ALLEN & OVERY

UK Corporate Insolvency and Governance Act 2020

What the aviation industry needs to know about the new moratorium regime.

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The Corporate Insolvency and Governance Act (the **Act**) which entered into force on 26 June 2020 represents the most significant insolvency reforms in the UK for a generation.

In addition to some temporary measures addressing the economic fallout from Covid-19, the Act introduces permanent reforms in three key areas: (1) the introduction of a new statutory moratorium (**Moratorium**); (2) a ban on the operation of termination clauses in supply contracts triggered by insolvency proceedings (or so called *ipso facto* clauses); and (3) the introduction of a new pre-insolvency rescue and reorganisation procedure (the **Restructuring Plan**). Our detailed analysis of the various measures introduced by the Act can be accessed **here.**

In a three part series of bulletins, we analyse the implications of each of these permanent measures for the aviation industry. This first bulletin co-authored by partners Jennifer Marshall and Paul Nelson and, associate Harini Viswanathan focusses on the implications of the new Moratorium for airlines, lessors and financiers.

1. What does the new Moratorium do?

The Moratorium provides businesses with a statutory breathing space within which to formulate a rescue plan by preventing creditors from taking certain actions against the company for a specified period. For as long as the Moratorium applies, it will prevent (among other things) the enforcement of security, the commencement of insolvency proceedings or other legal proceedings against the company and the forfeiture of a lease. With certain key exceptions, the company will not have to pay debts falling due prior to the Moratorium (or arising post Moratorium under contracts entered into prior to the Moratorium) but will have to pay debts falling due during the Moratorium under contracts entered into post Moratorium. The Moratorium is intended to be used by companies that are in financial distress but is not intended to simply delay the inevitable insolvency of a company that has no realistic prospect of survival. Accordingly, a company can only use a Moratorium where the monitor (an insolvency practitioner appointed to oversee the process) is satisfied that the company is capable of being rescued.

2. Are airlines/aircraft leasing companies eligible to apply for a Moratorium?

All airlines and aircraft leasing companies (including overseas companies with a "sufficient connection" to the United Kingdom) are eligible to apply for the Moratorium provided they do not fall within the list of Excluded Entities[1] as set out in the Act. Notably, the list of Excluded Entities includes: (a) banks; and (b) parties to a capital market arrangement involving debt of at least £10 million (depending on the structure of the financing arrangements, an aircraft lessor or an airline that has funded itself by raising debt in the capital markets may be caught by this exclusion).

[1] In short, Excluded Entities include those entities that currently have a specialist insolvency regime, such as insurance companies, banks, investment banks, investment firms, recognised investment exchanges and securitisation companies.

3. Which overseas companies are eligible to apply for a Moratorium?

As noted above, overseas companies will be eligible to apply for a Moratorium provided there is a "sufficient connection" with the United Kingdom (a test which the English courts are familiar with applying in the context of English schemes of arrangement (**Schemes**) and insolvency proceedings).

In the context of Schemes, English courts have usually found a sufficient connection with England on the basis that the debt to be subject to the Scheme is governed by English law (e.g. through an English law governed credit facility with a jurisdiction clause in favour of the English courts). In some cases, the courts have found sufficient connection even where the governing law of the facility agreement has been changed to English law and the jurisdiction clause has been amended to confer exclusive jurisdiction on the English courts, such amendments being disclosed to the court as having been made solely for the purpose of implementing a restructuring through a Scheme. Other factors that could create a sufficient connection (depending on the facts) include: (a) a majority of the lenders or other creditors being based in the UK; or (b) the company having a branch office and an employee in the UK.

In deciding whether to sanction a Scheme of a foreign company, English courts also consider what effect the Scheme would have and what recognition would be accorded to it in any jurisdiction in which such recognition would be necessary in order for the Scheme to be effective. In order to address this, parties often obtain local law expert opinions evidencing that the Scheme would be recognised in the country of incorporation of the parties.[2] It seems likely that the courts would take a similar approach in respect of the Moratorium and would consider whether a UK Moratorium would be recognised in the relevant jurisdictions (i.e. the jurisdiction of incorporation of the company and other jurisdictions where its business operates). In light of Brexit, it is not entirely clear how the UK Moratorium would be recognised in other jurisdictions although it seems likely that it would be recognised in the US under Chapter 15.

The sufficient connection test is very different from (and much narrower than) the test of where a company has its centre of main interests (**COMI**) which is used for the basis of commencing certain insolvency proceedings covered by the European Insolvency Regulation. Having said that, if the company does have its COMI in England, this is likely to give rise to there being sufficient connection for the purposes of both a Scheme and the Moratorium. English courts have previously accepted the following factors as evidence of a successful COMI shift to England: (a) principal restructuring discussions with creditors taking place in England; (b) notice being provided to creditors and contract counterparties of the company's correspondence address in the England and registration of the company with Companies House as an overseas company with a UK establishment prior to the commencement of the Scheme process; (c) the governing law of the loan agreement subject to the Scheme having been changed from New York law to English law and the jurisdiction clause being changed to English law specifically in order to facilitate implementation of the Scheme; (d) the head office, where the company's books were kept, being located in London; (e) a majority of board meetings taking place in the head office; (f) members of the board being based in England; and (g) the company being UK resident for tax purposes.

4. How does a company enter into a Moratorium?

The method of application depends on whether the company is an English company or an overseas company. Where a company is an English company that is not subject to a winding up petition, the directors of the company can obtain a Moratorium by filing relevant documents with the court. Where an overseas company (or an English company that is subject to a winding up petition) wishes to obtain a moratorium, it must make an application to the court.

The entry requirements are: (a) the company must not have been in a moratorium, administration, company voluntary arrangement (**CVA**) or subject to a winding-up order in the previous 12 months

[2] See Cortefiel SA and MEP 11 Sarl [2012] EWHC 2998 (Ch).

(although this requirement is inapplicable until 30 September 2020); (b) the application must contain a statement by the directors that in their view, the company is, or is likely to become, unable to pay its debts; (c) the application must contain a statement from the proposed monitor that the company is an "eligible company", and that the monitor is qualified and they consent to act as monitor in relation to the moratorium; and (d) the application must contain a statement from the proposed monitor that, in their view, it is likely that a moratorium for the company would result in the rescue of the company as a going concern (or, until 30 September 2020, that it would do so if it were not for any worsening of the financial position of the company due to Covid-19). The plan to rescue the company as a going concern does not need to be specified when filing for a Moratorium - this will be particularly helpful for airlines given the present uncertainty around the lifting of travel restrictions and consumer appetite for airline travel.

5. What happens to the directors of the company?

The directors will remain in control of the company. For the duration of the Moratorium a monitor will be in place, the role of the monitor is to protect creditor interests and to ensure continued compliance with the Moratorium entry requirements and conditions. The monitor will be able to attend board meetings and request information from the directors. Any transactions that are not in the ordinary course of business for the company will need to be sanctioned by the monitor. The introduction of a debtor-in-possession regime during the Moratorium is particularly beneficial for airlines given the specialist knowledge required for day-to-day operations.

6. Is there a payment holiday during the Moratorium?

Subject to certain exceptions (these exceptions being especially relevant to airline companies), a company will be subject to a payment holiday in respect of pre-moratorium debts.[3]

The company must continue to pay for: (a) any goods and services that it receives during the Moratorium period; (b) rent falling due during the Moratorium - which would appear to include rent under an operating lease[4]; (c) any pre-moratorium debt for which it does not have a payment holiday – this includes: (i) the monitor's remuneration or expenses; (ii) salaries or wages; (iii) redundancy payments; and (iv) all payments falling due under a loan agreement or other financial contract, regardless of whether these fall due pre or post the moratorium (accordingly, debts owed to secured aircraft funders and lessors under finance leases are not subject to the payment holiday)[5]. If the company cannot discharge its pre-moratorium debts which are not subject to a payment holiday, the Moratorium comes to an end.

As regards lease payments therefore, the payment holiday during the Moratorium does not apply to: (a) payments in respect of finance leases (whether these fall due pre or post the Moratorium) and (b) rent falling due under operating leases during the Moratorium. However, rent falling due under an operating lease before the Moratorium is subject to the payment holiday.

7. Impact of the Moratorium on rights of secured creditors:

Two provisions that directly affect the interests of secured creditors during a Moratorium are:

a) *Restrictions on enforcement of security:* Subject to certain exceptions, the commencement of the Moratorium would prevent: (i) the enforcement of security over the company's property except

[3] A pre moratorium debt is any debt or other liability of the company that has fallen due prior to the commencement of the Moratorium or, which becomes due during the Moratorium but under an obligation incurred by the company prior to the commencement of the moratorium.

[4] Some practitioners have suggested that rent for the purposes of the CIGA was only intended to relate to rent in respect of commercial premises and not leasing equipment and therefore, rent under operating leases would not be covered. We do not agree with this construction and consider the better view to be that the expression "rent" would cover rent under an operating lease.

[5] Financial contracts which are excluded from the payment holiday expressly include "financial leasing" and so a finance lease would clearly be subject to the payment holiday. In the case of an operating lease, there is no express exclusion and so the question is whether rent under such a lease would be preserved by the general carve-out for rent in respect of the period during the Moratorium. Unpaid rent that has accrued under an operating lease prior to the Moratorium would however be subject to the payment holiday.

where security constitutes a collateral security charge or financial collateral or security has been granted during the moratorium with the monitor's consent; (ii) the repossession of goods under a hire-purchase agreement (including a conditional sale agreement, a chattel leasing agreement and a retention of title agreement); and (iii) the crystallisation of a floating charge or any imposition of a restriction on disposal of a floating charge asset.

b) *Ability of the company to dispose of secured property:* The company can dispose of secured property during the Moratorium either: (i) in accordance with the terms of the security (which will usually allow the company to dispose of assets subject to a floating charge); or (ii) with the permission of the court - the court may give permission to dispose of the secured property only if it thinks that it will support the rescue of the company as a going concern. If the company disposes of any property subject to security with the permission of the court, the company must pay the secured creditors any net proceeds received and any additional money required to be added to the net proceeds to produce a total amount which in the court's determination would have been realised on a sale of the property in the open market by a willing vendor.

8. Differential treatment of creditors with "aircraft-related interests"

On the occurrence of an insolvency-related event (**Insolvency-Related Event**) as defined in the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (the **CTC Regulations 2015**)[6], creditors with "aircraft-related interests" ("international interests" in aircraft objects[7] that have been "registered" within the meaning of the CTC Regulations 2015) benefit from various insolvency remedies (**Cape Town Remedies**).[8] The Act amends the CTC Regulations 2015 to include the commencement of a Moratorium as an Insolvency-Related Event. Accordingly, on the commencement of a Moratorium, various Cape Town Remedies apply including that:

a) the company is required to either: (i) give possession of any aircraft object to the relevant creditor with "aircraft-related interests" on the earlier of the expiry of 60 days or the date on which the creditor is otherwise entitled to possession; or (ii) cure all defaults (other than the default constituted by the commencement of insolvency proceedings) and agree to perform all continuing obligations under the agreement. The creditor's right to repossess the aircraft object cannot be prevented or delayed beyond the 60 day waiting period. If the experience of UK airlines in administration can be taken as an indicator, it is likely that airlines will consent to lessors repossessing their aircraft objects far sooner than the conclusion of the 60 day waiting period. Consider the example of Monarch airlines: within approximately six weeks following the administrators' appointment, all aircraft had been returned to the lessors and moved to alternative locations.

b) unless and until the creditor is given the opportunity to take possession of its aircraft object: (i) the company is required to preserve the aircraft object and maintain it and its value in accordance with the underlying agreement (as defined in the CTC Regulations 2015); and (ii) the creditor is entitled to apply for any forms of interim relief available under UK law.

c) no obligation of the debtor under an agreement (as defined in the CTC Regulations 2015)[9] may be modified without the consent of the relevant creditor. The consequence of this is that creditors with "aircraft-related interests" need to expressly consent to any amendment to the terms of those agreements including the terms of payment obligations in a Moratorium.

[6] These are the regulations implementing the United Kingdom's ratification of the Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters specific to Aircraft Equipment (together, the **Cape Town Convention**).
[7] Aircraft objects are defined in the CTC Regulations 2015 to include certain types of airframes, aircraft engines and helicopters.
[8] It is necessary for the debtor to have consented in writing to the exercise of the creditor's remedies under the CTC Regulations 2015 in the event of a default – it is common practice to do so in the relevant mortgage deed or agreement at the outset of the financing.
[9] The CTC Regulations 2015 define an agreement to include a security agreement, title reservation agreement or leasing agreement.

The Act also amends the CTC Regulations to provide that:

a) the restrictions on enforcement of security in a Moratorium do not apply to aircraft objects after the end of the 60 day waiting period.

b) the provisions allowing a company to dispose of secured property during a Moratorium do not apply to aircraft objects. Consequently, creditors with "aircraft-related interests" are in a superior position to other secured creditors[10]. The CTC Regulations give certain rights and interests over the aircraft objects (for example Eurocontrol liens and possessory liens over aircraft objects for maintenance work) priority over registered international interests so monies owed to those creditors will need to be discharged before repossession by creditors with "aircraft-related interests".

Further implications of the commencement of a Moratorium

Article XXX(4) of the Cape Town Convention states that, "the courts of Contracting States shall apply Article XI in conformity with the declaration made by the Contracting State which is the primary insolvency jurisdiction."

'Primary insolvency jurisdiction' is defined as the Contracting State in which the centre of the debtor's main interests is situated, which is presumed to be the debtor's statutory seat (or, if none, the place where the debtor is incorporated or formed) unless proved otherwise. The Cape Town Convention doesn't define what is meant by the debtor's centre of main interests and the official commentary to the Cape Town Convention is also silent on the test for or the factors relevant to establishing this.

Plainly, airlines incorporated in the UK will be considered to have their primary insolvency jurisdiction in the UK. The commencement of a Moratorium is an "insolvency-related" event for the purposes of the CTC Regulations 2015 and the Cape Town Convention. Accordingly, on the commencement of a Moratorium, other Cape Town Contracting States will have to apply Article XI in accordance with the Article XXX(3) declaration made by the UK. This poses a conundrum as although the UK has adopted "Alternative A" into domestic law through Regulation 37 of the CTC Regulations 2015, it has not made an Article XXX(3) declaration in respect of "Alternative A".[11] On a purely textualist interpretation, as the UK has not made an Article XXX(3) declaration in respect of "Alternative A", other Cape Town Contracting States need not apply "Alternative A" style remedies against the debtor in their jurisdictions. A counter argument to this is that such an interpretation erroneously prefers form over substance i.e., the absence of an express opt in declaration under Article XXX(3) does not negate the fact that the UK has in effect adopted "Alternative A" style insolvency remedies into domestic law. This issue is yet to be decided conclusively and thus, it is unclear whether creditors with "aircraft-related interests" will be able to avail of "Alternative A" style insolvency remedies outside the UK on the basis that these have been triggered by entry into a Moratorium.

As regards overseas airlines who have applied for a UK Moratorium, a potential challenge from domestic creditors to the application of insolvency remedies under the CTC Regulations 2015 is possible on the basis that the debtor's primary insolvency jurisdiction is not in the UK. If such a challenge is successful (this will require, among other factors, the applicant to show that the COMI for the purposes of the Cape Town Convention is not in the UK which is possible given the different test for "sufficient connection" as referred to above), then the insolvency remedies available to creditors with "aircraft-related interests" will be the remedies pursuant to the Article XXX(3) declaration made by the Contracting State where the debtor has its primary insolvency jurisdiction. In practice, given that most Cape Town Contracting States

[10] The restriction on disposal of aircraft objects during a Moratorium does not apply to aircrafts or engines leased to airlines or charged by airlines before 1 November 2015 (the date the CTC Regulations came into force), although the lessor or chargee therein would have priority over the proceeds).
[11] Pursuant to the manner in which the EU ratified the Cape Town Convention, member states were allowed to lodge their own declaration under Article XXX(3).

have adopted Alternative A, this is likely to make a material difference only in cases where the debtor's primary insolvency jurisdiction is in a Contracting State that has: (a) not adopted Alternative A (for example Spain); or (b) adopted a shorter "waiting period" on the commencement of an insolvency-related event.

9. Does the obligation to preserve and maintain the value of the aircraft object pending repossession mean it cannot be used during the Moratorium?

The obligation to preserve and maintain the value of an aircraft object does not prevent it from being used under arrangements designed to preserve and maintain it and its value. Thus, technically, aircrafts can continue to be operated. In practice however, continued operations will depend on various factors including most importantly whether the UK Civil Aviation Authority (**CAA**) provisionally suspends an airline's Air Operator Certificate (**AOC**) on the commencement of a Moratorium - presently, if an airline enters administration, the CAA provisionally suspends its AOC on the grounds of safety thereby grounding all flights.

Assuming that all flights are not grounded, continued operations will depend on among other factors:

a) whether the airline is able to obtain insurance for continued flight operations;

b) whether the airline is able to continue payment in respect of air navigation charges and airport charges to avoid the risk of a fleet lien[12] - the risk of a fleet lien gives financiers and lessors a very powerful incentive to swiftly repossess an aircraft as this at least removes the risk of the fleet lien attaching to its aircraft;

c) whether the airline is able to resolve the practical difficulty of preventing creditor action disrupting operations at non UK airports (including the risk of competing liens over the aircraft objects);

d) availability of funding including state-aid: the operation of aircrafts is hugely capital intensive and all the recent European examples of major airlines continuing to operate in insolvency (eg Air Berlin and Alitalia) have involved significant additional funding being made available by their national governments;

e) ability of the airline to retain key staff required to operate the airline safely and in compliance with the regulatory and licencing regime applicable to an airline; and

f) whether entities/persons in favour of whom the airline has issued an IDERA (Irrevocable De-Registration and Export Request Authorisation) (if any) choose to request the export and de-registration of those aircraft.

In deciding to continue operations, the directors will need to consider all the factors above and the general areas of liability for directors of companies in financial difficulty. Further, the Act provides that a creditor or member (and in certain circumstances the Board of the Pension Protection Fund, in place of the trustees or managers of a pension scheme) can challenge the actions of the directors on the ground that, during the moratorium, the company's affairs, business and property are being or have been managed by the directors in a way that unfairly harmed the interest of creditors or members or that any proposed action would cause such harm.

[12] If an airline is unable to pay these charges, the CAA and the airport authorities (as applicable) can (with the permission of the court) detain and sell any aircraft in the airline's fleet (a fleet lien) in order to discharge the unpaid amounts.

10. What is the duration of the Moratorium?

The moratorium will last for an initial period of 20 business days with an ability to extend for a further period of 20 business days without consent. The maximum length of a moratorium is 12 months from its commencement in the case of an extension made with creditor consent. However, it is possible for directors to apply to court for a longer period or to request a further extension after the 12 months.

11. Which creditors need to consent to the extension of the Moratorium?

It is only those creditors who have not been paid during the Moratorium who will need to consent i.e. lenders and other creditors with excluded contracts will not be given any consent rights. Accordingly, secured aircraft funders and lessors under finance leases will not be given any voting rights however, lessors under operating leases will have voting rights in relation to any rent that was unpaid at the commencement of the Moratorium.

Conclusion- Are airlines likely to find the Moratorium an attractive option?

Presently, entry into an insolvency procedure in the UK is usually a terminal proceeding for airlines as, among other factors: (a) the CAA provisionally suspends the AOC of an airline as soon as it goes into administration thereby halting all revenue generation; and (b) entry into an insolvency procedure triggers the insolvency remedies under the CTC Regulation including creditors' rights to repossess aircrafts.

As the Moratorium will trigger the insolvency remedies under the CTC Regulations 2015, its adoption by airlines will depend in large part on how the CAA responds (as any rescue is near impossible if flights are grounded) and, how supportive creditors with "aircraft-related interests" are.

Furthermore, given the exclusions for financial contracts, a company is only likely to use the Moratorium if it has sufficient monies to keep paying its lenders and finance lessors (and its operating lessors in relation to rent accruing during the Moratorium).

In the specific context of overseas airlines, in addition to the reasons above, we do not consider the UK Moratorium to be an attractive option given the role of state-aid in the rescue and orderly wind-down of many airlines (consider the case of KLM, Alitalia and Air Berlin).

Although airlines may not wish to use the new Moratorium, they always have the well-established option of using a contractual or informal stand-still agreement to effect a moratorium in practice. In this context, care should be taken to ensure that the provisions of any such standstill agreement are not construed as an Insolvency-Related event, thereby triggering the insolvency remedies under the CTC Regulations 2015.

In the next bulletin in this series, we will analyse the implications of the ban on *ipso facto* clauses and in the third and final bulletin in this series, we will consider the ability to cram-down creditors under the Restructuring Plan.

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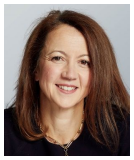

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