Thomas Cook's collapse and airline insolvency – lessons for the UK

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The collapse of Thomas Cook, the UK headquartered travel group, raises questions in relation to UK insolvency law. This article will consider four issues arising from the collapse: the reason why liquidation was chosen as the insolvency procedure for the UK companies in the group; whether using administration instead of liquidation would have enabled the airline to continue flying; the current proposals for reform of UK airline insolvency which were made following the collapse of Monarch Airlines in 2017 and, against the backdrop of existing reform proposals from the UK government, whether UK insolvency law needs more fundamental reform.

Thomas Cook, a UK headquartered global travel and airline business with a history dating back almost 180 years, collapsed in September 2019. The insolvency has raised questions in relation to UK insolvency law and its future development, particularly concerning the insolvency of airlines. Airline insolvency in the UK was already the subject of public debate following the collapse of Monarch Airlines in October 2017.

This article will briefly set out the background to Thomas Cook's collapse, then consider the following four issues in relation to its insolvency and the insolvency of its UK airline: the reasons behind liquidation being chosen as the insolvency procedure for Thomas Cook; whether using administration would have made any difference to the airline being able to continue flying; the current proposals for reform of UK airline insolvency; and, whether UK insolvency law in general needs more fundamental reform. Finally, there will be some conclusions.

The background to Thomas Cook's collapse

Notwithstanding the public's perception that Thomas Cook's insolvency was sudden, the group had been on restructuring and insolvency practitioners' watch lists for some time. Burdened by significant debt due to acquisitions, restructuring negotiations involving Thomas Cook's banks, bondholders and its largest shareholder, Fosun, had been ongoing since April 2019. These negotiations were occurring alongside various strategic reviews and potential sales of parts of its business, including its airlines.

In August 2019, as Thomas Cook headed into the quieter winter period when its cashflow would be most severely tested, it launched a restructuring process. The restructuring would have involved a £900m (approx. US$1.17bn) recapitalisation of the group, with half of this new money coming from Fosun and the rest from Thomas Cook's banks and bondholders, with a transfer of ownership of the group from its existing shareholders to the new money providers. However, this restructuring was derailed by a last-minute demand from Thomas Cook's banks for an additional £200m of new funding. As this additional funding could not be secured, the UK companies in the group filed for insolvency on 23 September 2019, with various European subsidiaries filing for local insolvency proceedings in the following days.

On the day of the insolvency filing, the UK airline subsidiary of the group immediately ceased operations, with all flights grounded, necessitating what was described as the 'largest peace time repatriation' of holiday makers stranded abroad. This repatriation was organised by the UK Civil Aviation Authority (CAA). Although some passengers were covered by various sector insurance schemes, others were not. Nevertheless, the UK government funded the repatriation so that all holiday makers were brought home.

In comparison to the UK airline, the group's German airline subsidiary, Condor, continued to fly with the benefit of a six-month bridging loan guaranteed by the German government. Although Condor did enter an insolvency procedure (the proceedings being under the *Schutzschirmverfahren* 'protective shield proceedings' clause of the German insolvency code), this procedure had the effect of protecting Condor from creditors, including other companies in the Thomas Cook group, so that their claims could not be enforced and there was time to find a new investor to take over the airline for the long term.

Liquidation not administration

The first noteworthy aspect of Thomas Cook's insolvency is that the insolvency procedure chosen was liquidation with the Official Receiver (OR) as liquidator. Furthermore, alongside the appointment of the OR as liquidator, special managers were appointed to assist with the day-to-day management of the insolvency.

The OR is a public official and part of the Insolvency Service, the UK government agency responsible for insolvency. The OR is automatically appointed as the liquidator of a company on its compulsory liquidation.[1] In some cases, a private sector liquidator is then appointed to take over the liquidation from the OR but in many cases the OR is the default liquidator, particularly in small company insolvencies where there are few assets to fund the work of a private sector liquidator. Therefore, the OR performs an important function ensuring that there is always a liquidator of a company.

It is unusual for a large company to enter liquidation, as this procedure usually immediately ends the company's business with the liquidator principally tasked with winding up the company's affairs and making a distribution to creditors. The alternative UK insolvency procedure of administration is far more common for large companies and is designed to be more flexible, allowing the company to continue to trade under insolvency protection, either to rescue the business as a going concern or to achieve a better result for the company's creditors. An administrator appointed over a company is invariably a private sector professional, who will need to be able to fund the administration from the company's assets or, if those assets are insufficient or not readily realisable, from an alternative source.

It is this last point, the funding of the insolvency, which was the reason why Thomas Cook entered liquidation and not administration. In applying to the court for a winding up order to commence the liquidation, Thomas Cook revealed that the group had insufficient funding available to support an administration.[2] Moreover, while the UK government was willing to support an insolvency process involving the OR as liquidator, it was not willing to fund an administration.[3]

The insolvency of Thomas Cook is another example of an emerging model for dealing with certain large scale, complicated insolvencies where funding is an issue or where there are onerous liabilities that a private sector insolvency practitioner is unable take on. Prior to Thomas Cook, the appointment of the OR as liquidator assisted by private sector special managers was a model also deployed in the insolvency of Carillion, British Steel and Sahaviriya Steel Industries (SSI). Carillion was similar to Thomas Cook, in that there was insufficient funding available to support an administration procedure and so the OR was appointed as liquidator with funding for the liquidation provided by the UK government. In the case of British Steel and SSI, the position was different: because of the environmental and health and safety issues related to these companies' operations as steelmakers no private sector insolvency practitioner was willing to accept an appointment as administrator.[4]

Therefore, Thomas Cook and other recent high-profile liquidations undertaken by the OR show that in certain circumstances an administration conducted by a private sector administrator may not be feasible and it is necessary for the OR to step in as liquidator. This practice reflects the OR's role as default liquidator tasked with ensuring that there is always someone to take on the role of properly winding up a company's affairs. However, that such an approach is necessary for large companies suggests a new trend in relation to UK corporate insolvency and, although exceptional, means that the UK government is, at least in part, covering the cost of resolving these corporate failures.

This trend and its consequences merit further reflection and debate: for example, would funding an administration make more sense; and should UK insolvency reform consider these experiences and use them to assess whether certain features of UK insolvency law need more fundamental reform (as to which see further below). Yet that debate has hitherto been absent.

Administration would not have made any difference to the airline's ability to continue flying

In the immediate aftermath of Thomas Cook's insolvency, some commentators remarked that the reason Thomas Cook's UK airline had ceased flying was because it had entered liquidation and not administration. Such commentary particularly focused on the fact that a large and expensive repatriation operation was being run by the CAA, which supposedly could have been avoided if Thomas Cook's airline had entered administration as opposed to liquidation. Although such reasoning reflects the common understanding that liquidation normally leads to the cessation of a company's business while administration allows a company to continue to trade, in the case of an airline the type of insolvency procedure it enters does not determine whether it is able to continue flying or not.

Recent experience has demonstrated that even if a UK airline enters administration, it is very likely to cease flying immediately.[5] Monarch Airlines, which went into administration in October 2017, is a recent high-profile example of this practice. Indeed, the commencement of Monarch's administration was timed to be at 4am, when all its planes were on the ground and Thomas Cook's liquidation was similarly made in the early morning (at 0147) so that the vast majority of its aircraft were on the ground (only six planes were in the air).

There are a number of reasons why a UK airline does not keep flying in insolvency (whether that be administration or liquidation):

- Action by creditors seeking payment of pre-insolvency debts may disrupt the operation of the airline, particularly where planes are impounded (eg, at a non-UK airport) with their release conditional on payment of the existing debt.
- Even if the airline can be protected from pre-insolvency creditors by an insolvency moratorium, funding would still be required to pay suppliers and other third parties required to continue the operation of the airline (eg, for fuel and airport charges) as these costs would be an expense of the administration.
- Operating an airline carries intrinsic risks (eg, of accidents or terrorism), which can potentially lead to very large and uninsurable liabilities and for which an administrator may become personally liable and so would be unwilling to risk incurring by operating the airline.
- Operating an airline for a short time merely to repatriate passengers otherwise stranded abroad is likely to be a loss-making exercise and so is inconsistent with the duties of an administrator in achieving the best outcome for creditors.
- The airline's aircraft may be subject to repossession or security enforcement proceedings by lessors or financiers of those aircraft, calling into question whether the airline would retain the aircraft required to operate. Although this issue may be partially mitigated in the short term by the insolvency moratorium, in the medium term this moratorium may not protect the airline after the 60-day waiting period provided for under the Cape Town Convention as incorporated into UK law.[6]
- It may not be possible to retain key airline staff required to operate the airline safely and in compliance with the regulatory and licencing regime applicable to an airline.
- Various regulatory issues arise in relation to an airline that is insolvent, which may mean that the relevant authority (in the UK, the CAA) is compelled by law to revoke or suspend the Air Operator Certificate (AOC) and/or the operating licence that are required for the airline to be able to fly.

While the practice in the UK, reflecting the specific features of UK insolvency law, is that an airline does not continue to fly following its insolvency, the experience in other jurisdictions is markedly different. In the US, a significant number of airlines have entered Chapter 11[7] and continued to operate, eventually emerging with their debts restructured.[8] In Europe, there have also been recent examples of airlines entering insolvency and continuing to fly. As mentioned above, Condor, Thomas Cook's German airline, continued to operate as did the German airline, Air Berlin, which entered insolvency in August 2017. Alitalia is yet another example, which most recently went into extraordinary administration in May 2017.

However, the European examples of major airlines continuing to operate in insolvency have involved significant additional funding being made available by their national governments. If this funding had not been available, the airlines would not have been able to continue to operate. Furthermore, in the European and US examples, the insolvency proceedings have been 'debtor in possession' proceedings, which has enabled existing management to remain in place and has not required an insolvency practitioner to take over the running of the airline, with the accompanying risks. It is notable that these features do not exist in the UK, because the UK government is less willing to provide funding and because debtor in possession insolvency proceedings are not part of the UK insolvency regime.

Proposals for reform of airline insolvency in the UK

Following the collapse of Monarch Airlines, the UK government commissioned the Airline Insolvency Review, which made proposals for reform in its final report in May 2019.[9] The review focused on the question of passenger protection in an airline insolvency, including how repatriation of passengers who are abroad at the time of an airline's insolvency can best be managed.

The reform proposals included specific measures in relation to the insolvency of an airline that seek either to mitigate or solve the issues listed above that mean a UK airline does not continue flying in insolvency. The policy reasoning behind these measures is that in larger airline insolvencies a repatriation will be most efficiently achieved by keeping the fleet flying notwithstanding the insolvency of the airline.

The central reform in relation to airline insolvency is the proposal for a Special Administration Regime (SAR) for airlines, which would enable an insolvent airline to continue to operate for a limited period to bring passengers home, who would otherwise be stranded. The SAR would:

- include a specific duty for the administrators to conduct a repatriation exercise, ensuring there is no ambiguity in relation to their duties or inconsistency with the purpose of the administration;
- prohibit essential suppliers (including aircraft lessors and fuel suppliers) from terminating contracts and demanding ransom payments;
- enable the UK government to provide a grant, loan or indemnity to the administrator appointed under the SAR; and
- provide for the administrator to be responsible for discharging any liens asserted against aircraft, explicitly extend the insolvency moratorium to cover statutory detention powers and provide for the terms of aircraft leases to continue to be met.

The SAR would come to an end once the repatriation has been completed, and the insolvency would revert to a normal administration.

In conjunction with the SAR, the Airline Insolvency Review recognises that funding must be in place to cover the costs of the SAR and the repatriation operation. The review proposes that this funding is paid for by a passenger levy, so that the creditors of the airline are not adversely affected by funds otherwise forming part of the insolvent estate being used for the repatriation and therefore not available to pay creditors' claims.

In light of the collapse of Thomas Cook, the UK government has indicated that it will shortly bring forward legislation to implement the proposals in the Airline Insolvency Review. However, some concerns have been raised over the proposals, particularly in relation to the SAR, including by R3, the UK trade association for insolvency and restructuring professionals. R3's concerns include: that practical challenges will continue to exist around whether aircraft are vulnerable to action by overseas creditors; the high level of funding required to keep an airline flying; and, that the SAR may be perceived as increasing losses to creditors and so deter lenders and investors from providing UK airlines with funding.[10]

The reform proposals made by the Airline Insolvency Review represent relatively small adjustments to the existing UK insolvency regime and only in relation to a specific subset of companies. However, the issues identified in the review raise broader questions concerning UK insolvency law and therefore call for a consideration of whether more fundamental reform is required.

UK insolvency law needs more fundamental reform

UK insolvency law is generally considered to offer an effective and flexible regime for rescuing companies and dealing with their insolvency. However, the current law is not perfect, and the UK government has consulted on possible reforms in 2009 and 2016, and published further proposals in 2018.[11] These consultations have focused on four broad themes:

- the introduction of a pre-insolvency moratorium, under which a company would have protection from creditors but where incumbent management would remain in place running the company;
- an expansion of the insolvency moratorium to prevent contractual counterparties terminating contracts on the grounds of insolvency;
- a new restructuring plan that would enable cross-class cram-down of dissenting creditors; and
- new rules to facilitate the provision of rescue financing to insolvent companies that would have super-priority status over existing creditors.

All these themes, other than the new restructuring plan, potentially overlap with the proposed reforms to UK airline insolvency. However, as things currently stand, no proposals are being brought forward in relation to rescue financing and it appears that the pre-insolvency moratorium will only be applicable in a very small number of circumstances.

It is therefore necessary to ask whether the UK insolvency regime needs more far-reaching reform and whether such reform would obviate the need for specific reform applicable only to UK airlines. Arguably, the answer to both these questions is yes. In particular, it is becoming increasingly clear that a debtor in possession procedure with the benefit of a wide-ranging moratorium would be a valuable addition to the UK insolvency tool kit. While valid concerns can be raised around whether such a procedure might be abused by incumbent management, who may have already failed to manage the company effectively, appropriate safeguards could be designed to mitigate any harm to creditors. The nettle of rescue finance also needs to be grasped, notwithstanding the opposition to it from some quarters.

Conclusion

The collapse of Thomas Cook is a further example of the OR acting as liquidator in relation to a major corporate failure in the UK. The need for the OR to act in these circumstances should be subject to wider reflection and debate.

The insolvencies of Thomas Cook and Monarch have been the catalyst for reforms to address the problems encountered on the insolvency of a UK airline. However, the proposed SAR for UK airlines is merely an adjustment driven by the current structure of the UK insolvency regime. In comparison, international experience of keeping airlines flying under debtor in possession insolvency procedures shows how such procedures offer flexible ways of keeping a business going and potentially promoting its rescue.

Therefore, recent airline insolvencies highlight issues in relation to UK insolvency law of wider significance, which suggest more fundamental reform of UK insolvency law is required. Many of the difficulties that arise under UK insolvency law in relation to airlines would be addressed by a debtor in possession insolvency proceeding, coupled with easier access to rescue financing. Reform along those lines would benefit not only airlines but businesses in the wider economy more generally.

Notes

1 Pursuant to Section 136 of the Insolvency Act 1986.
2 See *Re Thomas Cook Group PLC and others* [2019] EWHC 2626 (Ch) at paragraph 16.
3 Ibid, para. 17.
4 See *Re British Steel Ltd* [2019] EWHC 1304 (Ch) at paragraph 13.
5 Paramount Airways is the most recent example of a UK airline continuing to fly in administration during the summer of 1989. However, this experience highlighted the issues with continuing to fly following a company's insolvency, particularly around creditors in the UK and overseas potentially frustrating the operation of the airline by detaining aircraft and demanding payment for their release.
6 The Protocol to the Cape Town Convention on International Interests in Mobile Equipment on matters specific to Aircraft Equipment has been incorporated into UK law by The International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (SI 2015 No 912). These regulations provide for a 60-day waiting period after which the insolvency office holder must either return the aircraft or cure all defaults other than the commencement of insolvency proceedings and agree to perform all continuing obligations in relation to the aircraft.
7 Bankruptcy protection under Chapter 11 of the US Bankruptcy Code.
8 Recent examples are American Airlines (which entered Chapter 11 in 2011), Delta Airlines (2005) and United Airlines (2002).
9 Airline Insolvency Review Final Report, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/800219/airline-insolvency-review-report.pdf, last accessed 4 February 2020.
10 Airline Insolvencies – Reforms on the Horizon? Briefing from insolvency and restructuring trade body R3 (October 2019).
11 Insolvency and Corporate Governance Government Response, 26 August 2018, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG_-_Government_response_doc_-_24_Aug_clean_version__with_Minister_s_photo_and_signature__AC.pdf, last accessed 4 February 2020.

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