# Corporate Insolvency and Governance Act 2020: the Impact on Aviation Leasing and Financing Transactions

**The Corporate Insolvency and Governance Act 2020 (the "Act") has been given Royal Assent and came into force on 26 June 2020. The Act introduced both permanent changes to insolvency and corporate law and temporary measures intended to assist companies impacted by the COVID-19 pandemic.**

Whilst the aviation industry is not a focus of the Act, there is broad industry consensus that further guidance is required on the interpretation of the intended effect of relevant provisions. We consider below certain key measures introduced by the Act which may impact parties to existing aircraft leasing and financing transactions:

- a new restructuring plan process, inserted as Part 26A of the Companies Act 2006. This is similar to the existing framework for schemes of arrangement but includes a cross-class cram down process;
- a free-standing moratorium process, inserted as new Part A1 of the Insolvency Act 1986, available to UK-registered companies and to unregistered companies liable to be wound up under Part 5 of the Insolvency Act 1986; and
- a prohibition, appearing in s.233B of the Insolvency Act 1986, on the termination of contracts for the supply of goods or services where a company becomes subject to a relevant insolvency procedure.

## Restructuring Plan

Both distressed UK-based airlines and overseas operators who are eligible to be wound up under Part 5 of the Insolvency Act 1986 have been provided with an additional means to restructure their debts outside of a formal insolvency procedure.

The restructuring plan draws heavily on the existing Part 26 provisions for schemes of arrangement. This is intentional – the guidance notes published with the original Bill (as defined below) explain that judges will be able to draw on the considerable body of scheme case law when looking at restructuring plans.

Unlike schemes of arrangement, the restructuring plan is only available to a company which has encountered, or is likely to encounter, financial difficulties that are affecting its ability to carry on business as a going concern. The purpose of the plan must be to eliminate or reduce those difficulties.

Creditors and members (to the extent they are to be affected by the plan) have to be put into classes and must then vote on the plan proposals. The plan is approved if 75% by value of each class present and voting vote in favour. When formulating classes the company can apply to court for permission to exclude a class from the process if the class is "out of the money". This is a significant difference to and change from the scheme of arrangement process where no corresponding right exists. Although the detail is somewhat lacking, we assume that if the court agrees with the company's

assessment that the class is "out of the money", it will not be asked to vote on the plan but will be bound by it if sanctioned by the court.

The key feature of the new restructuring plan, the so-called "cross-class cram down process", allows the court to sanction the plan even if not all creditor classes vote in favour. However, the cross-class cram down mechanism cannot be used unless the court is satisfied that (a) no member of a dissenting class would be worse off under the plan than under the relevant alternative, and (b) the plan has been approved by at least 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" is whatever the court considers would be most likely to occur in relation to the company if the plan were not sanctioned – often this will be liquidation, but it could in some cases be administration or even a different restructuring proposal. It is likely that where the cross-class cram down (or cram up, where junior creditors impose the process on a dissenting class of more senior creditors) mechanism is to be used, the courts will have to consider in detail valuation evidence and arguments as to what the relevant alternative should be.

Companies with significant exposure to aircraft assets were in effect excluded from the new restructuring plan process under the first draft of the Corporate Insolvency and Governance Bill (the "**Bill**"). Creditors with "aircraft-related interests" under the Cape Town Convention and Aircraft Protocol (as implemented by the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (the "**Cape Town Regulations**") were precluded by the Bill from involvement without their consent in any restructuring plan. The rationale behind this was likely due in part to concerns that any "cross-class cram down" would conflict with the requirement under Regulation 37(9) of the Cape Town Regulations that in any insolvency proceedings of a debtor "no obligations of the debtor under the agreement may be modified without the consent of the creditor".

The Bill was amended prior to its enactment to remove this exclusion to allow the aviation sector, severely impacted by the economic fallout of the Coronavirus pandemic, access to a tool that might help them. Although a restructuring plan under Part 26A is likely to be considered an "insolvency proceeding" on the basis of Regulation 6(2) of the Cape Town Regulations, the removal of the exclusion should not necessarily result in restructuring plans involving "aircraft-related interests" requiring unanimous consent from all creditors of an operator as long as the affected creditor under the Cape Town Convention consents to the restructuring plan.

On 4 August 2020, as part of its solvent recapitalisation programme, Virgin Atlantic Airways Limited became the first company to obtain court permission to convene creditor meetings to approve a restructuring plan under Part 26A of the Companies Act 2006. The proposed restructuring plan is expected to deliver a refinancing package worth around £1.2 billion. Broadly it involves the extension of existing credit facilities, a new secured debt financing, reductions on lease rentals and amounts owed to trade creditors and a cash injection of £200 million from related-party creditors including its shareholder Delta Air Lines Inc. in exchange for the issue of preference shares. According to industry reports, of the four main creditor groups affected by the restructuring plan, Virgin has already secured the support of its related-party creditors, aircraft lessors and Virgin's revolving credit financiers. If any of Virgin's creditor classes does not vote in favour of the plan, it will be interesting to see whether Virgin's restructuring plan will also be the first to engage the "cross-class cram down process" and, if so, the impact on the process were there to be any non-consenting Cape Town creditors (and as a consequence, the treatment of such non-consenting Cape Town creditors (if any)).

## Moratorium

The new moratorium process has wide-reaching ramifications for all stakeholders in the aviation leasing and financing industry. Set out in new Part A1 of the Insolvency Act 1986, the moratorium is available to UK companies and overseas companies that can be wound up as unregistered companies under Part 5 of the Insolvency Act 1986. Although the process is overseen by a monitor who has to be a licensed insolvency practitioner, it is a "debtor in possession process" where the directors remain in control of the day to day operations of the company.

The moratorium provides the distressed company with a payment holiday from certain pre-moratorium debts and with protection from creditor action including the enforcement of security, the enforcement of statutory detention rights and the repossession of aircraft/engines subject to hire purchase agreements. Although court consent can be sought for such actions, no application can be made if it is to enforce a pre-moratorium debt for which the company has a payment holiday.

Lasting for an initial period of 20 business days, the moratorium can be extended by a company's directors for a further 20 business days. It can also be extended up to a total one year period with creditor consent, or indefinitely by court order. It will also be extended where a company voluntary arrangement, scheme of arrangement or restructuring plan is proposed.

For those in the aviation leasing and financing industry, the following points are particularly relevant:

- Payments under facility agreements and rentals under a finance lease arrangement

  Even whilst in a moratorium, the company has to pay all debts and other liabilities falling due under a contract or other instrument which involves financial services or financial leasing (including amounts due prior to the commencement of a moratorium period) – there is no payment holiday for these amounts. While there is no express obligation on the company under Part A1 to keep these amounts current, any extension of a moratorium beyond 20 business days is conditional upon amounts which are not subject to the payment holiday being paid up to date.

  In addition, where the monitor believes that the company is unable to pay debts which are not subject to the payment holiday and which have fallen due, he must terminate the moratorium. Finally, if any administration or liquidation of the relevant company commences within 12 weeks of the end of the moratorium, amounts which should have been paid during the moratorium but which remain outstanding are given super-priority, ranking behind fixed charge creditors but ahead of all administration / liquidation expenses, preferential creditors and floating chargeholders. However, this super-priority status will not extend to debts which have been accelerated during the moratorium period.

- Payments under operating lease agreements

  The treatment of lease rentals under operating lease arrangements during the moratorium is less clear as the term “rent” referred to in Part A1 is undefined. However, it is likely that operating lease rentals will not be treated as liabilities arising under a contract or other instrument which involves financial services or financial leasing and as such only lease rentals due and payable during the moratorium period are excluded from the payment holiday granted by the regime. So while lease rental amounts due during the moratorium must be paid in order for the moratorium to be extended, rental payments outstanding prior to the start of the moratorium may remain unpaid until after the end of the moratorium.

- Restrictions on enforcement and exercise of Cape Town remedies

  Lessors or financiers with pre-existing registered interests may exercise their remedies in respect of the enforcement of security and repossession of aircraft and engines pursuant to the Cape Town Convention after the mandated 60 day waiting period afforded by the Cape Town Regulations. They may do so irrespective of how long the moratorium continues. The proviso is that events of default under the relevant lease or loan remain unremedied by the company to which a moratorium applies. This affords Cape Town creditors an advantage over non-Cape Town creditors in a situation where a debtor's moratorium is extended beyond 60 days.

Given, for the most part, debt service amounts and lease rentals during the moratorium remain payable in the manner noted above, it is difficult to envisage a company with significant aircraft-related payment commitments entering into a moratorium arrangement without first informally obtaining the prior support of their creditors and agreeing at least the majority of the terms of a restructuring as a part of doing so.

### Termination clauses in lease, supplier and purchase agreements

Under the new section 233B of the Insolvency Act 1986, a provision in a contract for the supply of goods or services will be ineffective on insolvency if and to the extent that the contract or the supply would terminate or the exercise of any other right would take place because the counterparty becomes subject to the relevant insolvency procedure, or the supplier would be entitled to terminate the contract or the supply, or to exercise any other right, because the company becomes subject to the relevant insolvency procedure. It also provides that a right to terminate the contract or the supply which has arisen prior to the start of the relevant insolvency proceeding cannot be exercised once the counterparty has gone into a relevant insolvency proceeding. "Relevant insolvency proceedings" include a moratorium under Part A1 of the IA 86, administration, administrative receivership, a company voluntary arrangement, liquidation, provisional liquidation, or a convening order in relation to a restructuring plan.

Certain entities, including banks, insurers and securitisation companies are excluded from the impact of s.233B, both in circumstances where they are the supplier and where they are the counterparty. Certain contracts are also excluded from s.233B, including contracts for the provision of financial services (covering lending and financial leasing) and contracts forming part of an arrangement involving the issue of a capital market investment. There is also an express statement that nothing in s.233B affects Cape Town creditors with pre-existing registered interests (including those related to operating leases).

Where an operating lessee or purchaser has entered into a relevant insolvency procedure (and provided neither the supplier, the company nor the relevant supply contract is excluded from the ambit of s.233B as referred to above), operating lessors, maintenance repair or operations service providers ("**MROs**") and sellers of equipment are prohibited from enforcing any rights they may have in the relevant transaction documents with that company to terminate the leasing, supply of services or sale of the aircraft/engines or from taking any other step (such as charging default interest or changing the terms of the supply) on the grounds that the company has entered into the insolvency procedure. In addition, no right of termination which arose prior to the insolvency can be exercised once the counterparty has entered a relevant insolvency procedure, even if that right of termination has nothing to do with insolvency. All such pre-existing termination rights are suspended until the end of the relevant insolvency procedure.

Affected suppliers of goods and services such as non-Cape Town creditors (including operating lessors), MROs and sellers may only terminate relevant contracts if:

- the consent of the company (or relevant officer holder depending on the type of insolvency proceeding) is obtained;
- the court is satisfied that continuing the contract will cause hardship to the supplier; or
- the right to terminate the supply arises after the insolvency procedure begins (for example, for any ongoing non-payment of rental or fees or an inability to pay the purchase price).

## Conclusion

Key takeaways for aviation stakeholders likely to be affected by the new measures are: (i) the importance of registered Cape Town interests and (ii) the disparate treatment afforded to operating leases compared to loans or financial leasing arrangements. Additionally, the provisions introduced by the Act are currently untested by the courts. The result of these uncertainties of interpretation is that the true impact on aviation leasing and financing transactions will need to be assessed over time and on a case by case basis. We suggest stakeholders look again at the key provisions of their documentation with aircraft operators, as well as considering updates which may be needed to standard form agreements in order to cater for the impact of these new provisions.

## About Hogan Lovells

The Hogan Lovells Aviation Finance team has extensive experience advising on a wide range of structures for the acquisition, financing and disposal of aircraft. Our experience covers export credit agency and non-payment insurance supported financings, tax enhanced financings (such as JOLCOs), capital markets funded financings (such as EETCs and private placements) and the acquisition and disposal of aircraft and aircraft portfolios. Our team, based throughout Europe, the United States, the Middle East, and Asia, represents operators, lessors, investors, banks, manufacturers, and governments globally.

Our global restructuring and insolvency team is led by experienced lawyers ideally placed to advise on domestic and multi-jurisdictional transactions, ranging from out-of-court restructurings to formal insolvency proceedings across the globe. We are renowned for achieving successful resolutions of the most complex and challenging matters, our collaborative and pragmatic attitude, and our solutions-based approach to transactions — and for our exceptional commitment to clients.

We are recognised as having one of the deepest and broadest aviation practices in the world, with experience acting for a number of industry participants. We understand the unique regulatory challenges faced by the industry and use our insight and experience to provide a commercially focused service to our clients.

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