Report - Distressed Airlines: Model Toolkit for Asia and Beyond

I. Introduction

The webinar, *Distressed Airlines: Model Toolkit for Asia and Beyond*, held on 28 October 2024, was the second session in a series organized by INSOL Asia Hub. This event was conducted in collaboration with Baker McKenzie Thailand and the Centre for Asian Legal Studies at the National University of Singapore, focusing on the complex restructuring processes faced by airlines during periods of financial distress.

The session brought together industry experts to discuss the unique challenges and strategies associated with restructuring airlines impacted by financial difficulties. The discussion centered on prominent airlines such as LATAM Airlines, Thai Airways, NOK Air, and Hong Kong Airlines, each of which has faced significant hurdles due to multi-jurisdictional complexities, varying regulatory frameworks, and the financial strain caused by the global pandemic.

The objective of the webinar was to provide a comprehensive understanding of the legal, operational, and financial frameworks that have been employed to address these challenges. Panelists shared insights into the mechanisms and tools used to stabilize operations, manage creditor relationships, and navigate jurisdictional differences in insolvency laws. By exploring these case studies, the session aimed to highlight innovative solutions and lessons learned, offering a practical toolkit for stakeholders involved in the restructuring of distressed airlines across Asia and beyond.

II. Key Themes and Discussions

The webinar explored the restructuring journeys of four major airlines—LATAM Airlines, Thai Airways, NOK Air, and Hong Kong Airlines—offering an in-depth analysis of the legal frameworks, operational challenges, and strategic approaches adopted by each to navigate financial distress. Below is a summary of the key points discussed:

A. LATAM Airlines: Cross-Border Restructuring with Chapter 11

LATAM Airlines used Chapter 11 of the U.S. Bankruptcy Code as a primary tool to address multi-jurisdictional financial challenges. The restructuring plan was designed to stabilize operations, optimize costs, and manage creditor relationships across different legal systems. Key aspects of the strategy included:

- **Automatic Stay Protections:** LATAM leveraged Chapter 11's automatic stay provisions to shield its global assets from creditor actions. This allowed the airline to stabilize operations without the risk of asset seizures, particularly from U.S.-based creditors. These protections also facilitated a more controlled restructuring environment by creating a legal barrier against aggressive creditor enforcement across borders.

- **Contract Rejection Mechanism:** The airline utilized Section 365 of the U.S. Bankruptcy Code to terminate burdensome contracts, particularly above-market leases, and renegotiate them on more favorable terms. This was pivotal in reducing overhead costs and achieving financial sustainability.

- **Selective Creditor Payments Through Critical Vendor Cap:** To address cross-border enforcement challenges, LATAM allocated over $200 million to pay essential foreign creditors under the doctrine of necessity. This selective payment strategy ensured operational continuity by prioritizing critical vendors without undermining compliance with U.S. court orders.

- **Strategic Jurisdictional Selection:** LATAM sought recognition of its restructuring in Chile, leveraging the fact that many of its contracts were governed by New York law. This approach avoided the complexities and unpredictability associated with Brazilian commercial courts, despite Brazil being one of LATAM's largest markets.

- **Financing Through DIP Loans:** The airline secured debtor-in-possession (DIP) financing with super-priority provisions, which provided the necessary liquidity to continue operations and develop a debt-exit strategy. The financing also enabled LATAM to maintain critical services while renegotiating long-term financial obligations.

B. Thai Airways: Domestic Bankruptcy Act as a Framework

Thai Airways relied on Thailand's Bankruptcy Act to address financial distress, choosing a localized restructuring approach that aligned with its asset base and operational scope. The strategy was tailored to work within the constraints of Thai law while seeking recognition in other jurisdictions where necessary.

- **Selective Creditor Payments Under Section 90/12:** Thai law allowed the airline to prioritize payments to essential creditors as part of normal business operations. This provision was exercised cautiously to avoid misuse, as violations carried significant legal and criminal penalties.

- **Localized Framework for Reorganization:** With its primary assets and routes concentrated in Thailand, Europe, and Asia, Thai Airways opted for a domestic reorganization under the Thai Bankruptcy Act. The airline also sought recognition orders in other jurisdictions to extend the automatic stay beyond Thailand, ensuring creditor compliance in key markets.

- **Operational Challenges During the Pandemic:** The COVID-19 pandemic exacerbated the airline's financial challenges, grounding fleets and significantly reducing revenues. Thai

Airways collaborated with business units to address critical operational issues, including ticketing and loyalty programs, while negotiating with creditors to maintain cash flow within the legal framework.

- **Managing Stakeholder Expectations:** The airline engaged in extensive negotiations with creditors and business partners to develop feasible solutions that balanced operational needs with financial constraints, ensuring the long-term viability of the business.

C. NOK Air: Structural Challenges Within Thai Insolvency Law

NOK Air's restructuring highlighted both the strengths and limitations of Thailand's insolvency framework. The process underscored the importance of addressing procedural delays, optimizing legal tools, and managing creditor relationships effectively.

- **Delays in Procedural Timelines:** Procedural inefficiencies in Thailand's bankruptcy process caused delays in moving from petition filing to creditor claim resolution. These delays left assets vulnerable and highlighted the need for more streamlined judicial processes.

- **Contract Disclaimer Mechanism:** Thai insolvency law provided NOK Air with the ability to disclaim non-beneficial contracts. This rarely used provision allowed the airline to renegotiate lease terms and reduce financial burdens.

- **Impact of Non-Signatory Status to the Cape Town Convention:** Thailand's absence from the Cape Town Convention protected NOK Air from aircraft repossession during restructuring. However, this advantage was offset by the airline's reduced access to competitive leasing rates and limited fleet management flexibility, which posed long-term challenges for financial recovery and growth.

D. Hong Kong Airlines: Multi-Jurisdictional Strategies and Legal Innovations

Hong Kong Airlines employed creative strategies to address the limitations of its domestic legal framework while navigating multi-jurisdictional challenges. The airline's approach focused on creditor classification, jurisdictional compliance, and alternative financing mechanisms.

- **Creditor Classification for Negotiations:** Creditors were grouped into six distinct classes, including aircraft lessors, financial institutions, perpetual loan holders, trade parties, airport dues, and inter-group claims. This segmentation enabled the airline to address specific creditor concerns effectively and streamline negotiations.

- **Dual Jurisdictional Approach to the Gibbs Rule:** To address the Gibbs Rule, which restricts the modification of English law debts outside the UK, Hong Kong Airlines implemented a dual-scheme strategy. This involved a Hong Kong scheme of arrangement and a UK restructuring plan to secure cross-border creditor compliance.

- **Mitigating Cape Town Convention Risks:** The airline proactively obtained necessary consents from lessors to avoid asset repossession under the Cape Town Convention. This ensured operational continuity and retention of critical aircraft assets during the restructuring process.

- **Alternative Financing Solutions:** In the absence of super-priority debtor-in-possession (DIP) financing available under Chapter 11, the airline relied on commercial forbearance from lessors and raised new capital through post-restructuring investment agreements.

- **Voting and Cross-Border Sanctioning:** Creditors were grouped into three voting classes: critical lessors, unsecured creditors, and perpetual loan holders. This structure facilitated majority support (91%) for the restructuring plan, which was subsequently sanctioned in Hong Kong, the UK, and mainland China, ensuring broad recognition and compliance.

III. Highlights and Insights

- **Cross-Border Frameworks:** LATAM Airlines demonstrated the efficacy of Chapter 11 in addressing multi-jurisdictional complexities, while Thai Airways and NOK Air relied on local frameworks that highlighted the limitations of non-uniform insolvency laws.
- **Critical Asset Retention:** Airlines universally emphasized the importance of retaining critical assets, such as aircraft, through various strategies including contractual renegotiations and jurisdictional leveraging.
- **Challenges with Procedural Delays:** Prolonged timelines in jurisdictions like Thailand were identified as barriers to swift restructuring, emphasizing the need for streamlined processes.
- **The Rule in Gibbs:** Hong Kong Airlines highlighted the complexities introduced by this rule, necessitating dual jurisdictional strategies to ensure creditor compliance and effective restructuring.
- **Operational Continuity:** Maintaining business operations during restructuring required innovative financing, strong creditor communication, and alignment with business units to address immediate challenges.

IV. Audience Engagement

During the Q&A session, participants discussed challenges unique to the aviation sector, including the technical intricacies of aircraft maintenance contracts and regulatory oversight. The complexities of managing diverse creditor groups and securing creditor buy-in were also emphasized. The limitations imposed by the Rule in Gibbs were a focal point, with discussions on how jurisdictions differ in their recognition of cross-border debt restructuring. Questions regarding the accessibility of restructuring plans highlighted the varying degrees of transparency across different airlines and jurisdictions.

V. Conclusion

The webinar underscored the critical importance of tailored restructuring strategies for airlines, highlighting the role of jurisdiction-specific legal frameworks, cross-border coordination, and innovative financing solutions. The case studies of LATAM Airlines, Thai Airways, NOK Air, and Hong Kong Airlines offered valuable lessons for addressing financial distress in the aviation industry. Moving forward, the harmonization of international insolvency laws and streamlined domestic processes will be crucial for facilitating effective airline restructurings in Asia and beyond.