



The Corporate Insolvency and Governance Act 2020 and Aircraft Finance – Part 2

Insolvency termination clauses in Supply Contracts

What are the potential implications of the new measures in relation to contracts for the supply of goods or services set out in the Corporate Insolvency and Governance Act 2020 (the “**Act**”) for aircraft lenders, lessors and airlines? In the second of a series of three articles, we consider the new prohibition on suppliers invoking termination clauses (or changing other terms) upon an insolvency or formal restructuring process introduced in the Act.

For general information on the Act, please see our previous Law-Now article [here](#).

Insolvency termination clauses in aircraft operating leases

The Act attempts to maximise the opportunity for rescue of a business as a going concern by prohibiting (in certain circumstances) the reliance on clauses which enable a supplier to terminate a supply contract or the supply, or to do any other thing (such as change terms of the supply contract) after a company has entered into an insolvency or formal restructuring procedure, including where a moratorium under the new Part A1 of the Insolvency Act 1986 comes into effect. The new law under the Act also prohibits termination of a supply contract based on past breaches of the supply contract from the start of the insolvency period until such time as a company is no longer subject to a relevant insolvency procedure. Whilst these new provisions interfere with the concept of freedom of contract/commercially agreed terms, they have been implemented in order to give companies some ‘breathing space’ whilst subject to insolvency proceedings.

The new measures substantially update UK insolvency law and could have specific application to aircraft lessors’ and lenders’ remedies in the future, including during the ongoing COVID-19 crisis. Aircraft leases are, in their essence, contracts for the supply of “goods and services” and typically include clauses providing for termination due to insolvency procedures being taken in relation to an airline/lessee. As such clauses will cease to have effect as a result of the new measures introduced by the Act, aircraft lessors and lenders would need to look to other provisions in their operating lease agreements in order to be able to terminate the leasing of an aircraft if an airline/lessee enters into insolvency or a formal restructuring process. If such clauses cease to have effect and an airline/lessee becomes subject to a further relevant insolvency procedure, an aircraft lessor or lender may terminate the supply contract using the measures set out below under the section ‘Is there any way that supply contracts can be terminated due to an airline/lessee entering into an insolvency or formal restructuring process?’.

Aircraft leases also typically include termination provisions in relation to steps taken or circumstances that may occur prior to a formal insolvency procedure which are effectively an early warning trigger as to an airline’s financial deterioration, such as (a) being unable or admitting its inability to pay its debts as they fall due; (b) suspending or threatening to suspend making payments on any of its debts; or (c) due to actual or anticipated financial difficulties, commencing negotiations with one or more of its creditors with a view to rescheduling any of its indebtedness. Such provisions could be relied upon before any formal insolvency or restructuring process has commenced, but as noted in our previous Law-Now article [here](#) the commercial reality may be (and has been in the vast majority of cases during the Covid-19 pandemic) that aircraft lessors and lenders agree to short term rent deferrals and choose to reserve their rights in respect of such termination events in order to help the airline/lessee through these uncertain times. Termination provisions in relation to the non-payment of rent would also continue to apply and it remains to be seen what actions

aircraft lessors and lenders will take once the current rent deferrals expire this summer. Will shorter, perhaps monthly, rent deferrals be afforded to certain airlines/lessees?

Who is excluded from the application of the new prohibition on termination due to insolvency?

The Act provides that these new measures will not apply to, among others:

- certain financial services companies (banks and “banking group company” as defined in the Banking Act 2009), financial contracts (which includes contracts for the provision of financial services consisting of lending (including factoring and financing of commercial transactions), financing leasing or providing guarantees or commitments) and swap contracts. Although “financial leasing” is not defined in the Act, this is likely to include finance leases of aircraft. Finance leases may therefore not be captured by the Act, but it would appear to apply to operating leases, unless (for example) the operating lessor is part of a bank or financial institution;
- companies/suppliers that carry on the regulated activity of effecting or carrying out contracts of insurance and which are not an exempt person (as defined in section 417 of the Financial Services and Markets Act 2000) in relation to that activity. Insurers will likely be able to terminate their contracts due to an airline or aircraft lessor entering into a formal insolvency process or formal restructuring process, as the new law would not apply to the supply of insurance where the above applies;
- securitisation companies within the meaning of the Taxation of Securitisation Companies Regulations 2006 (S.I. 2006/3296). This would likely apply to aircraft lessors that have put in place asset-backed securities (ABS) in relation to portfolios of aircraft and/or airlines that have entered into enhanced equipment trust certificates (EETC) to finance the purchase of aircraft;
- agreements which are, or form part of, an arrangement involving the issue of a capital market investment. 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; and/or
- Cape Town Creditors (see below paragraph for further details).

Interestingly, these exceptions apply whether either the company or the supplier does or has done anything outside the United Kingdom which, if done in the United Kingdom, would cause any of the above exceptions to apply. This means that the supply or use of the aircraft does not need to take place in the United Kingdom for the above exceptions to apply.

Unless caught by the above or another exception in the Act, the above prohibition would still apply to all other suppliers (such as aircraft part manufacturers and maintenance and repair providers) to an airline that is subject to a relevant insolvency or restructuring procedure.

Insolvency termination clauses and the Cape Town Convention

The measures introduced by the Act in relation to the new prohibition on suppliers invoking termination clauses (or changing other terms) upon an insolvency or formal restructuring process will not affect the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (S.I. 2015/912) (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 this is 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 measures. 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. Cape Town Creditors will therefore continue to have such ability to enforce and repossess, as the prohibition of the use of termination clauses (or doing any other thing) relating to an

insolvency or formal restructuring process would not apply to a Cape Town Creditor, meaning that in theory, a Cape Town Creditor is in a superior position to another operating lessor or secured aircraft lender (that is not a financial services company) without a Cape Town registered interest.

Is there any way that supply contracts can be terminated due to an airline/lessee entering into an insolvency or formal restructuring process?

There are three main ways in which supply contracts can be terminated once an insolvency process or formal restructuring process has begun:

1. One of the protections for suppliers includes the ability of suppliers to cease to continue supplies if it causes 'hardship' to the supplier's business. Suppliers would need to apply for court permission to terminate a supply contract due to 'hardship' to the supplier's business. 'Hardship' is not defined in the Act and it is up to the supplier to show that continuing with the contract would cause the supplier 'hardship', for example due to its own financial hardship/supply chain issues;
2. If the company or, if applicable, an administrator, administrative receiver, liquidator or provisional liquidator consents to the termination of the supply contract; and/or
3. The Act also includes a temporary suspension for small suppliers/lessors, which will be in place until 30 September 2020. The Act states that a supplier is small if, in its most recent financial year, at least two of the below conditions were met:
 - The supplier's turnover was not more than £10.2 million;
 - The supplier's balance sheet total was not more than £5.1 million and
 - The average number of the supplier's employees was not more than 50.

This temporary exemption is unlikely to apply to most suppliers in the aviation industry, but it is possible it could apply to smaller part suppliers.

What next?

If suppliers and operating lessors are prohibited from enforcing termination provisions in relation to insolvency procedures pursuant to the Act, it is possible that termination clauses in aircraft operating leases could be drafted differently in the future, in order to provide analogous protections to aircraft lessors and lenders. Such provisions also have the potential to create an uneven landscape for the use of termination provisions between creditors, particularly as between Cape Town Creditors and other secured creditors. This is unlikely to be the desired outcome for airlines/lessees as they typically try and standardise what they agree to in respect of such fundamental provisions across their leases with aircraft operating lessors.

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