The Corporate Insolvency and Governance Act 2020 and Aircraft Finance – Part 1

The new moratorium regime

What are the potential implications of the new moratorium regime set out in the Corporate Insolvency and Governance Act 2020 (the "**Act**") for aircraft lenders, lessors and airlines? In the first of a series of three articles, we consider this new law.

For general information on the parliamentary bill that preceded the Act, please see our previous LawNow article here. At the time of writing, the Act has received Royal Assent and is due to come into effect at the end of June 2020.

The key purpose of the new moratorium regime is to provide "breathing space" for companies outside of a formal insolvency process so that the company can continue to operate whilst planning for rescue as a going concern and long-term survival.

Who is eligible to file for a moratorium?

The new moratorium regime could be a useful strategy for an airline that finds itself in a liquidity crisis, brought about by the Covid-19 pandemic – the market has seen an unprecedented level of rent deferral and payment holiday requests since March 2020 and some airlines have been vocal about their daily cash burn in light of their significantly reduced revenues. With the continuation of travel restrictions (including the new 14-day quarantine in the UK) and grounded fleets across the world, as the end of Q2 approaches we may reach a point where some aircraft lessors also find themselves in a distressed position. But would airlines and lessors be eligible under the new regime?

Companies will be generally eligible for the moratorium regime (including certain overseas companies that could be wound up under the current UK insolvency regime) unless one of the exclusions applies. The exclusions which seem most likely to affect the eligibility of airlines and lessors are:

— **Existing insolvency procedure currently applies to the company or the company has been subject to a moratorium, a CVA or administration in the preceding 12 months**: If subject to a moratorium, CVA or administration in the preceding 12 months, the new legislation will lift this restriction temporarily to account for the impact of the Covid-19 pandemic, so that this exclusion will not apply from the Act coming into effect until 30 September 2020, the so-called "relevant period". So the regime could even prove helpful for companies which have already been through a UK administration process in the past 12 months and have been dealt a further blow by the pandemic.

— **Financial services companies**: Banks, and "banking group companies" as defined in the Banking Act 2009, amongst other financial institutions, are not eligible, which could mean that an aircraft leasing business that is part of a bank would not be able to file for a moratorium.

— **Parties to capital market arrangements**: If a company is party to a capital markets arrangement involving debt of at least £10million and the issue of a capital markets investment, then it will not be eligible. For example, an aircraft lessor or an airline that has funded itself by raising debt in the capital markets may be caught by this exclusion, depending on the type and structure of the financing. It is often the case that a strong credit (which would arguably have a good prospect of being rescued as a going concern!) will raise liquidity in the capital markets and yet, this exclusion would preclude it from benefitting from the "breathing space" afforded to some other airlines, potentially its competitors, due to its chosen financing structure. From the explanatory notes to the Parliament Bill in respect of the Act, produced by the Department for Business, Energy and Industrial Strategy, it is not clear whether this was the intended effect of this exclusion however, it is possible that this position could change via secondary legislation.

If a company opts to file for a moratorium under the new regime, the directors will have to provide a statement confirming that, in their view, the company is or is likely to become unable to pay its debts (i.e. technically insolvent, in the eyes of English law), and the proposed "monitor" for the moratorium period (likely to be a qualified insolvency practitioner) will need to confirm the company's eligibility and that the moratorium would likely result in the rescue of the company as a going concern.

It is worth noting that the route or plan to "rescue as a going concern" does not need to be specified when filing for a moratorium. This flexible approach will be helpful for airline businesses: it is still not clear for how long travel restrictions will be imposed, to what extent travel will return to pre-pandemic levels of activity and therefore, for how much longer airlines will be directly adversely impacted; all of which will be important factors to consider as part of any restructuring or work-out. Further, the requirement for the monitor to confirm that the moratorium will result in the "rescue of the company as a going concern" will effectively ignore, temporarily, the impact of Covid-19 for the "relevant period" so that further deterioration of the company's financial position in connection with the pandemic does not have to be taken into consideration.

What is the effect of the moratorium?

Once a moratorium period comes into effect, the following key restrictions on creditors apply:

— No insolvency proceedings can be commenced against the company by a creditor. This changes the position of any aircraft lender or lessor: the mere fact of a creditor's ability to initiate insolvency proceedings against a debtor is often deployed as a negotiating "tool" in a default situation.

— The enforcement or payment of "pre-moratorium debts" is restricted. These are payment obligations that have fallen due before the moratorium period or which fall due during the moratorium period as a result of an obligation incurred before the moratorium came into force. However, there are several exclusions. Notably, debts or liabilities under a contract or instrument involving financial services are amongst the excluded categories of debt (in addition to wages, goods and services supplied during the moratorium period, etc). Rent payable during the moratorium period is listed as an exclusion from the restriction, so it seems possible that rent owed under aircraft operating leases would be payable throughout the moratorium - good news for operating lessors, whose own financings may well be impacted if rental income streams are suspended for an extended period. Interestingly, the Act does not define "rent", although it seems to be intended to relate to payment of rent for commercial premises rather than equipment leasing.

— During the moratorium period, a creditor cannot enforce security over the company's property or repossess goods from the company which are subject to a hire-purchase agreement (which is defined to include leases, even if they have no purchase option), without leave of the court.

In light of the exclusions in relation to certain pre-moratorium debts, any aircraft lender or any lessor under a finance lease will still be entitled to be repaid and would even be able to accelerate a defaulted loan or finance lease, during the moratorium period. However, the ability of some creditors to accelerate during the moratorium period could be perceived as a way for financial institutions to circumvent the regime. To counter this, the Act contains provisions which ensure that, even if certain pre-moratorium debts were accelerated, the creditors would not be afforded super-priority status, for example, in a subsequent winding-up process within the first 12 weeks after the moratorium period has ended.

Even if a creditor were to accelerate, as outlined in the paragraph above, it would be prevented from taking steps to enforce until the moratorium period has ended. However, there is an important distinction for certain aircraft lenders and lessors: the Act contains provisions amending the International Interests in Aircraft Equipment (Cape Town Conventions) Regulations 2015 (these are the regulations that implement the Aircraft Protocol of the Convention on International Interests in Mobile Equipment (known as the Cape Town Convention) in the UK) (the "**Cape Town Regulations**"). The effect of the amendments to the Cape Town Regulations is to ensure that certain of the enhanced creditor protections afforded to aircraft creditors with a registered international interest in an aircraft object ("**Cape Town Creditors**") are not overridden by the new moratorium regime. Under the Cape Town Regulations, after the first 60 days of an insolvency process (called the "waiting period") a Cape Town Creditor can enforce its security and repossess an aircraft object; the disposal of an aircraft object is also permitted. Under the new regime, Cape Town Creditors will continue to have such ability to enforce and repossess, even if a moratorium were to be extended beyond 60 days, meaning that in theory, a Cape Town Creditor is in a superior position to another secured aircraft lender.

How long will the moratorium period last?

The initial moratorium period under the new regime is 20 business days, which can be extended by an additional 20 business days by the directors of a company, and thereafter, any further extension would require the consent of the pre-moratorium creditors where there is a payment holiday or a court order. The ability to extend the moratorium period will likely prove important for airlines and lessors, given that the "bounce-back" for the aviation industry is not predicted to be as rapid as for some other industries.

As we saw in the previous section, most aircraft financings (including financial leases) and potentially, operating leases, would not constitute pre-moratorium debt for which a company is entitled to a payment holiday during the moratorium period, therefore aircraft lenders and lessors would not constitute "pre-moratorium creditors". This means that an airline would not have to seek their consent to extend the moratorium and if an airline applied to court for a further extension of the moratorium, aircraft financiers and lessors would not be included in the group of creditors whose interests the court would have to consider in deciding whether to make an order for such extension.

It certainly appears that the new moratorium regime has the potential to create an uneven landscape for creditors, particularly as between Cape Town Creditors and other secured creditors. Given the urgency to implement the new regime in the current climate, it is possible that some issues may be addressed after the new law comes into force, by way of secondary legislation. Our second article will look at the restructuring plan provisions which can, in some circumstances, cram down a class of creditors against their will.

Key Contacts

Keith Wilson
Head of Aircraft Finance, London
T +44 20 7367 2394
E keith.wilson@cms-cmno.com

Gwen Edwards
Partner, London
T +44 20 7367 2950
E gwen.edwards@cms-cmno.com

Neha Arora
Senior Associate, London
T +44 20 7367 3221
E neha.arora@cms-cmno.com

UK-641983182.5

Legal Flightpath – CMS Aviation first landing contacts

Airlines	Dominic Dryden	dominic.dryden@cms-cmno.com
Aircraft Finance, Leasing and Trading	Keith Wilson	keith.wilson@cms-cmno.com
Aviation Capital Markets	Neil Hamilton	neil.hamilton@cms-cmno.com
Airports	Stephen Scott	stephen.scott@cms-cmno.com
Aviation Restructuring	Glen Flannery	glen.flannery@cms-cmno.com
Aviation Insurance and Disputes	Alaina Wadsworth	alaina.wadsworth@cms-cmno.com
Competition Law	Brian Sher	brian.sher@cms-cmno.com
Aviation Disputes	Chris Gooding	chris.gooding@cms-cmno.com
Aviation Environmental	Valentina Keys	valentina.keys@cms-cmno.com
Aviation Regulatory/CAA	Paul Silver	paul.silver@cms-cmno.com
Hotels and Leisure	Tom Page	tom.page@cms-cmno.com
Outsourcing and Technology	Dominic Dryden	dominic.dryden@cms-cmno.com
Technology and Commercial Contracts	Sam De Silva	sam.desilva@cms-cmno.com
Data Protection	Loretta Pugh	loretta.pugh@cms-cmno.com
Intellectual Property	Joel Vertes	joel.vertes@cms-cmno.com
Reputation Management	Dan Tench	dan.tench@cms-cmno.com
Pension Funds and Pensions	Mark Grant	mark.grant@cms-cmno.com
Employment	Gary Henderson	gary.henderson@cms-cmno.com
Real Estate	David Crossley	david.crossley@cms-cmno.com
Planning	Ashley Damiral	ashley.damiral@cms-cmno.com
Construction	David Parton	david.parton@cms-cmno.com
Aviation M&A	Louise Wallace	louise.wallace@cms-cmno.com
Aviation Tax	Sam Dames	sam.dames@cms-cmno.com
Health and Safety	Lukas Rootman	lukas.rootman@cms-cmno.com
Regulatory Compliance/Corporate Crimes	Omar Qureshi	omar.qureshi@cms-cmno.com
CEE/CIS Aviation	Ihor Olekhov	ihor.olekhov@cms-cmno.com

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