Malaysia Airlines Berhad
Briefing Note

Malaysia Airlines Berhad ("**MAB**" or the "**Company**") is currently in financial difficulty. It is rumoured to be notifying lessor and lender creditors that it intends to embark on a new restructuring. It is thought likely to use the new English Part 26A restructuring plan to implement these changes.

This note sets out the current financial position of Malaysian Airlines and summarises the recent use of the new Part 26A restructuring plan (the "**restructuring plan**") by Virgin Atlantic Airways Limited ("**Virgin**") to determine how the courts might approach future applications under Part 26A of the Companies Act 2006 (the "**Act**"), including for foreign companies such as MAB.

Background on Malaysian Airlines[1]

In 2014 MAB was acquired by Khazanah Nasional, a Malaysian sovereign wealth fund, as part of a large restructuring exercise involving the transfer of assets of the old Malaysia Airlines into a new company, which became MAB. At the time of acquisition the airline declared that it planned to break even by 2017 and eventually return to profitability in 2018.[2] However, it has continued to suffer losses since Khazanah's acquisition, posting losses after tax of $180million in 2018.[3] Thus, in March 2019, Malaysia's then Prime Minister announced that the government was debating "*shutting it down, selling it off, or increasing investment*".[4]

The impact of Covid-19 has compounded the financial difficulties suffered by all airlines including MAB; passenger demand fell from 280,321 passengers per day in January 2020 to 7,500 passengers per day in May 2020.[5] Indeed the view that has been expressed in Malaysia is that "*industry's domestic and international sectors' recovery from Covid-19 pandemic's impact is expected to take 18 months and three years, respectively*."[6]

In July 2020 it was reported that Malaysia's sovereign wealth fund was considering providing as much as $1.63billion to see MAB through the Covid-19 induced slump in bookings and to help the airline to resume certain of its suspended operations. However, it is understood that these reports haven't come to fruition leaving MAB in ongoing financial difficulty.

1 Note that we have not been given materials on the financial condition of Malaysian Airlines, instead this section has been drafted based on the results of internet searches.

2 "Malaysia Airlines' search for a strategic partner", *FlightGlobal*, 5 May 2020, accessed on 11 September 2020, at https://www.flightglobal.com/airlines/malaysia-airlines-search-for-a-strategic-partner/138222.article

3 *Ibid.*

4 *Ibid.*

5 "'No discussions on potential Malaysian Airlines', AirAsia merger, deputy minister tells Parliament", *Malay Mail*, 27 August 2020.

6 *Ibid.*

More recently still it was reported that the government has been seeking a buyer to take a major stake in MAB to no avail. Another proposition has been for the airline to merge with AirAsia, but again no agreement has been reached in this respect either.[7]

In a letter to lessors (reported in Reuters on 2 October), Malaysian Aviation Group, the holding company for MAB) has said that the group is unlikely to be able to make payments to lessors owed after November 2020 unless it receives more funding from Khazanah.

It now seems inevitable that MAB will proceed with another restructuring. According to a report in Air Finance Journal on 1 October, MAB has given lessors until early October come to an agreement for the return of a number of surplus aircraft, failing which the airline will seek to use a Part 26A Scheme. This is a new procedure which only became available to companies and their creditors on 26 June 2020. To date the only Part 26 A restructuring plan put forward and approved is that for Virgin Atlantic in early September 2020.

If MAB does put forward a Part 26A restructuring plan, it would be the first such plan put forward by a non-UK airline.

The lessons learnt from Virgin's restructuring

Background

In common with many airlines, as a result of the Covid-19 pandemic Virgin had "*undergo*[ne] *a liquidity crisis*". Virgin claimed that absent an injection of new money the group's cash flow would "*drop to a critical level by the week commencing 21 September…trigger*[ing] *the rights of certain creditors to commence an enforcement process over* [Virgin's] *landing slots at Heathrow Airport*".[8] If this happened, Virgin stated that business would be "*destroy*[ed]". Without the restructuring, the view was that Virgin would go into administration by in mid-September.

In response to this cash crisis and as part of a significant recapitalization, Virgin proposed a restructuring plan (the **plan**), the first under the new Part 26A of the Act which was introduced by the Corporate Insolvency and Governance Act 2006 (**CIGA**).

The Part 26A restructuring plan is similar in many respects to the existing scheme of arrangement process under Part 26 of the Act. This is intentional, with the explanatory notes to CIGA stating that the overall commonality between Part 26 and Part 26A is "...*expected to enable the courts to draw on the existing body of Part 26 case law where appropriate*". The restructuring plan has to be a compromise or arrangement between the company and its creditors or members or any class of them, the creditors / members affected by the restructuring plan have to be placed into classes for the purposes of voting on the restructuring plan, and there is a two stage court process – a convening hearing and a sanction hearing.. The key differences are that:

- The restructuring plan can only be used by a company which "has encountered, or is likely to encounter, financial difficulties that are affecting, or will affect, its ability to carry on business as a going concern" (the **financial difficulties condition**)[9]. However, the company does not have to be insolvent;

- The restructuring plan must be for the purpose of eliminating, reducing or preventing or mitigating the effect of any of the company's financial difficulties (the **purpose condition**);

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7 "COVID-19 forces major change across Asia-Pacific airline industry", *Centre for Asia Pacific Aviation, 4 September 2020*, accessed on 11 September at https://centreforaviation.com/analysis/reports/covid-19-forces-major-change-across-asia-pacific-airline-industry-534197

8 Skeleton Argument on behalf of Virgin Atlantic Airways Limited, [3]

9 Section 901A(2) Companies Act 2006

- Part 26A expressly provides that every creditor or member of the company whose rights are affected by the compromise or arrangement must be permitted to participate in a class meeting. That does not apply to a class if on application the court is satisfied that none of the members of that class has a genuine economic interest in the company; and

- The court has the ability to "cram down" and impose the plan on whole classes of dissenting creditors provided that:

    - The court is satisfied that if the restructuring plan were to be sanctioned, none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative; and

    - The restructuring plan has been approved by one class who would receive a payment or have a genuine economic interest in the company in the event of the relevant alternative.

  The "relevant alternative" will vary from case to case but is most likely to be administration or liquidation.

Following the convening hearing on 4 August 2020 Mr Justice Trower made an order convening the class hearings which took place on 25 August 2020. All classes approved the plan by the relevant majorities. On 4 September 2020 Mr Justice Snowden sanctioned the plan.

Notable Findings in the convening hearing

The financial difficulties condition

The court found that Virgin had been "*severely affected by the COVID-19 pandemic, which* [had] *caused major disruption to the entire aviation industry*".[10] Hence the Court was "*satisfied that…the Company* [was] *on the brink of collapse".*[11] Together a witness statement by the Chief Executive Officer and the Explanatory Statement led the court to find that absent the plan and the broader recapitalisation: (i) the "*group's cashflow would drop to a critical level by 21 September*"; (ii) the closing cashflow would turn negative the following week; (iii) "*administration in mid-September 2020 would be inevitable*"; and (iv) "*in the event of an administration, the ultimate return for unsecured creditors would be substantially less than the return that they would receive under the proposed Restructuring Plan*".[12] On that basis the financial difficulties condition was met.

Section 901A(3), CA 2006 – Compromise or Arrangement to change the financial position

A "*compromise or arrangement*" must be proposed between the company and its creditors or its members, with the purpose to "*eliminate, reduce or prevent, or mitigate the effect of, any of the financial difficulties*."[13] The court stated that this requires "*some element of give and take between the company and its scheme creditors*", but went on to explain that *"a definition* [of what amounts to a compromise or arrangement] *is neither necessary nor desirable*".[14] The court explained that the concept of "compromise or arrangement" should be defined in the same way as it was for schemes of arrangement under Part 26 of the Act given that "*there is every reason to think that Parliament has intended the same language should be construed in the same way*".[15]

10 Re Virgin Atlantic Airways Ltd [2020] EWHC 2191 (Ch) [3].

11 *Ibid,* [3], [37].

12 *Ibid,* [4].

13 Section 901A(3), Companies Act 2006

14 Re Virgin Atlantic Airways Ltd [2020] EWHC 2376 (Ch) [38].

15 *Ibid,* [38].

The requirement for the compromise or arrangement to ameliorate the financial standing of the company was equally uncontroversial, with the court finding that the requirement adopts "*broad language which was intended to be expansively construed*".[16] The court found that the plan was for the requisite purpose, stating simply that "*the evidence neither discloses not hints to any other reasons why the Restructuring Plan* [had] *been proposed.*"[17]

Section 901A(4), CA 2006– Jurisdiction

In order to determine whether the court has jurisdiction to hear the claim it has to be shown that the company would be "*liable to be wound up under the Insolvency Act 1986*".[18] The court had no problem asserting its jurisdiction on the basis that Virgin is incorporated in England and Wales and thus would be liable to be wound up under the Insolvency Act 1986.

When the company is incorporated outside England and Wales the test will be whether the company has "*sufficient connection*" with England, and whether the scheme or restructuring plan will have international effectiveness as for the court not to act in vain.

Virgin also made submissions in relation to the jurisdiction of the plan creditors.[19] In response, the court adopted the usual practice of "*assuming without deciding that Chapter II and, therefore, Article 4 of the Recast Judgments Regulation* [applied]". [20] The court accepted that Article 8 of the Recast Judgments Regulation applied to Virgin's plan creditors, but did not agree that Article 25 applied on the basis that not *all* trade plan creditors had contracted with Virgin on terms including an English law jurisdiction clause. The court found it would be an "*unsafe foundation for the court to assume jurisdiction*", warning against applying Article 25 to a whole class where certain creditors had not accepted the jurisdiction of the English courts.[21]

Creditor Classes

Four classes were proposed by Virgin:

- Lenders under an English law secured revolving credit facility (the **RCF Lenders**);
- Lessors of 24 aircraft under various English law operating leases (the **Lessors**);
- Various connected party creditors (the **Connected Creditors**); and
- 168 unsecured trade creditors who individually were owed more than £50,000 (the **Trade Creditors**).

In order to determine which stakeholders would be able to vote together as a class the court took the view that it had to assess whether their rights "[were] *not so dissimilar as to make it impossible for them to consult together with a view to their common interest"*.[22] This test is the same as the one applied in schemes of arrangement and the court stated its intention to apply the test to the plan in the same manner.[23]

16 *Ibid,* [39].

17 *Ibid,* [39].

18 Section 901A(4), Companies Act 2006

19 Skeleton Argument on behalf of Virgin Atlantic Airways Limited [135] – [151]

20 Re Virgin Atlantic Airways Ltd [2020] EWHC 2376 (Ch) [59].

21 *Ibid,* [62].

22 *Ibid*, [42].

23 *Ibid*, [45].

Whilst approving the four classes proposed, the court also warned that there was a "*possibility that in some circumstances a company may have an incentive to increase rather than reduce the number of classes…. So that it can improve the prospect that at least one class votes to agree it*."[24] This suggests that the courts are alive to the possibility that a company may propose more classes than are needed to ensure that at least one class approves the restructuring plan, thereby opening up the possibility of a cross-class cram-down. It flags potential disputes that could arise in relation to the categorisation of the classes, acknowledging that in these circumstances the court would apply further scrutiny to the matter. As the classes were approved, the court (unfortunately) did not expand on any approach that might be taken in such circumstances.

Notice

Paragraphs 7 and 8 of the Practice Statement, dated 26 June 2020, which applies to Part 26A restructuring plans as well as schemes of arrangement, requires the company to take all steps reasonably open to it to notify any persons affected by the scheme or plan of certain matters. Notice has to be given in sufficient time to enable those affected by the scheme of arrangement or restructuring plan to consider the proposals and take appropriate advice. Case law has also emphasized the importance of proper notice being given to creditors who have not been involved in the negotiation of the terms of the scheme of arrangement or restructuring plan.

In Virgin's case, the RCF Lenders, the Lessors and the Connected Creditors had all entered into support agreements and had been involved in the formulation of the plan. That was not the case with the Trade Creditors, and accordingly the court was particularly concerned to ensure that the Trade Creditors had received proper notice.

The court was satisfied that Virgin had taken proper steps to notify the Trade Creditors. They had been sent a letter explaining the proposal. The letter also directed Trade Creditors to a plan website which held further information. Trade Creditors were invited to attend a virtual webinar and a recording of the webinar was posted on the plan website. The court was satisfied that proper notification had been given and that the Trade Creditors had been given sufficient time to assess their position. It was also satisfied that sufficient steps had been taken to identify the Trade Creditors.

Notable Findings in the sanction hearing[25]

As all of the classes had voted in favour of the plan, Mr Justice Snowden considered that he was in a similar position to that which would have arisen had a scheme of arrangement rather than a restructuring plan been proposed. "*Accordingly, I shall simply follow the tried and tested approach to the exercise of discretion which has been established under Part 26*"[26].

Cross-class cram down warning

Before considering whether to sanction the plan, the court did sound a note of warning. Agreement from all of the RCF Creditors, the Lessors and the Connected Creditors had been obtained to the plan prior to the convening hearing. The court commented that it would not be usual, in a scheme of arrangement, for the court to entertain an application to convene or sanction a scheme where it was known in advance that all creditors in a class had consented or would be prepared to consent to a variation of their rights against the company. Snowden J went on to speculate that the classes where 100% of the creditors had agreed to support the plan had been included to ensure that the cross-class cram down mechanism could be used should the Trade Creditors have voted against the plan. His comment was as follows:

> *"In paragraph 56 of the Convening Judgment, Trower J declined to be drawn on this point. In sanctioning the Restructuring Plan I should also not be taken to have decided that the power to cram down a dissenting class under section 901G can be activated by*

24 *Ibid*, [47].

25 Re Virgin Atlantic Airways [2020] EWHC 2376

26 Ibid, [46]

including within a plan a class of creditors who would otherwise all have been prepared to enter into consensual arrangements to give effect to the restructuring of their rights. Nor do I need to consider whether, if that were effective as a matter of jurisdiction, how the inclusion of such a class should be taken into account as a matter of discretion under section 901G."[27]

A warning, perhaps, that companies trying to ensure that they will be able to use the cram-down mechanism by including classes who have already agreed to the plan and who would usually would be left outside the plan proceedings will have their approach scrutinized very carefully by the court.

Steps to sanction

The court went through the now standard test as to whether the plan should be sanctioned. The main findings are summarized below:

Were the provisions of the statute complied with? Taking into account the analysis at the convening hearing of the financial difficulties condition, the purpose condition, the jurisdictional requirements, the form and style of the Explanatory Statement, and adding that the plan meetings had been held in accordance with the convening order and the requisite majorities had been obtained, the court was satisfied that the provisions of the Part 26A Companies Act 2006 had been complied with.

Was each class fairly represented at the class meetings and in each case was the majority coercing the minority in order to promote interests which were adverse to the class that they purported to represent:

- in three of the classes, approval had been by 100% of the creditors. A high number of the Trade Creditors had voted and approved the plan and no Trade Creditor had suggested that any of those voting in favour did so for any collateral motive or had any special interest different from other members.

- The Trade Creditors formed a sub-set of Virgin's trade creditors, a number of whom had been left outside the plan. In the context of schemes, it was well established that a company could decide which creditors should be included within the scheme. However, the choice of creditors by the company and the sufficiency of the information provided to them were also relevant to the exercise of the courts discretion. The court could only have faith in the majority vote as a reflection of the commercial judgment of the creditors as to their own best interests if sufficient information had been provided. In particular, where creditors who would otherwise rank *pari passu* with the scheme creditors were being treated more favourably outside the scheme, as was the case with the Virgin plan, the reasons for doing so should be fully explained to the scheme creditors, so they could assess whether they were being treated unfairly.

The court was satisfied on all counts. The reason given for excluding certain creditors was a reasonable justification. All information was also properly disclosed and explained to the Trade Creditors in the Explanatory Statement.

Was the plan a fair plan that a creditor could reasonably approve? Again drawing on scheme case law, "fairness" meant that the plan had to be one which "an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve." In the court's view, the plan met this requirement.

Although ultimately the Virgin plan went through smoothly, comments were made in both the convening decision and the sanction decision that should be kept in mind by any company wanting to use the restructuring plan process in the future.

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27 Ibid, [50]

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