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Legal Update

Airline restructurings under UK schemes of arrangement and restructuring plans

Over the past two months, we have seen a burst of case law that may impact the rights of aircraft lessors under schemes of arrangement, restructuring plans and the Cape Town Convention (as defined below) and how these rights may dovetail. Set out below is a summary of some of the headline points arising in respect of recent case law in relation to these questions.

1. Aircraft lessors are a single class

On 20 January 2021, the English High Court made an order convening a meeting of a single class of creditors for the purpose of considering a scheme of arrangement in respect of Malaysia Airlines' leasing wing. The Court held that the lessors constituted a single class of creditors for the purposes of a scheme of arrangement. The fact that such lessors may end up with different rights as a result of the scheme taking effect was not sufficient to fracture the class. It was important here that each lessor had been given the same options pursuant to the terms of the scheme, including the option to recover its aircraft and receive a termination payment.

This is a useful tool for airlines considering whether or not to use an English law scheme to address financial difficulties as it provides that dissenting lessors can be crammed down.

2. Schemes and restructuring plans as "insolvency-related events"

The question of whether UK schemes of arrangement and restructuring plans constitute insolvency proceedings (and therefore, insolvency-related events) has come under scrutiny in the context of aviation-related cases, due to the effect of this categorisation under the Convention on International Interests in Mobile Equipment and the associated aircraft protocol (together, the **Cape Town Convention**).

Cape Town Convention

The Cape Town Convention governs the rights of lessors and other persons holding international interests in aircraft. On ratifying the Cape Town Convention, the UK amended its insolvency laws, through the International Interest in Aircraft Equipment (Cape Town Convention) Regulations 2015 (the **Regulations**).

Amongst other things, the Regulations deal with the effect of an "insolvency-related event" (the first limb of which is the "commencement of insolvency proceedings") on the parties to an "agreement" and the rights and remedies available to a relevant creditor in those circumstances. A significant consequence of an "insolvency-related event" is that "no obligations of the debtor under the agreement may be modified without the consent of the creditor": if this applied to schemes and restructuring plans, the creditor cram down provisions become redundant and lessors must each be dealt with on a bilateral basis.

Schemes of arrangement do not constitute "insolvency-related events"

At the convening hearing of the Malaysia Airlines scheme, without ruling on the issue (as no creditor had raised an objection to the scheme pursuant to the Regulations), the Court commended the airline's submission that schemes do not constitute an "insolvency-related event" for the purposes of the Cape Town Convention. By the time of the sanction hearing, all creditors had consented to the scheme and so the Court did not consider this point in detail.

Restructuring plans fall within the bankruptcy exception

On 17 February 2021, the decision to convene a meeting of creditors in respect of Gategroup's restructuring plan was handed down. Zacaroli J held that a Part 26A restructuring plan falls within the bankruptcy exception in the Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial matters (the **Lugano Convention**). Coincidentally this case is aviation-related as Gategroup provides airline catering services. The Lugano Convention and the Cape Town Convention are obviously different pieces of legislation but, the decision is of interest here because of the similarities between the types of proceedings (set out in the table below) which fall within (i) the bankruptcy exception under the Lugano Convention and (ii) insolvency-related events for the purposes of the Cape Town Convention.

Lugano Convention bankruptcy exception applies to the following proceedings:	**Cape Town Convention insolvency-related event applies from the commencement of the following "insolvency proceedings" under English law:**
"bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings"	"liquidation, bankruptcy, sequestration or other collective judicial or administrative insolvency proceedings, including interim proceedings, in which the assets and affairs of the debtor are subject to control or supervision by a court (or liquidation committee)"

Whilst we should stress that the Gategroup judgement relates only to the application of the Lugano Convention to Part 26A restructuring plans, we cannot ignore the similarities highlighted above between the relevant definitions in each of the Lugano Convention and the Cape Town Convention. If we draw the analogy, the implication of this judgment for creditors with rights that may arise by virtue of the application of the Cape Town Convention is that:

1. Restructuring plans may fall within the definition of "insolvency-related event" for the purposes of the Cape Town Convention.
2. Schemes of arrangement are distinguishable from restructuring plans and may not constitute an "insolvency-related event" for the purposes of the Cape Town Convention.

The distinguishing features of schemes and restructuring plans highlighted in the Gategroup judgment (unless otherwise stated) are set out in the table below.

Part 26 Schemes of Arrangement	Part 26A Restructuring Plans
» This law is not designed exclusively for insolvency situations. » Part 26 applies irrespective of the financial state of the company and so is available to both solvent and insolvent companies alike.	» This law is designed exclusively for insolvency situations. » Part 26A applies only if the threshold conditions are satisfied: a debtor must have "encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern" and "the purpose of the compromise or arrangement is to eliminate, reduce or prevent, or mitigate the effect of, any of the financial difficulties".
» Malaysia Airlines' counsel submitted that the company's assets and affairs are not subject to the Court's control or supervision in a scheme (in particular, there is no limitation on directors' powers. nor supervision by an appointed court officer).	» A restructuring plan operates to modify the company's liabilities, and since the court has the power to sanction the restructuring plan, it follows that the court has control or supervision over the assets of the company. » The court retains a specific measure of supervision under section 233B of the Insolvency Act 1986 (which disapplies ipso facto clauses in certain contracts) as plans are designated as a "relevant insolvency procedure" for the purposes of this section.
	» A restructuring plan involving all of the financial creditors could be considered a "collective" proceeding[1].

One of the key considerations when analysing any distinction between a scheme of arrangement and a restructuring plan, and how they each dovetail with the Cape Town Convention, is the manner in which the Cape Town Convention was adopted into English law through the Regulations. In adopting the insolvency provisions (Alternative A) of the Cape Town Convention, English law makers amended the definition of "insolvency proceedings" to narrow its applicability by including the highlighted text "*bankruptcy, liquidation or other collective judicial or administrative* ***insolvency*** *proceedings, including interim proceedings, in which the assets and affairs of the debtor are subject to control or supervision by a court for the purposes of reorganisation or liquidation*". The narrowing to "administrative ***insolvency*** proceedings" suggests that the correct interpretation is that:

(i) the Cape Town Convention does not apply to schemes of arrangement as these are merely administrative proceedings owing to the fact that schemes may be used by solvent and insolvent companies alike; but

(ii) the Cape Town Convention does apply to restructuring plans owing to the fact that there is a threshold test for a company to qualify for a restructuring plan – that it is encountering financial difficulties – meaning that this is not a proceeding that is available to solvent companies and so may be regarded as an "administrative insolvency proceeding."

1 "Collective" is introduced in a different way under the Cape Town Convention (by reference to the words "bankruptcy", "liquidation", "sequestration" and "insolvency proceedings") and this reasoning is unlikely to have direct applicability for Cape Town Convention cases.

To further confuse the situation, the first draft of the Corporate Insolvency and Governance Bill included specific wording which prevented schemes of arrangement and restructuring plans from modifying the rights of Cape Town Convention creditors without their consent, implying that schemes and plans were "insolvency-related events" for the purposes of the Cape Town Convention. However, this wording was removed by the government such that it does not appear in the Corporate Insolvency and Governance Act 2020. It is not entirely clear why this wording was not replaced with express wording to the opposite, but it is clearly unhelpful in reaching a conclusion on the question being considered. The position is likely to remain unclear until properly tested.

Virgin Atlantic restructuring plan

This issue was not relevant for the Virgin Atlantic restructuring plan, as prior to the sanction hearing, the consent of all creditors, to whom the Cape Town Convention would apply, had been obtained, and accordingly, none of these creditors were being crammed down.

AirAsia X scheme

As an adjunct to the cases cited above, on 19 February 2021, the High Court of Malaya ruled that AirAsia X's scheme of arrangement constituted an "insolvency-related event" for the purposes of the Cape Town Convention. The Court found that schemes could constitute an "insolvency-related event" when they were formulated in an insolvency context, if they were collective proceedings, where the debtor's assets and affairs were subjected to the control or supervision by a court. It is important to note that this judgment was handed down in Malaysia and has no effect in English law. But it is also noteworthy that Malaysian companies law closely follows English companies law (along with other common law systems), and so the interpretation of the courts on this point is of interest.

3. Conclusion

The question of whether UK schemes and restructuring plans constitute "insolvency-related events" for the purposes of the Cape Town Convention has not been answered by the UK courts and we await urgent clarification on this.

However, the effect of the Gategroup judgment appears to be that a scheme of arrangement may be used to restructure airlines with lessors being crammed down in the normal way, but that a restructuring plan may not (unless the consent of all Cape Town Convention interest holders is received). Therefore, it is our view that UK schemes of arrangement remain a viable tool for airlines to use for restructuring their leases.

Contacts

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