a contractual set-off of the BSP & CASS Net Proceeds against the ICH Balance and the costs incurred. This right is recognized by the following applicable contractual provisions (contractual set-off).

36. In particular, Section 16.2 of the Passenger Agency Conference Resolution 850 (“**Resolution 850**”) (**Exhibit I-2**), provides that:

“Where a BSP Airline participating in a BSP defaults on a material obligation to IATA in respect of the IATA Clearing House, or other financial arrangement for services provided by IATA, it shall be grounds for IATA to withhold funds due from the BSP to such BSP Airline in order to settle the debt...” (our emphasis)

37. Likewise, Section 12 (b) of the Clearing House Regulations (**Exhibit I-17**) provides as follows:

“set-off also applies, and may be invoked by the Clearing House, with respect to any monies held or owed by IATA or any of its divisions or affiliated entities against any debt or claim owing to IATA or any of its divisions or affiliated entities in order to effect Clearance or to collect or pay any such debt or claim.”

38. Section 4 of the Agreement on refunds (**Exhibit MX-17**) also stipulates as follows:

“After IATA has completed the refund process described in this Agreement and deducted all fees and charges payable to IATA, any funds remaining in the possession of IATA shall be returned to Mexicana” (our emphasis)

39. Thus, when the process of refunds under the Agreement on refunds was completed on or about February 2011, and the BSP & CASS Net Proceeds became owing by IATA to Mexicana. Mexicana was already indebted towards IATA in connection with the Clearing House, in the amount of approximately USD\$12,088,195.46 (excluding fees and costs) and this amount was outstanding since September 2010. This debt was certain, liquid and exigible.

40. At the same time, given the structure of the Clearing House operations, IATA was indebted towards other Clearing House Members in the same amount. This amount too was outstanding since September 2010.

41. Despite the above, as a pure courtesy to Mexicana, and without any obligation whatsoever to do so, IATA did not immediately use the BSP & CASS Net Proceeds to pay IATA's indebtedness towards such other Clearing House Members.

42. In practice this allowed Mexicana several months to negotiate with other Clearing House Members and explore whether some of the debts owing to them by IATA could be reduced. As a courtesy to Mexicana, and again, without any obligation to do so, IATA indicated to Mexicana that it would recognize such reductions, provided proper releases of IATA obligations were executed by the Members concerned, the whole as appears from the email at **Exhibit I-8**.

43. However, in December 2011 there appeared to have been little to no progress on the part of Mexicana to negotiate bilaterally with other Members and the Mexicana restructuring proceedings showed little to no progress.

44. On January 4, 2012, IATA's indebtedness to other Clearing House Members in respect of Mexicana was in the amount of approximately USD\$12,086,280 (excluding fees and costs) (i.e. the ICH Balance minus the releases received by IATA before January 4, 2012).

45. Thus, in early January 2012, IATA assembled the BSP & CASS Net Proceeds in one single bank account. As a result, save for *de minimis* amounts, all of the funds held in other currencies than US Dollars were converted into US Dollars.

46. As part of this process, and as appears from Exhibit MX-18, the sum of MXN 89,893,309.49 was converted to USD\$6,565,581.05 on January 4, 2012, with a value date of January 6, 2012, and was then credited to a specifically designated bank account at the Citibank in London, along with the funds coming from other sources.

47. Given the clear application of set-off, both legally and contractually, IATA was perfectly entitled to assemble the BSP & CASS Net Proceeds and to convert them into USD with a view to apply them to the ICH Balance and pay the Clearing House Members.

C) The Process

48. Despite the above, in February 2012, with a view to try to bring this matter to an end in a way that was more favorable to Mexicana despite its lack of progress in negotiations with other ICH Members, IATA, again without any obligation to do so, refrained from applying the BSP & CASS Net Proceeds against its own indebtedness towards the other Clearing House Members, and filed the present Reconciliation & Payment Process Motion.

49. At the time the indebtedness of the Clearing House towards other Clearing House members in connection with Mexicana was USD\$11,134,280.59.

50. The initial hearing on the Reconciliation & Payment Process Motion was scheduled on February 27, 2012. On February 24, 2012, Mexicana request a first postponement of the hearing, which IATA accepted on the condition that the hearing be held as soon as possible, subject to the Court's availabilities. Therefore, the next hearing was scheduled on April 24, 2012, the whole as appears from the emails at **Exhibit I-26A**.

51. On April 20, 2012 the parties had hoped to achieve a consensus on all the issues raised by the Reconciliation & Payment Process Motion and be able to be heard on April 24, 2012. However, in light of outstanding contention points, this hearing had to be postponed a first time to April 26, 2012 and a second time *sine die*, the whole as appears from the emails at **Exhibit I-26B**.

52. While IATA was prepared to proceed on its motion since February 27, 2012, it had accepted to negotiate with Mexicana in good faith to obtain a Process satisfactory for both parties.

53. However, by June 15, 2012, IATA felt it could no longer delay the conclusion of the process and the application of the BSP & CASS Net Proceeds against the ICH Balance, which had already been delayed since February 2011. Thus, IATA's attorneys requested to be heard by the Court.

54. At that time and for most of the days between May 15 and July 31, the exchange rate of conversion of Mexican Pesos to one US dollar was near (or higher than) what it was on January 6, 2012, the whole as appears from daily data obtained from the US Federal Reserve, **Exhibit I-27**.

55. The Court suggested a hearing on July 3, 2012.

56. Unfortunately, once again, since negotiations between the parties were still going on, IATA agreed to postpone the hearing the whole as appears from the emails at **Exhibit I-26C**.
57. On August 12, 2012, since there was no meaningful progress in the negotiations, and since IATA was determined to have the Process approved as soon as possible, the undersigned attorneys contacted the Court to schedule another hearing. The Court graciously accepted to hear the parties on August 23, 2012.
58. However, one more time, Mexicana requested a postponement of the hearing. While IATA was reluctant to accept, the hearing was finally postponed to September 11, 2012. This hearing led to the partial approval of the Process, which was then set in motion diligently.
59. One of Mexicana's largest debts (i.e. Iberia), was only settled as a result of lengthily negotiations between Mexicana and Iberia late into the Process on December 12, 2012, the whole as appears from an email from Iberia to IATA dated December 12, 2012 (**Exhibit I-28**).
60. Moreover, as a result of the important volume of claims inputted by Mexicana and other airlines, which had all to be verified, as well as a result of the fact that IATA had to consult with third parties like the ACH, the process was not concluded until April 2, 2013, the whole as appears from the email transmitting the final Form 1 and Form 3 (**Exhibit R-3**).
61. However, IATA doesn't provide hedging services against currency risks; it has always acted prudently and diligently and within its right in this matter and has committed no fault whatsoever. Quite to the contrary, IATA has refrained from exercising its rights to apply the BSP & CASS Net Proceeds against the ICH Balance for over two years as a pure courtesy to Mexicana.
62. There was no way for IATA to (nor did it have to) predict the outcome of the Process or the fluctuation of currencies. The depreciation of the US Dollar is an unfortunate event outside of IATA's control and it should not be held liable for the unforeseen strength of the Mexican Peso of any other currency.
63. Moreover, IATA was prepared to present the Process to the Court for its approval on February 27, 2012; the various postponements of the hearing on the implementation of the process were solely due to IATA's willingness to negotiation in good faith with Mexicana. Had IATA started the process on February 28, 2011, the results of Mexicana's alleged losses could have been totally different, but once again this is speculation.

C) Indemnification Provisions

64. Moreover, IATA is not liable for the operation or the management of the BSP & CASS Net Proceeds.

65. Indeed, Mexicana has contractually agreed to hold IATA harmless of all actions carried on in good faith in the performance of services related to the Hinge Account (the Hinge Account are the specific bank accounts operated locally by IATA in each BSP geographic region on behalf of the participating BSP Airline).

66. Section 2 of the Counterindemnity Agreement (**Exhibit I-16**) provides that:

“The undersigned Airline will indemnify IATA, its officers and employees, against any liability and costs, for any action taken or omitted in good faith in the performance of the operation of the Hinge Account or other accounts mentioned in paragraph 1 above, or arising in any other way from the operation of these accounts”

67. Mexicana has also agreed, in the Agreement on refunds (**Exhibit MX-17**), that IATA shall not be held liable in relation with the services provided pursuant to the said agreement. Section 6 of the Agreement on refunds provides that:

“Mexicana agrees that IATA shall assume no liability of any nature whatsoever in connection with the performance of the services described in this Agreement.”

68. Therefore, in addition to the arguments above, and given its obvious good faith, IATA should not be held liable in any way for currency fluctuations.

D) Mexicana’s Cross Demand is not receivable

69. The present proceedings are about the international restructuring of Mexicana. IATA is an interested party and has intervened to these proceedings since August 2010 in order to safeguard the interests of its members and the traveling public (the Agreement on refunds) and to ease Mexicana’s restructuring by implementing the Process.

70. IATA is not a defendant or a plaintiff to any action by or against Mexicana.

71. The current proceedings are not the appropriate forum for Mexicana to voice a claim against IATA. In reality, as long as the Process will not be completed, Mexicana’s alleged damage has not yet materialized.

72. The procedural rights of any defendant to a civil liability suit have not been applied to the proceedings. Therefore, IATA’s right to a full defense against the allegations of Mexicana (such as the right to conduct examinations, the right to produce a defense, the right for a complete hearing with all of the appropriate witnesses, etc.) cannot be respected in the current proceedings.

E) The fees and costs owing

73. The Process also provides for the final payment of the fees and costs incurred by IATA with the BSP & CASS Net Proceeds.

74. The fees and costs to date are filed as **Exhibit I-29** and are already partially paid by IATA.

75. The costs above-mentioned include the legal fees incurred by IATA in relation with the services provided in the context of the restructuring proceedings of Mexicana, in the jurisdictions where Mexicana filed for protection and where IATA had to be involved, namely in Mexico, in the United States, as well as in Canada.

76. These fees are owed pursuant to the applicable provisions of the Passenger Agency Conference Resolutions, the Clearing House Regulations, as well as pursuant to the Agreement on refunds.

77. First, Resolution 850 (**Exhibit I-2**) is one of the key components of the contractual relationship between Mexicana, the BSP accredited travel agents and IATA. As such, IATA is entrusted with the task of administering the BSP systems and operating the relevant bank accounts (the "Hinge Accounts") for the benefit of the participating airlines. The relevant provisions of Resolution 850 are:

- Section 13 which provides that Mexicana "undertake[s] to indemnify IATA, its officers, employees and other appointees against liability (including liability for legal costs) for any action undertaken in good faith in the performance of their functions with respect to [the operation of the IATA processing center]";
- Section 2 of Attachment C, which provides that Mexicana "will indemnify IATA, its officers and employees, against any liability and costs, for any action taken or omitted in good faith in the performance operation of the Hinge Account".

78. Second, the Clearing House Regulations (**Exhibit I-17**) govern Mexicana's participation in the Clearing House, through its membership in the ACH. Section 40 of the Clearing House Regulations is relevant for the purposes of the legal fees and provides that:

"(a) Members shall reimburse to the Clearing House any direct charges incurred by the Clearing House on their behalf, including without limitation:

[...]

(ii) legal fees and costs incurred through action taken with regard to bankruptcy reorganization under bankruptcy and/or insolvency laws, court-appointed (or otherwise) administration, receivership, insolvency or liquidation of a Member."

79. Finally, the Agreement on refunds also provides for the payment by Mexicana of the fees incurred by IATA pursuant to the services incurred in relation therewith. As such, Section 4.1 specifically acknowledges that "all fees and charges payable to IATA" will be deducted. Moreover Section 6 provides that Mexicana agreed to indemnify IATA against "any legal action, damage, cost and fees that IATA may incur or be subject to in connection with this Agreement".

80. The fees incurred as of April 11, 2013, are in the amount of USD\$343,128.88 the whole subject to additional fees to be incurred by IATA and the conversion rate applied on the invoices in Canadian dollars (**Exhibit I-29**).

81. These amounts are fully reasonable and are commensurate with the complexity of the matters, and the multijurisdictional aspects of these proceedings.

FOR THESE REASONS, MAY IT PLEASE THE COURT TO:

ALLOW the present *Reply of the Applicant to the Insolvent Debtor's Contestation*;

DECLARE that the service of this Reply is proper and sufficient;

GRANT the *Motion for an Order Regarding the Final Settlement of the Debtor's outstanding Balance with the IATA Clearing House and for the Final Distribution of BSP & CASS Proceeds*;

DISMISS the *Insolvent Debtor's Contestation to the Motion for an Order Regarding the Final Settlement of the Debtor's Outstanding Balance with the IATA Clearing House and for the Final Distribution of BSP & CASS Proceeds and Cross Demand*, dated April 18, 2013;

APPROVE the full Reconciliation and Payment Process at Exhibit I-1/IATA and **GIVE EFFECT** to section 5 of the Reconciliation and Payment Process regarding the final distribution of BSP & CASS Net Proceeds;

ORDER Mexicana to pay the full amount of the costs and legal fees owed to IATA in connection with the Mexicana restructuring proceedings;

AUTHORIZE IATA to apply any part of the BSP & CASS Net Proceeds in full payment of the ICH Balance (together with the interest applicable pursuant to Section 29 of the Clearing House Regulations) in accordance with such process and to pay all associated costs and fees owing by Mexicana to IATA;

ISSUE any other order as this Court may deem appropriate in the circumstances;

THE WHOLE, with full costs.

MONTREAL, April 21, 2013



McMILLAN LLP
Attorneys for Applicant
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N° / No.: 500-11-039418-104

**SUPERIOR COURT
(COMMERCIAL DIVISION)
DISTRICT DE / OF MONTREAL**

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**REPLY OF THE APPLICANT TO THE
INSOLVENT DEBTOR'S CONTESTATION ;
EXHIBITS I-26A TO I-29**

M^e ERIC VALLIERES

Réf. / Ref.: 557190-09900/EV/cl

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