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Avianca's Future Flow Financing – Not Quite Déjà Vu

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Recently, the Colombian airline Aerovias Nacionales de Colombia S.A. – Avianca ("Avianca"), which had filed for U.S. Chapter 11 protection, reached a settlement with the lenders to its existing future flow receivables transaction that will result in a restructured loan facility. This article provides background and further detail.

The Colombian airline Aerovias Nacionales de Colombia S.A. – Avianca ("Avianca") has made a habit of accessing the structured credit markets by monetizing its expected stream of credit card receivables, filing for U.S. Chapter 11 protection when in distress, and then challenging the structured credit agreements to which it had committed. Recently, Avianca reached a settlement with the lenders to its existing future flow receivables transaction, entered into in December 2017, which will result in a restructured loan facility. Unlike in Avianca's 2003 challenge to its then existing credit card financing, the settlement agreed to for the current transaction affirms the fundamental future flow sale structure but at the price of concessions on interest rate and maturity by Avianca's USAV lenders (as well as a release of debt service reserve account).

In the current financing transaction, Avianca sold all existing and future credit card receivables under card processing agreements with American Express, Master Card and Credomatic to USAVflow Limited, a Cayman Islands orphan special purpose entity ("USAV"). Avianca received an initial payment of $150 million plus future payments equal to collections on future receivables in excess of certain reserved amounts (basically amounts sufficient to pay USAV's debt service). USAV financed the purchase by a $150 million loan from a syndicate of lenders, agented by Citibank, N.A. This transaction structure varied in one key respect from the future flow receivables structure that Avianca entered into in 1998, in that the purchaser of the receivables from Avianca in that transaction was a New York common law trust – strengthening the New York nexus of the transaction.

Avianca, like most airlines, experienced a dramatic drop in traffic in the spring of 2020 due to the COVID-19 pandemic – meaning that revenue dropped to almost nothing with no immediate recovery in sight. On May 10, 2020, Avianca filed a Chapter 11 bankruptcy case with the United States Bankruptcy Court for the Southern District of New York. The

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bankruptcy filing constituted a cash retention event under the financing documents, and Citibank as agent delivered a notice of such cash retention event that resulted in the lenders sweeping all payments on the receivables owned by USAV to a collateral account for the benefit of lenders. This cash trap effectively stopped the payment of the additional purchase price payments to Avianca.

Consequently, Avianca launched multiple legal challenges to the future flow financing structure. These challenges mirrored the motions filed by Avianca in its 2003 Chapter 11 proceeding seeking to set aside its then-existing future flow financing of credit card receivables. (The outcome of those earlier challenges is unknown because Avianca and its creditors entered into a confidential settlement agreement, but there are considerable market suspicions that the settlement required the creditors to take a "haircut" on principal owed).

First, Avianca filed a motion to reject the Receivables Sale and Purchase Agreement with USAV and other related financing documents as executory contracts, with the hope of being freed from its obligations to continue to sell future receivables to USAV. Secondly, Avianca filed a complaint seeking to recharacterize the Colombian law sale of receivables to USAV as a disguised financing. The effect of recharacterization would have been to cut off the Lenders' ownership rights on post-petition receivables and thus free up collections on post-petition receivables for Avianca. The Bankruptcy Court granted in part and denied in part the motion to reject the financing agreement, and both USAV and the Lenders filed a notice of appeal. Thereafter, Avianca filed a complaint against USAV and Citibank seeking a declaration that the application of funds from USAV's Collection Account and Debt Service Reserve Account to repay the loan violated the automatic stay under Chapter 11. The settlement will resolve the appeal of the rejection order, Avianca's complaint seeking to recharacterize the sale, and the complaint regarding violation of the automatic stay.

In the settlement, Avianca will acknowledge that the sale of receivables to USAV is a "final, definitive and irrevocable true sale and transfer" – which is a victory for the future flow structure based on a Colombian law "true sale" of the future receivables. However, the settlement modifies the transaction terms. Payments swept by the lenders after the bankruptcy filing (approximately $30.7 million) will be applied to the USAV debt owing to the lenders resulting in an immediate and substantial paydown of USAV debt. However, following approval of the settlement, collections on credit card receivables will be paid to Avianca after deduction for interest and covered expenses. After giving effect to the paydown of USAV debt from trapped cash, the amount of the outstanding debt is established at $66,962,332.85. The amortization schedule will be modified to consist of monthly payments of $697,524, with a balance of $33,481,166.43 owed on the maturity date (extended to December 31, 2025). And the interest rate will be modified to LIBOR plus 1.00% (reduced from LIBOR + 4.75%), with a 25 basis point increase on each anniversary of the settlement date. The settlement introduces numerous amendments to the existing transaction documents in order to facilitate DIP financing and a plan of reorganization for Avianca. Finally, if the Collection Coverage Ratio exceeds a certain threshold, the Lenders agree to release their lien on one of the Visa, Amex or Mastercard receivables, provided that post-release, certain parameters are met.

Although the settlement respects the basic structure of the future flow transaction (which is good news for future flow financings generally), the settlement highlights that such transactions face risks in U.S. Chapter 11 proceedings. Accordingly, creditors can be expected to be wary of such structure with companies in industries prone to U.S. Chapter 11 filings (the airline industry being a prime example), unless robust mitigation provisions can be structured into the transactions in these industries.

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