

## Airline Restructurings – Schemes of Arrangement and Restructuring Plans

NOVEMBER 24, 2021

Over the course of the past 18 months, the impact of COVID-19 has been felt by airlines across the globe, with airlines grounding their fleet, ceasing to operate flights and being in breach of their debt and leasing obligations. Technical insolvency events occurred, and many airlines sought to restructure their business.

Some airlines turned to Chapter 11 insolvency protection in the US whilst other airlines looked to the UK, on the basis of having entered into leasing and financing documents governed by English law.

In recent months we have seen certain airlines seek to restructure their business using either a UK restructuring plan (“**RP**”) or a UK scheme of arrangement (“**Scheme**”). How are creditors who should have the benefit of Cape Town insolvency protections being impacted by these proceedings?

### ***Creditors’ rights under the Cape Town Convention***

The Cape Town Convention, as implemented into English law by the CTC Regulations<sup>[1]</sup>, provides that the commencement of insolvency proceedings will trigger a number of insolvency remedies, including the following<sup>[2]</sup>:

- upon the occurrence of the insolvency proceedings, the obligations of the debtor under the relevant lease or finance agreement cannot be modified without the consent of the relevant Cape Town creditor;
- possession of the aircraft object is to be given to the relevant Cape Town creditor within 60 days after the occurrence of the relevant insolvency proceeding, unless the insolvency office-holder has cured all defaults within that time (excluding the defaults constituted by the opening of insolvency proceedings); and
- until the Cape Town creditor has taken possession of the aircraft object, the insolvency office-holder must preserve the aircraft object, maintaining it and its value in line with the provisions of the relevant creditor’s agreement.

There has been much commentary as to whether a RP or a Scheme may constitute an “*insolvency proceeding*” (and therefore, an “*insolvency-related event*”) for the purposes of the CTC Regulations. Both Schemes and RPs under English law permit the cram down of dissenting minority creditors within a class of creditors that has otherwise

approved the Scheme or RP. In addition, a RP also permits cross-class cramdown, with the consequence that the court can sanction a RP even where an entire class of creditors has voted against such plan.

However, these features of RPs and Schemes are contradictory to the Cape Town Convention's key creditor remedy of not permitting modifications without the consent of the creditor. Therefore, if a RP or a Scheme can be classed as an insolvency proceeding, then the cram down provisions become redundant and Cape Town creditors will retain their ability to consent to any changes to their own specific transactions and not be required to accept a cram-down.

There has been no direct ruling by the English courts on the question of whether RPs and Schemes will constitute insolvency proceedings for the purposes of the CTC Regulations. However, the guidance that is available from the English courts and other decisions dealing with various airline and non-airline RPs and Schemes is not entirely clear that both proceedings would be treated in the same manner.

## UK Schemes of Arrangement

To understand the distinction in the potential treatment of the two types of proceedings as regards the Cape Town Convention, it is important to understand how the Cape Town Convention was adopted into English law.

The definition of "insolvency proceedings" used in the Cape Town Convention differs from that implemented into English law by the CTC Regulations. See the table below with an important difference highlighted:

| CAPE TOWN CONVENTION DEFINITION   | CTC REGULATIONS 2015 DEFINITION   |
|---|---|
| "...bankruptcy, liquidation or other collective judicial or administrative 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." | "...liquidation, bankruptcy, sequestration or other collective judicial or administrative <b>insolvency</b> 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)." |

On the basis of this difference in language, it has been argued that Schemes, which are administrative proceedings that can be used in both a solvent and an insolvent context, would not constitute an insolvency proceeding for the purposes of the CTC Regulations.

The recent decision in the Gategroup restructuring<sup>[3]</sup> involved consideration of a RP and is discussed in more detail in this context in the section below. However, in his judgment handed down, Mr. Justice Zacaroli, as *obiter*, noted that there was a distinction between Schemes and RPs. He pointed to the fact that proceedings which are based upon general company law and are not designed exclusively for insolvency scenarios should not be considered as being based on laws relating to insolvency, suggesting that a Scheme may not be considered an "administrative insolvency proceeding" for the purposes of the CTC Regulations.

In respect of the recent Malaysia Airlines scheme of arrangement<sup>[4]</sup>, all consents were received by the scheme creditors and so the question of whether a Scheme constituted an insolvency-related event for the purposes of the CTC Regulations did not need to be considered. However, the court had noted at the convening hearing that there was an arguable case that the CTC Regulations would not apply to the Scheme proposed by Malaysia Airlines.

Therefore, on the basis of the above, it would appear possible that an English court may hold that a Scheme would not constitute an insolvency proceeding for the purposes of the CTC Regulations, and thus creditors would not

obtain the benefit of the Cape Town insolvency remedies set out above, including the right to consent to amendments on a bilateral basis.

However, in spite of the above, it should be noted that the High Court of Malaya ruled in early 2021 that AirAsia X's scheme of arrangement constituted an insolvency-related event for the purposes of the Cape Town Convention<sup>[5]</sup>. Whilst this decision does not have any effect in English law, company law in Malaysia is similar to English company law and the Malaysian scheme of arrangement resembles in many ways an English Scheme. Therefore, this interpretation could be considered as instructive by English courts in the future.

In addition, the Aviation Working Group has submitted an expert opinion strongly advocating the inclusion of a Scheme, when entered into in an insolvency context, as an insolvency proceeding, including in such opinion many compelling arguments for such an analysis<sup>[6]</sup>. Further, an annotation to the Official Commentary on the Cape Town Convention<sup>[7]</sup> has been issued which confirms that a proceeding will constitute an insolvency proceeding “*where they are formulated in an insolvency context, or by reason of actual or anticipated financial difficulties of the debtor company*”. However, whilst this annotation has considerable weight, and indeed was referenced in the AirAsia X case, it does not have binding legal status.

## ***UK Restructuring Plans***

Alternatively, and again within the backdrop that there has been no direct ruling on the matter (noting that the Virgin Atlantic case<sup>[8]</sup>, whilst involving a RP, obtained consent of all creditors and so no creditors were being crammed down), it would appear that a RP would likely be held to constitute an insolvency proceeding under the CTC Regulations.

In the Gategroup decision, Mr. Justice Zacaroli held that a RP falls within the bankruptcy exception in the Lugano Convention<sup>[9]</sup> such that the Lugano Convention would not apply to RPs<sup>[10]</sup>.

Whilst this case is not relevant for the purposes of consideration of whether the CTC Regulations apply to RPs, and indeed is not even an airline case, the important point to note is that the scope of the Lugano Convention bankruptcy exception is considered similar to that of the definition of “insolvency proceedings” for the purposes of the CTC Regulations, with the Lugano Convention setting out such exception as “*bankruptcy, proceedings relating to the winding up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings*”. Therefore, commentators argue that if an RP meets the definition of the Lugano Convention bankruptcy exception, then it will also meet the definition of insolvency proceedings under the CTC Regulations. In addition, it was highlighted in the Gategroup case that the Lugano bankruptcy exception mirrors the equivalent bankruptcy exception in the Recast Brussels Regulation<sup>[11]</sup>, which itself is intended to dovetail with the concept of insolvency proceedings under the Insolvency Regulation<sup>[12]</sup>. As such, using this European legislation as a guide, again it is reasoned that if a RP would constitute an insolvency proceeding under the Insolvency Regulation, then it would also do so under the CTC Regulations, giving rise to the likelihood of an English court finding that a RP is an insolvency proceeding for the purposes of the CTC Regulations.

One further key distinction between a Scheme and a RP is that in order for a company to qualify for a RP, it must satisfy a threshold test, which includes that it is encountering financial difficulties. Therefore, this reinforces the notion that this is for use in insolvent scenarios, and so would constitute an “administrative insolvency proceeding” for the purposes of the CTC Regulations.

## ***Summary***

As highlighted above, a lack of direct authority on this subject matter prevents certainty on how Schemes and RPs may be affected by the CTC Regulations, albeit that it looks increasingly likely that an English court would find that both types of proceedings constitute insolvency proceedings for the purposes of the CTC Regulations. However, it should be noted that even if the law is clarified such that both, or either, of these proceedings fall within such definition of insolvency proceedings, this does not mean that any such Scheme or RP would not be sanctioned by

the court. In the event that a termination option is included for creditors in such Scheme or RP, such that if a creditor objects to a proposed variation, it can withhold its consent and terminate the relationship with the airline and take repossession of the aircraft object, then such a formulation would not conflict with the terms of the Cape Town Convention.

Therefore, we may continue to see airlines use Schemes, and even RPs, in the future, but clarity on the law will be very welcome.

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<sup>[1]</sup> The International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015

<sup>[2]</sup> Alternative A of Article XI of the Aircraft Protocol and regulation 37 of the CTC Regulations 2015

<sup>[3]</sup> Re Gategroup Guarantee Limited [2021] EWHC 304 (Ch)

<sup>[4]</sup> Re MAB Leasing Ltd [2021] EWHC 379 (Ch)

<sup>[5]</sup> *AirAsia X Berhad v BOC Aviation Limited* (Originating Summons WA-24NCC-467-10/2020)

<sup>[6]</sup> L. Gullifer and R. Mokal, 'UK Restructuring Plan and Scheme of Arrangement Proceedings – Expert Opinion on Status under the Cape Town Convention' (23 November 2020, revised on 29 April 2021) (at <http://awg.aero/wp-content/uploads/2021/04/CTC-status-of-RPs-and-Schemes-Expert-Report-Revised-29-Apr-2021.pdf>)

<sup>[7]</sup> Dated 16 June 2020

<sup>[8]</sup> Re Virgin Atlantic Airways Ltd [2020] EWHC 2376 (Ch)

<sup>[9]</sup> Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters, adopted in Lugano on 16 September 1988 (88/592/EEC)

<sup>[10]</sup> The case involved consideration of this point for the purposes of establishing jurisdiction. It was agreed between the parties that if the Lugano Convention applied to a RP, the English court would not have jurisdiction based on an exclusive jurisdiction clause in favour of the Swiss courts. The Lugano Convention covers civil and commercial matters but contains an exception for bankruptcy proceedings.

<sup>[11]</sup> Regulation (EU) 1215/2012 of the European Parliament and of the Council on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast)

<sup>[12]</sup> Regulation (EU) 2015/848 of the European Parliament and of the Council on insolvency proceedings (recast)

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