The Corporate Insolvency and Governance Act 2020 and Aircraft Finance – Part 3

The UK has introduced a new restructuring tool, the Restructuring Plan, which when coupled with other provisions of the new law creates the possibility of the management of a company in financial difficulty remaining in control of a process designed to turn the company around as a going concern whilst in many cases having the benefit of a moratorium. Sounds a little like Chapter 11 in the US?

We examine whether the Restructuring Plan will offer aviation companies in the UK (and elsewhere?) a potential route to deal with the difficulties caused by the COVID-19 pandemic.

The Act giving rise to the new Restructuring Plan is the Corporate Governance and Insolvency Act 2020. For a more general description of its provisions please see our previous Law-Now here.

One of the key questions provoked by the new Act is whether it applies only to UK companies or whether it has wider application. In fact, it applies to any company that is capable of being wound up (liquidated) in the UK. If this is interpreted in the same way for the new Act as it has been historically in respect of Schemes of Arrangement, then the test is not a tough one: having English law documents and a UK bank account have been held to be sufficient. Furthermore, the courts have held that “being capable of being wound up” is not a test that has to be met at the time of assessment provided it could be met at some point in the future. It is reasonable to expect that some companies with a thin connection to the UK may seek to avail themselves of the new law protections.

In Part 1 of this series of Law-Nows we looked at the moratorium provisions contained in the Act. These are not part of the Restructuring Plan proposal but unless one of the exclusions (see previous Law-Now) applies, would also be available to the company embarking on utilising the Restructuring Plan. To this extent the concept is like the moratorium enjoyed by a company filing for Chapter 11 protection in the US.

Historically many airlines in the US have utilised Chapter 11 including the three “majors”. It has been described as a “useful business tool” allowing a company under financial pressure to obtain protection while it rationalises its business. Although the process is court supervised, it is run by the company’s management allowing the company to implement a restructuring plan. The new Restructuring Plan in the United Kingdom is similar: the company itself is responsible for developing the Restructuring Plan and

submitting it to creditors and the court for approval. It is intended for companies in financial difficulty.

Chapter 11 is a bankruptcy process. There is no direct equivalent in the UK with administration being arguably the closest. The primary purpose of an administration is to turn the business around as a going concern. In an airline context there has not been an administration that has successfully achieved this purpose. In light of recent UK airline failures, the UK Department of Transport recommended the introduction of a new special administration regime but, even then, the primary purpose was to facilitate a more orderly repatriation of passengers on an airline insolvency rather than improve the possibility of an airline being turned around as a going concern. Administration involves the appointment of an insolvency practitioner who becomes responsible for the management of the company in administration in place of the previous management. An administrator may then delegate some of his management tasks back to existing management but that rarely happens (though in the current crisis we have seen it what have been dubbed “light-touch” administrations) - in no ordinary sense could it be said that existing management continue in control of a turnaround plan. In that respect administration is different to US Chapter 11.

The UK has two other relevant restructuring regimes. The first is a Company Voluntary Arrangement (a “CVA”). A CVA often forms part of a turnaround plan but it cannot bind secured creditors who do not consent to it and this is often a severe limitation on its utility. The other alternative is a Scheme of Arrangement which has strong similarities to the new Restructuring Plan. Neither a Scheme of Arrangement nor a Restructuring Plan carries it with an automatic moratorium. A company could still benefit from the new moratorium under the Act and both a Restructuring Plan and a Scheme of Arrangement could subsequently provide for an additional moratorium to become effective if the Scheme or Plan is sanctioned by the Court.

Both a Scheme of Arrangement and a Restructuring Plan require approval by creditors. For a Scheme, a majority of all creditors and 75% by value of each class of creditors must vote in favour before the Court considers approval; under the new Restructuring Plan it is 75% by value of each class but with an exception that may be crucial: a dissenting class of creditors can be forced to comply with the Restructuring Plan provided that their position under the proposed plan is no worse than their position under the next most likely alternative and the Restructuring Plan has been approved by the requisite majority of another class of creditors which would have an economic interest in the company in the event of the relevant alternative. What is the next most likely alternative will vary to some extent depending on facts but will likely be either administration or liquidation. The onus will be on the company to demonstrate that the test is met. This ability to “drag along” a dissenting class of creditors is a significant distinction from the previous law and may be helpful in pursuing a turn-around plan and is likely to make the Restructuring Plan a more popular option than the Scheme (and closer to Chapter 11). Deciding what constitutes a class for these purposes has case law history but for an airline that owns some of its equipment with secured lenders providing finance, has some leased fleet, has credit card acquirers and general unsecured trade creditors, the classes may define themselves. In other cases, it may need greater scrutiny and advice. Ultimately the court must approve.

The UK adoption of the Cape Town Convention included a rule that "no obligation of the debtor under the [*Cape Town registered*] Agreement may be modified without the consent of the creditor". Does this over-ride the new law? Unfortunately the position is unclear: the rule appears in a section of the rules intended to deal with a situation where the debtor has entered into a formal insolvency process and it is likely that many, probably most, Restructuring Plans will be proposed outside of formal insolvency but the actual drafting of the section leaves unclear whether the rule only applies on formal insolvency or is of more general application. The first draft of the bill leading to the Act expressly excluded creditors with a Cape Town registered interest from being subject to the Restructuring Plan without their consent but this was removed at a later stage leading one to infer that Parliament intended that a creditor with a Cape Town registered interest should be subject to a Restructuring Plan and the possibility of cram down or being dragged along.

Pulling a restructuring together for a company with a capital stack with different creditor groups (for example, lenders, bond holders and operating and finance lessors) is not easy, particularly where concessions are likely to be required from each class of creditors and the shareholders. The new Restructuring Plan only makes this marginally easier. In the aviation context the uncertainty over the effect on a creditor with a Cape Town registered interest is very unhelpful.

For a reasonable size UK company in the aviation space, the support that is available to furlough staff, apply for a CLBILS Government backed loan of up to £200 million and have the benefit of the new moratorium and Restructuring Plan possibilities under the new Act may seem slightly meagre when compared to the levels of direct financial support being provided by the US and other EU neighbours to their airlines and aviation companies (see previous Law-Now). And it is likely that the creditors of a UK company in the aviation space would prefer a more direct financial solution too…

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