NEW UK RESTRUCTURING AND INSOLVENCY LAWS – IMPACT ON ASSET FINANCINGS

The Corporate Insolvency and Governance Act ("**CIGA**"), effective from 26 June 2020, brings fundamental and far-reaching changes to the UK insolvency landscape. The CIGA affects UK obligors but will also potentially impact wider restructurings of English law transactions.

Our cross-practice briefing "UK Corporate Insolvency and Governance Act: Different Stakeholder Perspectives" examines the final legislation and the broad themes running through it. In this supplemental sector briefing, we focus on the aviation specific considerations arising out of the permanent measures, from the perspective of a lessor or a financier of aircraft or of separate engines, where the transaction involves a UK debtor or where the CIGA rules may otherwise apply. We also briefly consider financing of other equipment, such as rail assets or ships.

Key issues

- The new Part A1 moratorium for viable companies
  - Rent obligations continue
  - Enforcement of security and repossession of leased property require court order
  - Liens and statutory detention rights affected
- The new S233B termination prohibition
  - Contracts for supply of goods and services
  - Excluded contracts and/or excluded entities
- The new Part 26A compromise – cross-class cram down introduces more flexibility to schemes concept, subject to court fairness protections
- Relationship between the CIGA and the UK Cape Town Regulations
  - Express exclusions
  - New moratorium will not extend beyond Regulation 37 60 day waiting period
  - New termination prohibition will not affect Cape Town interests – Regulation 21 default remedy
  - Regulation 37(9) analysis

UK Cape Town Regulations

These considerations must be read against the backdrop of the UK's adoption of the Cape Town Convention and Aircraft Protocol, as implemented by the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (the "**UK Cape Town Regulations**"). The UK did not make the relevant Article XXX(3) declaration in respect of the treaty's "hard" insolvency provisions under Article XI, commonly referred to as Alternative A; instead the UK amended its domestic insolvency law to import Alternative A, with a 60-day waiting period, as provided for by Regulation 37 of the UK Cape Town Regulations.

The new Part A1 moratorium for viable companies

Lessors and lenders should note that the payment holiday for certain debts does not extend to rent in respect of a period during the moratorium or to amounts payable in respect of goods or services supplied during that time. Scheduled rentals payable under either an operating lease or a finance lease and vessel charter hire payments should therefore fall within this exclusion. It is part of the entry criteria to the process that a company seeking the benefit of

the moratorium can continue to meet such payments. If payments are not made, then the independent monitor must bring the moratorium to an end.

Similar to the effects of the moratorium upon an administration, during the new moratorium, creditors are restricted from enforcing security (except for financial collateral) and repossessing goods subject to hire-purchase, without the consent of the court. "Hire-purchase agreement" for the purpose of the new moratorium in the Insolvency Act 1986 is expressly defined to include a chattel leasing agreement, a conditional sale agreement and a retention of title agreement. The company is also given powers to dispose of hire-purchase property, subject to court approval.

Helpfully, the CIGA (at paragraph 55 of Schedule 3) amends Regulation 37 of the UK Cape Town Regulations to provide that those restrictions on enforcement of security and on repossession of hire-purchase/leased property shall not apply beyond the waiting period; and to disapply the disposal of hire-purchase property rules for relevant aircraft objects. In other words, creditors with a registered Cape Town international interest against a debtor company which enters into a Part A1 moratorium may be reassured that (assuming no cure of the relevant default, other than the insolvency itself) they may enforce against and/or recover the airframe or engine, as applicable, at the latest by 60 days, regardless of any extension of the moratorium beyond this date.

The CIGA does not expressly confirm that there will be no second waiting period pursuant to Regulation 37(6) and clarification on this would be welcomed.

Impact of new moratorium on liens and statutory detention rights against the aircraft

In a distressed airline environment, aircraft owners and lenders will be increasingly concerned about the risk of a third party claim against the aircraft, for example, (a) a possessory lien for work undertaken on the aircraft for which the repairer has not been paid by the airline or (b) outstanding airport and air navigation charges due from the airline. In the UK, certain airports and the Civil Aviation Authority (acting on behalf of Eurocontrol and/or NATS) have extensive statutory detention powers against aircraft which have incurred these charges or, more controversially, against other aircraft operated by the defaulting airline at the relevant time (the so-called "fleet lien" power). It is well-established that the exercise of a lien would contravene the prohibition on enforcement of security which applies during the moratorium on an administration. Further, in the leading case *In Bristol Airport Plc v Powdrill* [1990] *Ch. 744*, the English court held that for the purposes of the Insolvency Act 1986, the statutory right of detention given by the Civil Aviation Act 1982 s.88 is a "lien or other security" over the debtor's property and that the exercise of this right during the moratorium on an administration requires the consent of the administrator or the court.

We anticipate that the same analysis will apply both to the exercise of a repairer's lien and to the assertion of a statutory detention right against an aircraft, including the fleet lien, in respect of the new moratorium.

The new S233B termination prohibition

The new termination prohibition introduced by the CIGA into Section 233B of the Insolvency Act 1986 applies to contracts for the supply of goods or services, subject to certain exclusions. While contracts for "financial leasing" are expressly listed as excluded financial contracts, leases in general and

other title financing devices are not so exempted, notwithstanding that these may be utilised for the purposes of financing the long-term use and possession of an asset by the operator. There is an argument that such leases should be distinguished from ongoing trade supplies which the CIGA intends to protect to allow businesses to continue trading. Unfortunately, there is no clear guidance on whether "dry" operating leases of aircraft or other large transportation assets, such as rail rolling stock, or bareboat charters of vessels fall outside of the S233B rule.

Further, under Regulation 21 of the UK Cape Town Regulations, upon an event of default (which may be contractually agreed by the parties), the Cape Town lessor (or conditional seller, as the case may be) **may terminate the relevant agreement** and take possession or control of any aircraft object to which the agreement relates (i.e. by way of self-help); or may apply to court for an order authorising either of these acts. This default remedy of termination in respect of a Cape Town operating lease or a conditional sale agreement would clearly conflict with the S233B rule, if the rule does apply to such agreements.

A last-minute, welcome amendment has made its way into the CIGA (at paragraph 21, Schedule 12, Part 3 (Excluded Contracts)) which provides that nothing in S233B affects the UK Cape Town Regulations. We consider that the effect of this express exclusion is that an operating lessor (or conditional seller) with a registered Cape Town international interest would not be prevented from terminating the relevant agreement upon the debtor lessee (or conditional buyer) entering a relevant insolvency procedure.

However, where the operating lessor does not have the benefit of such Cape Town registration, for example, in relation to a "pre-existing lease interest", or the transaction involves non-Cape Town aircraft objects, including rolling stock, locomotives and vessels, then the lessor should consider the potential impact of S233B on its termination rights on a lessee insolvency. Termination for a separate and non-insolvency related event should not be caught by the prohibition, provided that the company has not entered insolvency at the relevant time. Likewise, if such leases are ultimately considered to be subject to the termination prohibition, it should also be noted that termination may in certain circumstances be permitted either by consent of the company/insolvency officeholder or with the court's approval. Draft Explanatory Notes published with the draft Bill in May 2020 also provide that where non-payment occurs after insolvency, the right to terminate is not prohibited.

The S233B rule may be viewed as a substantive rule of English insolvency law and therefore, without clear guidance to the contrary, parties should assume it has general application to English law governed contracts for the supplies of goods and services, not only those involving a UK debtor and/or a UK supply.

The new Part 26A compromise

Regulation 37(9) of the UK Cape Town Regulations provides that upon an insolvency-related event (as defined), "no obligations of the debtor under the agreement may be modified without the consent of the creditor". The relationship between this provision (and to an extent, the default remedy of termination and repossession under Regulation 21 discussed above) and the cross-class cram-down powers introduced by the CIGA in a Part 26A compromise is unclear. During the Bill's progress through Parliament, certain

market commentators suggested that a dissenting Cape Town creditor could not be bound by a compromise arrangement (or by a scheme, if applicable) because this would contravene Regulation 37(9). This argument relies, in part, on the contention that a new compromise (or a scheme) is an "insolvency proceeding" within the definition of insolvency-related event and which activates the creditor protection of Regulation 37(9).

In contrast, the general view amongst UK insolvency practitioners and certain aviation lawyers appears to be that neither a new compromise nor a scheme easily qualifies as such insolvency proceeding; and therefore, if the Cape Town debtor seeks to agree a compromise (or a scheme) with the relevant creditors, Regulation 37(9) is not engaged.

In any case, it is generally accepted that the proprietary interests of a creditor, including the rights of an owner or lessor, may not be compromised by a scheme nor by the new compromise which is modelled on the existing scheme provisions in Part 26 of the Companies Act. While case law on schemes and other existing procedures has primarily involved landlord and tenant arrangements and the landlord's reversionary interest, our view is that a similar analysis should apply to the ownership or other proprietary right of any lessor of personal property, not only a lessor with the benefit of a Cape Town registered interest over an aircraft object.

Conclusion

The implications of the CIGA for aviation and other asset financings will need to be carefully analysed and applied to individual fact patterns. Distressed operators may look to avail themselves of the debtor-centric measures, however, the legislature and the courts would do well to balance these against the interests of equipment owners and providers of finance. A lack of certainty as to parties' respective rights may impair investor confidence and may lead to increased costs and potential disputes, none of which would ultimately assist the industry.

CLIFFORD CHANCE

CONTACTS

ASSET FINANCE

Paul Carrington
Partner

T +44 207006 8124
E paul.carrington@cliffordchance.com

Marisa Chan
Knowledge Director

T +44 207006 4135
E marisa.chan@cliffordchance.com

William Glaister
Partner

T +44 207006 4775
E william.glaister@cliffordchance.com

Oliver Hipperson
Partner

T +44 207006 4767
E oliver.hipperson@cliffordchance.com

Ranbir Hunjan
Partner

T +44 207006 2612
E ranbir.hunjan@cliffordchance.com

Antony Single
Partner

T +44 207006 3722
E antony.single@cliffordchance.com

RESTRUCTURING

Melissa Coakley
Partner

T +44 207006 1963
E melissa.coakley
@cliffordchance.com

Adrian Cohen
Partner

T +44 207006 1627
E adrian.cohen
@cliffordchance.com

Philip Hertz
Global Head of
Restructuring and
Insolvency

T +44 207006 1666
E philip.hertz
@cliffordchance.com

John MacLennan
Partner

T +44 207006 1642
E john.maclennan
@cliffordchance.com

Gabrielle Ruiz
Knowledge Director

T +44 207006 1615
E gabrielle.ruiz
@cliffordchance.com

David Towers
Partner

T +44 207006 8036
E david.towers
@cliffordchance.com

Iain White
Partner

T +44 207006 2825
E ian.white
@cliffordchance.com