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# Chapter 11 and the Airline Industry

*Hosted by the International, Legislation and Secured Credit Committees*


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CONCURRENT SESSION

2021



Chapter 11 and the Airline Industry

- This panel will examine and discuss recent trends and issues in the chapter 11 reorganizations of airlines, including foreign-based airlines that have sought chapter 11 protection in the United States, such as Avianca, LATAM Airlines, Aeroméxico, and Philippine Airlines. We will also analyze and discuss governmental and legislative initiatives in the United States taken in response to the COVID-19 pandemic that at the time staved off formal proceedings for United States based airlines.
- The COVID-19 pandemic struck few industries as dramatically as airlines. 2019 was a banner year for the industry and many airlines were in growth mode. Early in 2020, it looked like that trajectory would continue. Then, the COVID-19 pandemic began its spread across the globe. On March 11, 2020, the World Health Organization declared the widespread outbreak of COVID-19 a global pandemic.
- By April 2020, over 8,500 aircraft were grounded, with some airlines seeing reductions greater than 90% in passenger service. The impact on airlines was severe and swift.


Chapter 11 and the Airline Industry (continued)

- By May 2020, airlines around the world were scrambling to cut back costs and looking for life lines in the form of government aid, new financing, or exploring insolvency proceedings.
- Airlines found themselves struggling to map out a survival plan while facing an unpredictable and evolving future. At the same time, airlines were arranging hundreds of repatriation flights and adding cargo services, including by using the seating area of passenger planes, to move critical medical supplies around the Globe.
- A year and a half later, travel is up (but still far from pre-pandemic levels) and airlines are facing different challenges as they chart a path forward and develop business plans (including fleet plans) for the next 5 to 10 years.


Foreign Airlines Seek Chapter 11 Protection

- Airlines are vulnerable to global disruptions because they have significant fixed costs in the form of fleet costs and employee costs. Additionally, flight operations, due to fuel costs and personnel costs are very expensive if flights are being operated significantly below capacity.
- Despite all airlines being impacted by the COVID-19 pandemic, not all airlines had the same tools available to them.
- Airlines in the United States, much of Europe and parts of Asia were able to take advantage of government relief (which we will discuss in greater detail below). Other airlines, particularly Latin American airlines did not have the same level of government relief available and turned to chapter 11 protection in the United States.


Recent Airline Cases

- *In re Avianca Holdings S.A., et al.,* Case No. 20-11133 (MG)
  - Colombian Airline and Latin America's second-largest airline carrier filed on May 10, 2020, in the Southern District of New York.
  - The chapter 11 petitions reported $7.27 billion in assets and $7.26 billion in liabilities.
  - The company attributed the filing to the COVID-19 pandemic and the Colombian government's complete shutdown of its airspace.
    - The COVID-19 pandemic reduced consolidated revenue by over 80% and placed significant pressure on the company's cash reserves.
  - The company also faced a May 10, 2020, maturity of its $65.6 million holdout notes.
  - In addition, collection issues for credit card receivables led to trigger events under securitization vehicles.


Recent Airline Cases (continued)

- *In re LATAM Airlines Group S.A., et al.,* Case No. 20-11254 (JLG)
  - A Santiago, Chile-based airline conglomerate and Latin America's largest airline holding company filed on May 26, 2020, in the Southern District of New York.
  - The chapter 11 petitions reported $21.088 billion in assets and $17.959 in liabilities as of December 31, 2019.
  - The company attributed the filing mainly to the COVID-19 pandemic, citing a 95% reduction in passenger service.


Recent Airline Cases (continued)

- *In re Grupo Aeroméxico, S.A.B. de C.V., et al.,* Case No. 20-11563 (SCC)
  - Mexico's leading airline company by market share, fleet size, and network filed on June 30, 2020, in the Southern District of New York.
  - The chapter 11 petitions reported $1 billion to $10 billion in both assets and liabilities.
  - The company attributed the filing in part to the negative effects of the COVID-19 pandemic on passenger demand.


Recent Airline Cases (continued)

- *In re Philippine Airlines, Inc.,* Case No. 21-11569 (SCC)
  - A Philippines-based commercial airline filed for chapter 11 protection on September 3, 2021, in the Southern District of New York.
  - The purpose of the filing was to implement the "final stages of comprehensive restructuring that the [Company] has negotiated with its constituencies for the past year," according to the first-day declarant.
  - The company reported $4.1 billion in assets and $6.1 billion in liabilities as of August 31, 2021.
  - The company attributed the filing to the COVID-19 pandemic, particularly its extended nature, which continues to have a critical impact upon Philippine Airlines' business and operations.


Eligibility and Venue Selection

- All four of the airlines filed for chapter 11 bankruptcy protection in the Southern District of New York, even though none of the airlines are based in that jurisdiction, or domestic airlines. Eligibility and venue were not challenged in any of these cases.
- Avianca:
  - First-filed debtor was Avianca, Inc, a New York corporation, for which eligibility to file in SDNY was proper under section 109(a) ("domicile") and venue was proper under 28 USC § 1408(1).
  - Venue for all Avianca affiliates was then proper under 28 USC § 1408(2).


Eligibility and Venue Selection (continued)

- LATAM:
  - First-filed debtor was LATAM Airlines Group S.A, which holds millions of dollars in cash and investments in New York bank accounts. Eligibility to file in SDNY was proper under section 109(a) ("property") and venue was proper under 28 USC § 1408(1).
  - Venue for all LATAM affiliates was then proper under 28 USC § 1408(2).
- AeroMéxico:
  - First-filed debtor was Aerovías de México, S.A. de C.V,. which holds cash in New York bank accounts. Eligibility to file in SDNY was proper under section 109(a) ("property") and venue was proper under 28 USC § 1408(1).
  - Venue for all AeroMéxico affiliates was then proper under 28 USC § 1408(2).


Eligibility and Venue Selection (continued)

- Philippines Airlines:
  - The only debtor is Philippines Airlines, Inc., which has significant assets, leases, employees, and operations in New York. Eligibility to file in SDNY was proper under section 109(a) ("place of business"; "property") and venue was proper under 28 USC § 1408(1).


What Made Chapter 11 Attractive to Foreign Airlines?

- Familiarity of aircraft lessors and other large financial players with the chapter 11 process.
- Well developed case law and the expectation that large financial institutions would respect the automatic stay imposed by the United States Bankruptcy Courts.
- In the case of Philippine Airlines, it was a requirement under certain of the restructuring support agreements that the restructuring be implemented through a chapter 11 proceeding in the United States.
- Most aircraft and engine leases are governed by New York law, and most of their debt agreements were governed by New York law, some of which also included New York forum selection clauses.


What Made Chapter 11 Attractive to Foreign Airlines? (continued)

- United States courts will accept jurisdiction over all entities that constitute a multinational enterprise.
- The United States provides a well-established reorganization regime, while some other countries may provide only for liquidation or may be untested for large-scale reorganizations.


Why the Lack of Domestic Filings?

- The International Air Transport Association has projected net global airline industry losses of more than $47 billion in 2021.
- One potential explanation for the lack of domestic filings during the COVID-19 pandemic is the government aid that domestic airlines received.
  - In March 2020, Congress approved a $25 billion program, which required larger airlines to repay 30% of the payroll grants over time and offer government warrants. Separately, in March 2020, Congress also approved $25 billion in low-cost government loans for airlines and suspended some aviation excise taxes through December 31, 2020.
  - In December 2020, airlines and airline contractors received an additional $15 billion to keep workers employed.
  - The most recent comprehensive COVID-19 pandemic relief legislation enacted in the United States included an additional $14 billion in payroll support for the airline industry through September 30, 2021.


Why the Lack of Domestic Filings? (continued)

- Another explanation is that most United States airlines restructured their costs and business models in the aftermath of 9/11, while foreign airlines were not directly impacted.
  - United States travel industry had already shifted to being less luxury-focused and more affordable for leisure travelers.
  - Most United States airlines filed for bankruptcy in the years following 9/11 and the 2008 financial crisis.
  - United States airlines were able to drastically reduce burdensome retiree liability by shifting costs to the Pension Benefit Guaranty Corporation and by reducing future liabilities under employee defined contribution plans.
  - Foreign airlines did not have the same urgency to right-size their fleet and address labor inefficiencies, network redundancies, and real estate excesses.
- Last, but not least, low interest rates set by the Federal Reserve have made it easy for United States airlines to raise debt and equity financing to provide sufficient liquidity to survive the downturn.


Ancillary Proceedings

- Avianca
  - Has not sought recognition in Colombia.
- LATAM Airlines
  - LATAM Airlines obtained recognition of the chapter 11 cases in Chile and Colombia.
  - Ancillary proceedings were also filed in the Cayman Islands and Peru.
  - Recognition of chapter 11 cases was not possible under Brazilian law at the time of the filing. Brazil has since adopted the Model Law, but LATAM Airlines has not sought recognition there.
- AeroMéxico
  - Has not sought foreign recognition, but in July 2020, the bankruptcy court approved a motion authorizing the debtors to seek recognition in any judicial or other proceedings in any foreign country.
- Philippine Airlines
  - Philippine Airlines obtained recognition of its chapter 11 case in the Philippines.


## Issues in Recent Airline Cases

- Valuation
  - Although valuation is a significant issue in most cases, the COVID-19 pandemic has made it even more difficult, especially when it comes to equity value.
    - Confirmation issue raised by 2023 Noteholders in Avianca.
    - The AeroMéxico parties are in mediation over insufficient valuation materials provided by the company.
    - Uncertainty concerning what the airline industry will look like over the next decade.
  - EETC (Enhanced Equipment Trust Certificates) securitization structure also poses intercreditor asset valuation issues.
- Equity conversion component of DIP financing
  - In *In re LATAM Airlines Group S.A.,* Judge Garrity held that the structure was an improper *sub rosa* plan.
- Loyalty Programs
  - Club Premier dispute in AeroMéxico.


## Issues in Recent Airline Cases (continued)

- Substantive Consolidation
  - 2023 Noteholder confirmation objection in Avianca.
- Claims resolution issues in jurisdictions without recognition
  - Alternative dispute resolution for smaller foreign claimants. *See In re LATAM Airlines Group S.A.*
- Enforcing Automatic Stay
  - Citibank adversary proceeding in *In re Avianca Holdings, S.A.*
    - The debtors filed an adversary proceeding against Citibank and other parties seeking to enforce the automatic stay and halt postpetition sweeps of cash from certain receivables accounts.
      - After participating in bankruptcy court ordered mediation, the parties reached a settlement, which among other things, restructured the loan agreement in exchange for certain claims against the debtors.


## Issues in Recent Airline Cases (continued)

- Enforcing Automatic Stay (continued)
  - In Avianca, a creditor in Ecuador filed a lawsuit in Ecuador to collect an unpaid debt owed by Avianca's Ecuador-based debtor affiliate. Avianca sought a TRO from the bankruptcy court, arguing that continuation of the Ecuador lawsuit violated the automatic stay. The bankruptcy court denied the TRO because Avianca did not establish personal jurisdiction over the Ecuador-based defendant.
- Enforcing Assumption of Executory Contracts
  - Debtors may have difficulty enforcing the assumption of executory contracts governed by foreign law in a country (like the UK) that enforces an *ipso facto* clause terminating a contract upon insolvency of a contract party.
- Enforcing Impairment of Rejection Damages
  - Foreign counterparties and foreign law may not respect the Bankruptcy Code's impairment of rejection damages.


## Issues in Recent Airline Cases (continued)

- Unions and collective bargaining agreement negotiations
  - AeroMéxico union settlement provides for claim offset in the event that prior to the record date for initial distributions, a change in Mexican law occurs prohibiting outsourcing of certain activities previously performed by employees represented by Independencia union.


Foreign and International Law Issues; Conflicting Laws

- LATAM Airlines
  - Under Chilean law, unanimous consent is required to approve a bankruptcy filing, but the LATAM shareholders only obtained 90% approval.
  - Several parties have argued that any confirmed plan must also comply with Chilean law, which requires observance of statutorily-mandated shareholder preemptive rights.
- AeroMéxico
  - Mexican law requirement that Mexican investors own majority of post-reorganization equity.
    - This arose in the context of a letter that the Aeroméxico Mexican Pilots' Union filed that urged the debtors to conclude the exit financing process.
- Avianca
  - The bankruptcy court held that Colombian law prohibited non-executory contracts related to receivables purchase and servicing agreement from being deemed "inseparable" from the executory contracts for purposes of rejection.


Fleet Negotiations – Section 1110 of the Bankruptcy Code Not Applicable to Foreign Airlines

- §1110 of the Bankruptcy Code provides special protections for lessors, conditional vendors or secured parties with security interests in aircraft, aircraft engines, propellers, appliances or spare parts (collectively, "Aircraft Equipment") after a bankruptcy filing.
- Generally, §1110 provides that notwithstanding the automatic stay, aircraft creditors may exercise remedies provided for in the applicable financing agreements or lease, including taking possession of the Aircraft Equipment, 60 days after a bankruptcy filing, unless the debtor agrees to perform under such financing agreements or lease and cures any outstanding defaults during the 60-day period (a "1110(a) Election"), which is subject to approval of the bankruptcy court.
- Once a 1110(a) Election is made, the protections of the automatic stay, which are in effect for the initial 60-day period, remain in place until: (i) the parties agree otherwise, (ii) there is a default under the 1110(a) Election, or (iii) the debtor's case is completed.
  - Importantly, obligations due under the governing agreement are deemed to be administrative expenses.


## Issues Related to 11 U.S.C. § 1110

- § 1110(b) permits the parties to mutually agree to extend the initial 60-day period, subject to bankruptcy court approval.
- If a debtor fails to make the election and meet the requirements of §1110(a) within the initial 60-day period, and the parties fail to consensually agree to extend the initial 60-day period under § 1110(b), then under § 1110(c), upon the receipt of a written demand for surrender of the Aircraft Equipment, the automatic stay is not applicable and the creditor may proceed to exercise its contractual and state law rights against the collateral, which may include repossessing the Aircraft Equipment.
- §1110 is limited to certain types of users of aircraft (as provided in § 1110(a)(3)(A)).
- Debtors could not receive the benefits of section 1110 because it only applies to U.S. carriers. *See In re LATAM Airlines Group S.A., et al.; In re Grupo Aeroméxico, S.A.B. de C.V., et al.; In re Avianca Holdings S.A., et al.*
- Nevertheless, debtors obtained a similar result by negotiating stipulations with secured aircraft counterparties. *See id.*


## Debtors' Changed Posture During Cases

- Aircraft lease rejection
  - Early in many of the cases the focus was on reducing the fleet and the airlines had significant leverage in fleet negotiations due to the massive oversupply of aircraft and lessors' aversion to taking back aircraft they would not be able to redeploy.
  - Later in the cases, after industry began to improve, the leverage began to shift and the airlines moved quickly to lock in long term agreements at favorable rates.
- Appraisals, which are critical to staying within loan to value ratios that are covenants under certain loans largely held firm throughout the COVID-19 pandemic. Appraisal companies largely chose to ignore the COVID-19 pandemic for valuation proposals.

# Faculty

**Hon. Kevin J. Carey** is a partner in Hogan Lovells US LLP's Business Restructuring and Insolvency practice in Philadelphia and is a retired bankruptcy judge. He represents both companies and creditors in domestic and cross-border bankruptcy proceedings. Judge Carey was first appointed to the U.S. Bankruptcy Court for the Eastern District of Pennsylvania in 2001, then in 2005 began service on the U.S. Bankruptcy Court for the District of Delaware (as chief judge from 2008-11). During that time, he authored more than 200 reported decisions, issued important rulings on key issues such as valuation, fiduciary duties and other complex chapter 11, confirmation issues, and presided over high-profile cases, including *Exide Technologies*, *Tribune Co.* and *New Century Financial*. Judge Carey is ABI's President-Elect and a Fellow of the American College of Bankruptcy. He also is member of the International Insolvency Institute and was the first judge to serve as global chair of the Turnaround Management Association. Judge Carey lectures worldwide on bankruptcy issues and is a contributing author to *Collier on Bankruptcy*. In addition, he is a part-time adjunct professor in the LL.M. in Bankruptcy program at St. John's University School of Law in New York City. Judge Carey began his legal career in 1979 as law clerk to Bankruptcy Judge Thomas M. Twardowski, then served as clerk of court in the U.S. Bankruptcy Court for the Eastern District of Pennsylvania. He received his B.A. in 1976 from Pennsylvania State University and his J.D. in 1979 from Villanova University School of Law.

**Cecily A. Dumas** is a partner at BakerHostetler in Los Angeles and focuses on the areas of business restructuring and chapter 11. She represents clients across diverse industries in all facets of financial distress, notably debt restructuring, mergers and acquisitions and chapter 11 cases. Her background with business insolvency has led to favorable results for debtors, creditors' committees, chapter 11 trustees, secured and unsecured creditors, lessors and assets acquirers. Ms. Dumas has worked with leaders in technology, health care, biopharmaceuticals, real estate, energy and other fields. She currently leads the firm's representation of the Official Committee of Tort Claimants in the chapter 11 reorganization of PG&E Corp. Ms. Dumas is a Fellow in the American College of Bankruptcy and has consistently been recognized by *Chambers USA*, *The Best Lawyers in America* and other publications as a top lawyer in her field, and she was named among the *Daily Journal*'s top 100 lawyers in California in 2019. Ms. Dumas received her A.B. *cum laude* from the University of California, Berkeley, and her J.D. from Golden Gate University School of Law.

**Evan R. Fleck** is a partner in the New York office of Milbank LLP and a member of the firm's Financial Restructuring Group. He represents debtors and creditors in in-court and out-of-court restructurings, lenders, and other strategic parties, and he routinely advises creditors in distressed situations and has focused on the insolvency aspects of derivative and structured financing transactions. Mr. Fleck has been a featured panelist and lecturer at national conferences and law schools on topics involving distressed situations. He is recognized in *Chambers USA: Americas Leading Lawyers for Business* as a top Bankruptcy/Restructuring lawyer in 2021 in New York and globally. He is also known for his staunch defense of creditors' rights and successful representation of debtors on the creative management of their assets and business affairs in domestic and international restructuring proceedings. Mr. Fleck received his B.A. from the University of Pennsylvania and his J.D. from Georgetown Law.

**Hon. Martin Glenn** is a U.S. Bankruptcy Judge for the Southern District of New York in New York, sworn in on Nov. 30, 2006. Previously, he was a law clerk for Hon. Henry J. Friendly, Chief Judge of the U.S. Court of Appeals for the Second Circuit, from 1971-72, and he practiced law with O'Melveny & Myers LLP in Los Angeles from 1972-85 and in New York from 1985-2006, where he focused on complex civil litigation including securities, RICO, financial and accounting fraud, and unfair competition. Judge Glenn is a Fellow of the American College of Bankruptcy and a member of the American Law Institute, International Insolvency Institute, New York Federal-State Judicial Council, New York City Bar, National Conference of Bankruptcy Judges and ABI. He also is a past member of the Committee on International Judicial Relations of the U.S. Judicial Conference, and the Bankruptcy Judge Advisory Group of the Administrative Office of the U.S. Courts. In addition, he is an adjunct professor of law at Columbia Law School and a contributing author to *Collier on Bankruptcy*. Judge Glenn received his B.S. from Cornell University in 1968 and his J.D. from Rutgers Law School in 1971, where he was an articles editor of the *Rutgers Law Review*.

**Kyle J. Ortiz** is a partner with Togut, Segal & Segal LLP in New York, where he provides corporate restructuring advice to debtors, creditors and other parties in interest in corporate restructurings, both in and out of court. He has represented debtors in some of the largest and most complex chapter 11 cases of the past decade, including Pacific Drilling, Westinghouse, Toisa, SunEdison, Aeropostale, American Airlines and Lehman Brothers Holdings, Inc. Mr. Ortiz's *pro bono* work has been recognized by both the Legal Aid Society and the New York State Bar Association. He is a frequent lecturer and has published over 50 articles on a range of bankruptcy topics. In 2018, Mr. Ortiz was honored as one of ABI's "40 Under 40" rising stars in the restructuring community and by *Finance Monthly* as Restructuring Lawyer of the Year. In 2019, he received an Emerging Leaders Award from The M&A Advisor and was recognized as one of *Global M&A*'s Rising Star Dealmakers. Mr. Ortiz began his career in the Business Finance and Restructuring Group at Weil, Gotshal & Manges LLP. He is a member of ABI, INSOL International and the Turnaround Management Association. Prior to beginning his legal career, Mr. Ortiz founded Operation ASHA in Cambodia, an arm of the worldwide tuberculosis treatment organization, Operation ASHA, which in Cambodia has grown to over 50 tuberculosis treatment centers serving over a million people in 1,283 villages in and around Cambodia's capital, Phnom Penh. Mr. Ortiz currently sits on the U.S. Board of Directors for Operation ASHA Worldwide. He received his B.S. from Northern Michigan University, where he graduated as Outstanding Graduating Male, served as student body president and was the student commencement speaker at his graduation. He received his M.P.P. in 2006 from the Harris School of Public Policy at the University of Chicago, and his J.D. in 2009 from the University of Chicago Law School, where he was an Edmund Spencer Scholar.