

Bankruptcy

Deep Dive

Foreign Airlines Rely on Chapter 11 as Bankruptcy Tourists in US

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Brazilian airline Azul SA is the latest in a string of overseas carriers turning to Chapter 11 in the US, becoming “bankruptcy tourists” to access legal protections largely out of reach in their home countries.

Azul’s bankruptcy plan, approved this month, slashes more than \$2 billion in debt and allows it to reject aircraft leases it couldn’t easily shed at home.

Other foreign carriers seeking Chapter 11 in the US over the past five years include Avianca, LATAM, Grupo Aeroméxico, and, more recently, Brazil’s Gol Linhas Aéreas.

US bankruptcy law requires that a debtor have a domicile, business, or property in the country, which can be satisfied by a bank account or law firm retainer, to be eligible for Chapter 11. The law offers a worldwide automatic stay against creditor actions, the ability to reject or negotiate burdensome leases, and access to debtor-in-possession financing to cover bankruptcy costs.

Latin American countries such as Mexico and Brazil, among the region’s largest economies, lack the same flexibility.

"The standard for rejection in the US is very low," said Michelle McGreal, a Clifford Chance partner specializing in airlines. "It's whatever the company thinks is in its best interest, and they don't have to give much more of a reason."

As Latin American airlines began filing, others in the region followed. Europe has produced fewer cases, with Scandinavian Airlines in 2022 becoming the first publicly traded European airline to file Chapter 11 since the pandemic.

"To some extent, it may also just be a precedent comfort level," said Kelly DiBlasi, a partner at Weil, Gotshal & Manges LLP. "Once one Latin American airline does it, the next one says, 'Well, my neighbor did the same thing, I can go through it as well.'"

Foreign Regimes

Brazilian law has incorporated certain concepts inspired by Chapter 11, particularly after a 2020 reform, said Fernanda Drugowich, a partner at Brazilian law firm Galdino Advogados. But those additions have been in "a far more limited and formalistic way," she said.

"While Brazilian law provides for a stay period and now expressly allows debtor-in-possession financing, these tools operate within narrower statutory boundaries and lack the same level of flexibility and predictability found in the US system," Drugowich said.

The Brazilian stay period is initially 180 days with a potential extension and doesn't apply to all creditor classes, such as certain secured claims and aircraft lessors, she added. And while bankruptcy financing is permitted, uncertainty around collateral protections and enforcement limits its practical use.

Brazil has also taken steps to build up cross-border cooperation and facilitate "pre-packaged restructurings," in which a company finalizes its turnaround plan before filing bankruptcy. However, these mechanisms are subject to strict statutory constraints, Drugowich noted.

Azul's lease obligations totaled \$6.42 billion, according to court papers. The airline sought to reject agreements with lessors, including Bank of America, Wells Fargo Trust Co., ICBC, and Avolon. Azul's deal with its largest lessor, AerCap, is expected to save around \$1 billion.

Mexico's commercial bankruptcy law, enacted in 2000, was designed to follow global shifts toward business reorganization, but the process remains unappealing and has produced relatively few filings, according to María Susana Dávalos Torres, professor at the Institute of Legal Research at the National Autonomous University of Mexico.

Total bankruptcy filings admitted under the regime as of May 31 were 1,099, according to the Mexican Administrator for Insolvency Procedures.

"These figures serve as a clue that something is going wrong with Mexican commercial insolvency in order to accomplish corporate reorganization," Dávalos Torres said.

In Mexico, enforcement action suspension depends on the admission of insolvency and a judge's decision to impose precautionary measures, she said. Debtors also can't quickly terminate burdensome contracts.

The Mexican bankruptcy proceeding was established in a restrictive economic environment after the 1994 economic collapse and subsequent bank bailouts, Dávalos Torres said.

It was intended to prevent the support of "dishonest or careless debtors," she noted. But that resistance "has kept the Mexican commercial insolvency regulations from incorporating provisions provided by the US bankruptcy process."

US Regime

Lenders are often unwilling to provide DIP financing in an untested jurisdiction.

The US and UK "are probably the two jurisdictions that the big banks and other lenders are familiar with and feel comfortable," said Stephen J. Lubben, a Seton Hall University School of Law professor and co-author of a paper on "corporate bankruptcy tourists."

McGreal said lenders rely on Chapter 11 case law and familiarity with judges and the system.

"It's not as risky as saying, 'We are going to fund you in a restructuring regime that we don't know how it works. We don't know how the judges will be, and it might be unfriendly to us,'" she added.

Additionally, foreign debtors generally have easier access to judicial protection and benefits such as emergency hearings in the US. In many other countries, there's little precedent or assurance that similar protections are available, said Patrick J. Potter, partner at Pillsbury Winthrop Shaw Pittman LLP.

"An important question for any prospective debtor is, can I run my business during Chapter 11 in another country as easily as I can in the US? If someone violates the automatic stay, can I get an emergency hearing right away?" he said. "I think the answer outside the US is often either we don't know, because it's never been tested, or you should assume the answer is no."

Closing Gaps

When a company files in the US, it may still want recognition at home, particularly if there's a possibility local creditors or courts would push back.

Additional recognition can sometimes "close the gap," DiBlasi added.

Potter said that while foreign enterprises often seek Chapter 15 recognition in the US, the opposite seems to occur less often.

"You see less foreign recognition of US bankruptcy judgments because parties are often less worried about it," Potter said. "People know that ultimately a US bankruptcy court order is likely going to be honored."

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