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## AIRLINE INSOLVENCIES IN GERMANY: QUESTIONS AND CHALLENGES FOR AIRCRAFT LESSORS

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### *Airlines under pressure*

The market for airlines is under **extreme competitive pressure**. We have seen some recent examples of European airlines that have gone into insolvency proceedings (Air Berlin, Condor, Germania, Monarch, Small Planet, Flybe). Airlines are struggling with volatile commodity markets and political instabilities (trade wars, protectionism). In addition, the **Covid-19-Crisis** ('Coronavirus') is leading to further distress. Flight routes have been suspended and in March 2020, the U.S. government has cancelled all air travel from the EU to the U.S. UK regional airline **Flybe** had to file for administration in March due to a Covid-19 related liquidity shortfall. Just days after the Flybe insolvency, **Norwegian Air Shuttle** had to receive state aid from Norway. **Other airlines** are considering asking for state-aid to overcome the Covid-19 crisis.

### *Aircraft lessors need to act swiftly*

Aircraft lessors are **major stakeholders** in airline insolvencies. In this snapshot, we would like to give you a brief overview of the recurring themes in order to safeguard the lessors' position in the event of financial difficulties of their lessees. In our experience, airline insolvencies often require **swift action** as situations can develop rapidly. Allen & Overy has a significant track-record in dealing with these situations and the complex legal issues surrounding them. Our team of aviation, finance and insolvency experts is best placed to support aircraft lessors in protecting their assets in restructurings and insolvency proceedings.

### *Restricted termination rights*

In the current situation, aircraft lessors should constantly monitor the solvency of their lessees. Under German insolvency law, **termination rights** of a lessor are **heavily restricted** after the lessee has filed for insolvency. After the filing, the law forbids a termination of the lease agreement due to outstanding lease payments that were due before the insolvency filing. In addition, at that point in time a filing due to a MAC or similar clause referring to a (material) deterioration of the lessor's finances may no longer be permitted. This can lead to a situation where the **lessor is locked into the lease agreement** with lease rates unpaid. Termination rights and defensive options should be analysed as early as possible and a strategy should be set up to best protect the interests of the lessor.

### *Anti-repossession order*

In a worst-case scenario, the lessor could be locked into the lease agreement for a period of usually up to three months despite a valid termination of the lease agreement. This situation can arise, if the insolvency court orders a prohibition of redelivery of the leased aircraft, a so-called '**anti-repossession order**'. While an anti-repossession order is in place, the **redelivery of the aircraft can no longer be demanded**. To avoid this, one may file a **protective writ** in advance. Allen & Overy's Frankfurt-based restructuring team has gathered significant experience in lodging protective writs. It is best placed to represent the interests of aircraft lessors towards all insolvency court in Germany.

## *Protective shield*

A **typical theme** in German airline insolvencies is the use of so-called ‘**protective shield proceedings**’, sometimes also called ‘umbrella proceedings’. The airline’s management will stay in place (‘self-administration’) and usually the insolvency court will order an approximately three month **moratorium** in order to present an **insolvency plan**. During the moratorium, no creditor-led enforcement measures are allowed. Under certain circumstances the court may order that claims against the debtor arising after the opening of the protective shield proceeding are paid as a preferential liability (*Masseverbindlichkeit*). During the protective shield, a **preliminary custodian** as well as a preliminary creditors’ committee supervise the airline. Protective shield proceedings are only eligible if the airline is **not unable to pay its debts**, which needs to be **validated by an independent expert**.

## *Insolvency plan*

Lessors may be required to make **complex decisions**, should the insolvency proceeding include an **insolvency plan**. Creditors will be grouped into certain classes in order to vote on the plan. There might be certain options under the plan from which the lessor can choose. It should also be considered whether the plan should be opposed or when and how to bring that opposition to the attention of the court. Allen & Overy can assist you with the analysis of a potential plan and the formalities that are required to take part in the negotiation and decision making process. In particular, we can represent your interests in creditors’ assemblies.

## *Creditors’ committee*

It may be advisable for an aircraft lessor to apply for a seat in the **creditors’ committee** of the insolvent lessee. The creditors’ committee has **important rights and functions** in overseeing the work of the insolvency administrator. For various important measures, e.g. the cessation or sale of business operations, the insolvency administrator needs to get the prior consent of the committee. Allen & Overy has extensively acted for creditors in various committees and effectively safeguarded the interests of our clients within German insolvency proceedings.

## *Filing of claims*

The **filing of claims** after the commencement of main insolvency proceedings is a necessary step but can become challenging since several legal aspects need to be considered. Our insolvency experts can assist you with all the formalities that are required to make a correct filing with the insolvency administrator.

## *Eurocontrol charges*

We have often experienced that lessors need to be prepared to settle claims with **Eurocontrol** (‘**fleet lien**’) and file recourse-claims in the insolvency proceedings. In our experience, the settlement structure usually proposed by Eurocontrol may complicate the filing of recourse-claims in the insolvency proceedings. Allen & Overy has experience in negotiating alternative structures with Eurocontrol.

## *Airport operators*

Airport operators in Germany often try to prevent the redelivery of aircraft to the lessor in claiming that they have a ‘**landlord’s lien**’ on the plane due to outstanding airport fees. Allen & Overy has successfully advised lessors in the past in repossessing their aircraft from airport operators who have tried to leverage on a potential landlord's lien.

## Letters of credit

Under most aircraft leasing agreements, the lessee has to provide the lessor with **guarantees or standby letters of credit** from a reputable bank or other types of credit providers. These instruments are usually a substitute to security deposits or securing claims arising under maintenance provisions. Allen & Overy can advise you whether payment demands under the guarantees are a sensible step or whether negotiations with the lessee will put you in a better position.

## Cash-flow disruption of SPV

As most aircraft lessors have set up SPV structures, the insolvency of the lessee can cause cash-flow problems with the relevant lenders under the SPV structure. In such a scenario, **intermediate measures** should be taken swiftly in order to prevent a corresponding insolvency filing of the SPV. This may include **standstills** on financial payments, capitalisation of interest payments, a **refinancing** or **debt-waiver**. Allen & Overy's aviation finance and restructuring experts have wide-ranging experiences in negotiating special payment terms with the lender side.

## Some examples of our experience

**Ad-hoc group of lenders** on the protective shield and subsequent insolvency proceeding of **Condor Flugdienst**.

**GTLK Europe** on German insolvency law in connection with the insolvency of **Germania** and **Bulgarian Eagle**.

**Major airline leasing company** on German insolvency law in connection with the insolvency of **Small Planet Airlines**.

**State bank of Abu Dhabi** on the insolvency of **Air Berlin**.

**GE Capital Aviation Services** on its restructuring with **Aeroflot Cargo** and subsequent insolvency proceedings regarding the airline.

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