

COVID-19 AND A NEW PARADIGM IN AIRLINE RESTRUCTURING

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As the COVID-19 crisis escalates, airlines are under an enormous strain caused by the current unprecedented disruption to the aviation industry. The likely result is that many airlines will need to restructure their debts and other financial commitments. But how will they do so and what can we learn from previous airline insolvencies as well as experience from other industries that have faced issues that, while not as unprecedented, nonetheless have parallels that can be drawn with the current crisis?

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Airline insolvencies have always been a feature of the aviation industry. In Europe and many other regions, the response to an insolvency has generally been for secured lenders and aircraft lessors to enforce against their security and repossess aircraft, save in those situations where government support has meant that the airline has continued to fly (e.g. Alitalia). This approach is to be contrasted to the United States, where airline Chapter 11 bankruptcies leading to restructurings have been common.

However, not even in the aftermath of 9/11 has the aviation industry previously faced such widespread disruption to its business, with the financial pain spread across so many airlines and regions. In these circumstances, the old paradigm of

repossessing aircraft from stressed and insolvent airlines and redeploying them to stronger airlines or more buoyant regions may not be an option in a globally distressed market and will not provide a solution that preserves value. Instead, lenders and lessors looking to avoid the costs of repossessing, storing and maintaining aircraft (as well as the environmental risk that comes with it) will need to find different ways of addressing the problems of airlines who simply cannot meet their financial commitments.

The COVID-19 crisis will be transient and should not affect long-term aviation demand. Where lenders and lessors think an airline's impending failure is only a result of the current crisis, they should appreciate that value can be preserved by working with the other creditors on a coordinated basis. This will ensure that one creditor's actions do not adversely affect the interests of others and, with creditors working together, the airline can weather the effects of the current crisis and deploy its key assets when the crisis abates in order to generate revenues and repay accrued debts.

A parallel can be drawn from the maritime sector, which has gone through various global downturns in recent years due to overcapacity in the market and distress caused by falls in the oil price. Here, mortgage enforcement against a vessel is not the favoured route, as vessels are sometimes bespoke and costly to repurpose and many sales at a time of poor demand would result in little more than the scrap value of the vessel being realised. The lesson that can be drawn from these periods of financial distress caused by a sharp drop in global demand is that coordinated action by creditors is key to preserving value and saving those debtors that are viable were it not for the downturn. This coordination has resulted in successful restructurings of shipping companies, safeguarding value and leading to better returns for creditors.

Therefore, the aviation industry in general, and particularly lenders and lessors, will need to find ways to co-ordinate their efforts in relation to distressed airlines to avoid a wave of insolvencies and the destruction of value across the industry. Creating an environment where unilateral action is forestalled will likely require coordinating committees (“CoComs”) to be established. CoComs are a common feature of restructurings across other industries, including in the maritime sector.

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Yet establishing CoComs to deal with airline restructurings will mean addressing a number of industry specific traits, which include: airlines having a greater number of counterparties financing their aircraft; a more established (and therefore more prevalent) leasing market alongside debt financing; and the previous practice of (and therefore instinctive recourse to) repossessing aircraft rather than engaging in a workout of an airline’s financial difficulties.

The aviation industry’s unfamiliarity with CoComs and various industry-specific issues may lead to tension between members that will inevitably need to be ironed out. Further complication may come from the various initiatives already being discussed in relation to state aid or even state intervention to save favoured national

champions. However, it is difficult to see an alternative that does not lead to greater pain in these unprecedented times.

Watson Farley & Williams is uniquely placed to guide lenders and lessors through this new landscape. We have advised on more restructurings of maritime assets than any other law firm and have a track record advising CoComs. This, coupled with our in depth understanding and experience of the aviation industry, means that we can draw on the complete set of skills necessary to navigate this new paradigm of airline restructurings.

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