# International airlines and the benefits of Chapter 11

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This article examines the unique benefits of the Chapter 11 bankruptcy regime for international airlines that need or could benefit from a court-supervised restructuring process. It examines how Chapter 11 can provide international airlines with access to capital markets and restructuring tools that are not offered collectively in other jurisdictions. More specifically, it explores how a US bankruptcy proceeding provides international airlines with the most sophisticated and deepest financing alternatives, an automatic stay that is unparalleled in its reach, and a statutory framework that uniquely positions airlines to right-size their fleets and contractual obligations.

## Introduction

The international travel industry enjoyed steady growth in the first two decades of the 21st century – notwithstanding tragic terrorist attacks, an unprecedented financial crisis and various public health emergencies.[1] Yet, the coronavirus dramatically stopped what many thought was going to be another banner year for travel.[2] While many segments of the broader travel industry have suffered during the Covid-19 pandemic, the effect on airlines has been particularly acute.[3]

In certain jurisdictions, central governments infused their domestic carriers with tens of billions of dollars to save them from liquidating or having to restructure through a court-supervised process.[4] However, government aid has not been universal, either as a matter of policy or as an economic reality. As a result, some major airlines have found themselves with no choice but to liquidate, while others have filed restructuring proceedings to survive the pandemic.

Three Latin American carriers – Aeroméxico, Avianca and LATAM – recently chose to file for Chapter 11 bankruptcy protection in the United States to mitigate the effects of the pandemic. Leading up to the pandemic, each of these airlines was sufficiently capitalised and poised for growth through operational initiatives and strategic partnerships. However, due to pandemic-related worldwide travel restrictions and a collapse in consumer demand, these airlines were faced with exponential declines in revenue and monumental cash burn. There was no option other than to enter a proceeding with the principal goal of stabilising the business through a capital infusion.

For an international airline with operations, assets and liabilities spread around the world, picking the right jurisdiction in which to restructure is critical, though not necessarily straightforward. This article will explain why the Chapter 11 process can serve as an effective means to restructure an international airline – even one not headquartered in the United States.

## Filing in the US

An entity – even one that is not domiciled in the US or organised under US law –is eligible to file for relief under the bankruptcy code[5] as long as it has a place of business or property in US to be a debtor's principal place of business or the location of its principal assets.

For Aeroméxico, Avianca and LATAM, there was no question they were eligible to file in the US because each had both operations and property in the US. For example, Aeroméxico had significant cash accounts in the US, US-law governed debt and flight operations in the US. Any one of these attributes alone would have been a sufficient basis for Aeroméxico to file in the US. In addition, the Southern District of New York was the appropriate venue for Aeroméxico, Avianca and LATAM because at least one of the debtors in each case had its main US asset in New York.[6] LATAM, for example, had hundreds of millions of dollars of cash and investments in accounts located in New York City.

## The US as a central forum

For some international airlines, the choice of jurisdiction in which to restructure is easier than others. For example, when American Airlines filed in 2011, the choice on where to restructure was more straightforward since American Airline's assets and liabilities were primarily based in the US, and the US has a robust restructuring regime, Chapter 11.

Similarly, when Japan Airlines Corp (JAL) filed for corporate reorganisation in Japan in 2010, the choice was also more straightforward since JAL's assets and liabilities were primarily based in Japan, JAL's existing management and board of directors were being replaced by a state-backed turnaround company and state-backed financing was being provided to backstop JAL's continued operations.[7] Conversely, for an international airline with assets in multiple countries or mainly in a single country without a restructuring regime with the appropriate restructuring tools to handle the airline's complex capital structure and/or operations, the choice is less clear. However, an international airline that is not principally based in the US may still be able to utilise the US's restructuring regime to reorganise, so long as it has some connection with the US – which could be easier to satisfy than one would initially suppose.

One of the central reasons that the US is an ideal forum is because the US bankruptcy code broadly defines property of the estate to include property *wherever* located.[8] In short, this means that a US bankruptcy court has jurisdiction over a debtor's assets whether they are in the US or anywhere else in the world.

Moreover, the broad jurisdictional reach of the US bankruptcy court makes the automatic stay – one of bankruptcy's most powerful tools – even more powerful.[9] The automatic stay is '[o]ne of the most important provisions of the US insolvency regime.'[10] In practice, the automatic stay is the 'legal mechanism that ensures creditors do not try to collect [on their prepetition debts] while the debtor is in bankruptcy'.[11] Not all popular restructuring regimes have such protections. For example, the English scheme of arrangement, the Dutch scheme of arrangement and the new UK restructuring plans do not have automatic stay provisions that immediately apply upon filing for bankruptcy.[12]

Of course, a bankruptcy court also needs personal jurisdiction in order to enforce its broad powers. For an airline with sophisticated financial creditors, it is almost certain that those creditors will have at least some connection to the US as the operative restructuring forum. The same is true for international trade creditors that do business in the US. Once a party files a proof of claim, they are deemed to have consented to the bankruptcy court's jurisdiction. But even if the bankruptcy court does not have personal jurisdiction over a creditor, the court's *in rem* jurisdiction 'over a debtor's property, wherever located, and over the estate' still offers significant protection from, and leverage over, non-US creditors.[13] That is because the bankruptcy court's *in rem* jurisdiction permits it to 'determin[e] all claims that anyone, whether named in the action or not, has to the property or thing in question'.[14] In addition, if a creditor has not availed itself of the bankruptcy court's jurisdiction but wants to ensure it will receive certain distributions under the debtor's Chapter 11 plan, then it will be forced to the bargaining table or to appear in court, as the bankruptcy court has exclusive authority to approve all claims and estate distributions. In short, the US bankruptcy court has both personal jurisdiction over a uniquely broad set of constituencies as compared to any other restructuring regime and control over all the property any creditor would want to get a piece of.

Even still, despite the broad reach of the bankruptcy court's jurisdiction, a debtor may find that some of its creditors outside the US ignore the automatic stay or orders of the bankruptcy court. Fortunately, the bankruptcy code and the corresponding body of case law give a debtor tools to deal with these situations. For example, under the 'doctrine of necessity', a debtor can seek court authority to pay prepetition debt to certain of its creditors when doing so would be necessary to preserve value. In addition, with court approval, a debtor can enter into settlements with its creditors. A debtor can also seek sanctions for violations of the automatic stay.

The broad reach and powers of the US restructuring regime are another reason why so many international companies, and most recently international airlines and aviation service providers, have also filed ancillary proceedings under US Chapter 15 in addition to their primary restructurings elsewhere. The filing for US Chapter 15 relief, in addition to a domestic in-court process, undergirds that even if an internationally focused company decides not to perform its primary restructuring in the US under Chapter 11, it will still more likely than not need the broad powers of the US bankruptcy system to ensure that its restructuring is respected around the world if it has issued US debt.

For example, Virgin Atlantic Airways Limited (Virgin Atlantic) recently filed the very first restructuring plan in the UK.[15] Even so, Virgin Atlantic filed for US Chapter 15 relief to ensure that it could leverage the power of the US restructuring regime to ensure that non-UK-based creditors respect Virgin Atlantic's UK restructuring.[16] Similarly, the Swissport Group, a provider of ground and cargo handling services to the aviation industry, also recently filed for US Chapter 15 relief in addition to its English scheme of arrangement.[17]

## Managing and financing the estate

Upon a Chapter 11 filing, the default rule is that existing management remains in control of the debtor's affairs.[18] This 'debtor in possession' regime is a fundamental feature of Chapter 11 that allows those who are often the most knowledgeable about a debtor's business to guide it through a restructuring process. This is especially beneficial when an exogenous event, like the Covid-19 pandemic, has upended an otherwise stable business or industry. Complementing the debtor's ability to remain in control of its business affairs is its ability to exclusively propose a plan of reorganisation for up to 18 months.[19]

It is not uncommon for lenders to identify opportunities when a well-managed company finds itself faced with unforeseen circumstances. Debtor in possession (DIP) financing is therefore a competitive market with participants that include money-centred banks, distressed investors and existing equity holders and commercial counterparties.

Typically, DIP lenders will receive a court-approved superpriority claim secured by a superpriority lien on substantially all of the debtor's assets. The DIP loan must be paid in full in cash for the debtor to emerge, and the DIP lenders have a first call on the assets in the event of a liquidation. However, an airline may find itself with a limited pool of unencumbered collateral to offer a DIP lender, or an inability to offer a 'priming' lien absent the consent of their existing lenders.

Aeroméxico, Avianca and LATAM each found itself with a critical need for financing. Undoubtedly, that helped to make Chapter 11 the best option with which to restructure. Not only is DIP financing explicitly provided for in the bankruptcy code,[20] but courts and market participants are well versed in DIP financing, even when collateral is located across multiple jurisdictions. The market for DIP financing in the US is deep and provides debtors with a level of capital that is not seen anywhere else in the world (eg LATAM received a DIP loan for $2.3bn). Each of the airlines was able to obtain a robust and bespoke financing solution.[21] Aeroméxico and Avianca have DIP facilities that are convertible into equity at the option of the DIP lenders and borrower, respectively. This allows the debtors to leverage a valuable, though intangible, asset: the equity value of the reorganised company. While LATAM initially proposed an equitising facility, the bankruptcy court ultimately concluded that the conversion feature of the proposed DIP constituted an improper *sub rosa* plan, which is 'any transaction by a debtor that adversely impacts [] interested parties' rights to participate in the restructuring process', or:

> 'dictate[s] some of the terms of any future reorganization plan, restructure[s] the rights of creditors, and require[s] all parties to release all claims against the debtor, its officers, directors, and secured creditors . . . [in a way] that will, in effect, "short circuit the requirements of Chapter 11 for confirmation of a reorganization plan."'[22]

However, LATAM's DIP was ultimately approved without an equity conversion; its multi-tranche structure was designed to suit the needs of different types of lenders.

## Fleet and contract rationalisation

Even with fresh infusions of capital, distressed airlines may be faced with the reality that they have more aircraft (or the wrong mix of aircraft) than they need to support demand. Since it is not uncommon for aircraft to be leased, an international airline in Chapter 11 can use a debtor in possession's power to assume or reject unexpired leases as a means of rationalising their fleet.[23] Contract rejection is not found in all restructuring regimes, underscoring the unique tool set that Chapter 11 offers. Aeroméxico, LATAM and Avianca all rejected leases for surplus aircraft and parts very early in their cases.

The bankruptcy code also gives debtors another tool: a breathing spell for the first 60 days of a case from performing their obligations under unexpired leases of personal property that have not yet been rejected.[24] That time period can be extended by agreement or by order of the court if 'the equities of case' warrant an extension.[25] Debtors are able to use the bankruptcy code's tools – and the leverage of rejection – to enter into usage stipulations with their lease counterparties that convert fixed payments into market-based 'power by the hour' rates. Similarly, debtors can use the bankruptcy code to enter into stipulations with their finance counterparties that lower their monthly cash burn and avoid burdensome (and costly) litigation.

The flexibility provided by a debtor in possession's ability to assume or reject contracts and leases extends beyond leases for personal property and includes any executory contract or unexpired lease.[26] For example, a debtor can reject burdensome or overpriced contracts or leases (eg, Aeroméxico was able to reject real property leases in jurisdictions where it is either temporarily not flying or where it is seeking to minimise its footprint, even though the leases were not set to expire until later).

Moreover, a debtor can leverage its ability to assume or reject contracts to bring contract counterparties to the (re)negotiation table. This is particularly useful for an international airline with contracts that are operationally important but overpriced. They likely predate the Covid-19 pandemic and contain terms that contemplate a very different market reality – one with much greater international and domestic air travel. They therefore need to be – and should be – repriced.

## Conclusion

Chapter 11 provides international airlines with access to capital markets and restructuring tools that are not offered collectively in other jurisdictions. A US bankruptcy proceeding provides international airlines with the most sophisticated and deepest financing alternatives, an automatic stay that is unparalleled in its reach, and a statutory framework that uniquely positions airlines to right-size their fleets and contractual obligations.

Therefore, for international airlines looking to restructure in the face of an unprecedented global pandemic, the Chapter 11 process provides a powerful and unique opportunity.

**Notes**

1 S Borko, W Geerts and H Wang, *The Travel Industry Turned Upside Down*, (Skift Research, Septembe 2020) at 9.
2 YM Bar-On, A Flamholz, R Phillips and R. Milo, 'SARS-CoV-2 (COVID-19) by the numbers', (*eLife*, 1 April 2020); *see also ibid.*
3 *Ibid.* at 11.
4 'IATA in late November estimated that globally governments have provided $173 billion in aid to keep airlines operating since the pandemic hit. The US government, for example, provided $58 billion in grants and loans to the airline industry.' See 'How European states stepped in to support grounded airlines in 2020' (Flight Global, 24 December 2020), www.flightglobal.com/strategy/how-european-states-stepped-in-to-support-grounded-airlines-in-2020/141681.article, accessed 22 March 2021.
5 11 USC. s. 101 *et seq.*
6 28 US Code s. 1,408. This provision of the bankruptcy code contains what is colloquially referred to as the 'affiliate rule', which permits an entire corporate family to file for bankruptcy in a particular venue so long as it is an appropriate venue for one of the corporate family's debtor-affiliates.
7 M Ngishi and M Katsumura, 'Japan Airlines files for $25 billion bankruptcy' (Reuters, 18 January 2010), see www.reuters.com/article/us-jal/japan-airlines-files-for-25-billion-bankruptcy-idUSTRE60H4NA20100119, accessed 22 March 2021; 'A decade after Japan Airlines' went bankruptcy, criticism over the government bailout remain', (*The Japan Times* (19 January 2020), see www.japantimes.co.jp/news/2020/01/19/business/corporate-business/10-years-japan-airlines-bankruptcy-bailout/, accessed 22 March 2021; J. McCurry, 'Japan Airlines files for bankruptcy', (The Guardian, 19 January 2010), see www.theguardian.com/business/2010/jan/19/japan-airlines-files-bankruptcy, accessed 22 March 2021.
8 11 USC. s. 541.
9 See *SIPC v Bernard L. Madoff Inv. Sec. LLC* (In re Bernard L. Madoff Inv. Secs. LLC), 474 B.R. 76, 84 (S.D.N.Y. 2012) (upholding extraterritorial enforcement of the automatic stay and injunction barring foreign creditor's lawsuit); *Nakash v Zur* (In re Nakash), 190 B.R. 763, 768 (Bankr. S.D.N.Y. 1996) ('[B]ased upon the applicable Code sections [and] other indicia of congressional intent . . . the automatic stay applies extraterritorially'.).
10 DS Bernstein, T Graulich, DP Meyer and R.M. Brown, 'Chapter 26: United States' (2013), 333, *The International Insolvency Review*, see www.davispolk.com/sites/default/files/52350054_1.PDF, accessed 22 March 2021.
11 MB Masaro, Note, 'Incorporating the Fresh Start into Sovereign Debt Restructuring Through Odious Debt', 104 *Cornell L. Rev.* 1643, 1646.
12 J Marshall, J Cho & G Orban, 'The Big Three: the UK Restructuring Plan, the Dutch Scheme and US Chapter 11 Proceedings', *INSOL World – Second Quarter 2020*, at 27.
13 *Tennessee Student Assistance Corporative v. Hood*, 541 US 440, 440 (2004)
14 *Ibid* at 448.
15 *See In re Virgin Atlantic Airways Limited,* Case No. 20-11804 (MEW) (Bankr. S.D.N.Y. Aug. 4, 2020) [ECF No. 2].
16 *Ibid.*
17 *In re Swissport Fuelling Ltd.*, Case No 20-11524 (MWF) (Bankr. D. Del. June 12, 2020) [ECF No. 2].
18 11 USC s. 1107.
19 11 USC s. 1107.
20 11 USC s. 364.
21 See Final Order Granting Debtors' Motion to (I) Authorize Certain Debtors in Possession to Obtain Post-Petition Financing Pursuant to 11 USC. ss. 105, 362, 363 and 364; (II) Grant Liens and Superpriority Administrative Expense Claims to DIP Lenders Pursuant to 11 USC. ss. 364 and 507; (III) Modify Automatic Stay Pursuant to 11 USC. s.s. 361, 362, 363, 364 and 507; and (IV) Grant Related Relief [ECF No. 527], In re Grupo Aeroméxico, S.A.B. de C.V., No. 20-11563 (SCC) (Bankr. S.D.N.Y. 2020); Amended Order (I) Authorizing the Debtors to (A) Obtain Postpetition Financing, and (B) Grant Superpriority Administrative Expense Claims, and (II) Granting Related Relief [ECF No. 1454], No. 20-11254 (JLG) (Bankr. SDNY. 2020); Final Order (I) Authorizing the Debtors to (A) Obtain Postpetition Financing, and (B) Grant Liens and Superpriority Administrative Expense Claims, (II) Modifying the Automatic Stay, and (III) Granting Related Relief [ECF No. 1031], No. 20-11133 (MG) (Bankr. SDNY 2020).
22 *In re LATAM Airlines Group, S.A.*, 620 B.R. 722, 812-13 (SDNY 2020) (internal citations omitted). The bankruptcy court found that the DIP was a *sub rosa* plan because the financing subvert[ed] the reorganisation process in the following ways: (1) the DIP credit agreement hard-coded discount to plan value without being market-tested; (2) a covenant in the credit agreement provided that a plan that is not a 'Company Approved Reorganisation Plan' would lead to an event of default; (3) the company did not have to seek court approval prior to election of equity conversion; and (4) the conversion feature 'prematurely allocat[ed] reorganization value to LATAM's existing equity holders'. *Ibid* at 820.
23 11 USC. s. 365. While 11 USC. s. 1,110 would normally provide the framework governing the rights of counterparties to aircraft leases, such section only applies to holders of certain operating certificates that are granted to US domestic carriers. The US has also adopted the so-called Cape Town Treaty, which may also impact the rights of aircraft carriers.
24 11 USC. s. 365 (d)(5).
25 *Ibid.*
26 11 USC. s. 365(a).

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