



# AVIATION CHAPTER 11 CASES TAKE FLIGHT

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**T**he COVID-19 pandemic hit the bottom line of many businesses. Among the hardest hit industries has been the travel industry and, in particular, airlines and aviation companies.

After suffering a complete shutdown at the beginning stages of the pandemic, airlines struggled to generate ticket sales and fares were depressed, even as travel began to reopen.<sup>1</sup> While those challenges have eased, one industry source predicts that passenger numbers will not return to 2019 levels prior to 2024.<sup>2</sup> In

addition, aviation companies continue to grapple with the fallout from staffing shortages and cancellations. Compounding this are increased costs of fuel and other expenses.<sup>3</sup>

These stresses have forced airlines, aircraft lessors, and other aviation companies to reevaluate their business plans and balance sheets. To implement operational and financial changes, one restructuring path that aviation companies have turned to with more frequency lately is Chapter 11 of the U.S. Bankruptcy Code. The Bankruptcy Code offers many tools and benefits



that are attractive to aviation companies experiencing financial distress, including (i) a worldwide stay applicable to virtually all acts to collect on pre-filing debts, (ii) continuity of management and the board, (iii) the ability to reject burdensome contracts and leases (e.g., above market aircraft leases) and to abandon assets, (iv) the ability to bind dissenting creditors, and (v) access to debtor-in-possession (DIP) financing to fund operations and the restructuring process.

What may not be fully appreciated by the uninitiated is that these and other provisions render Chapter 11

an extremely flexible regime that can be utilized in different stages of a restructuring, in scenarios with varying levels of stakeholder consent, and by companies incorporated, headquartered, and operating outside the U.S. As such, non-U.S. airline and aviation companies have increasingly considered Chapter 11 as an efficient and effective regime to implement their restructurings.

### **Chapter 11 Launches, With or Without a Deal**

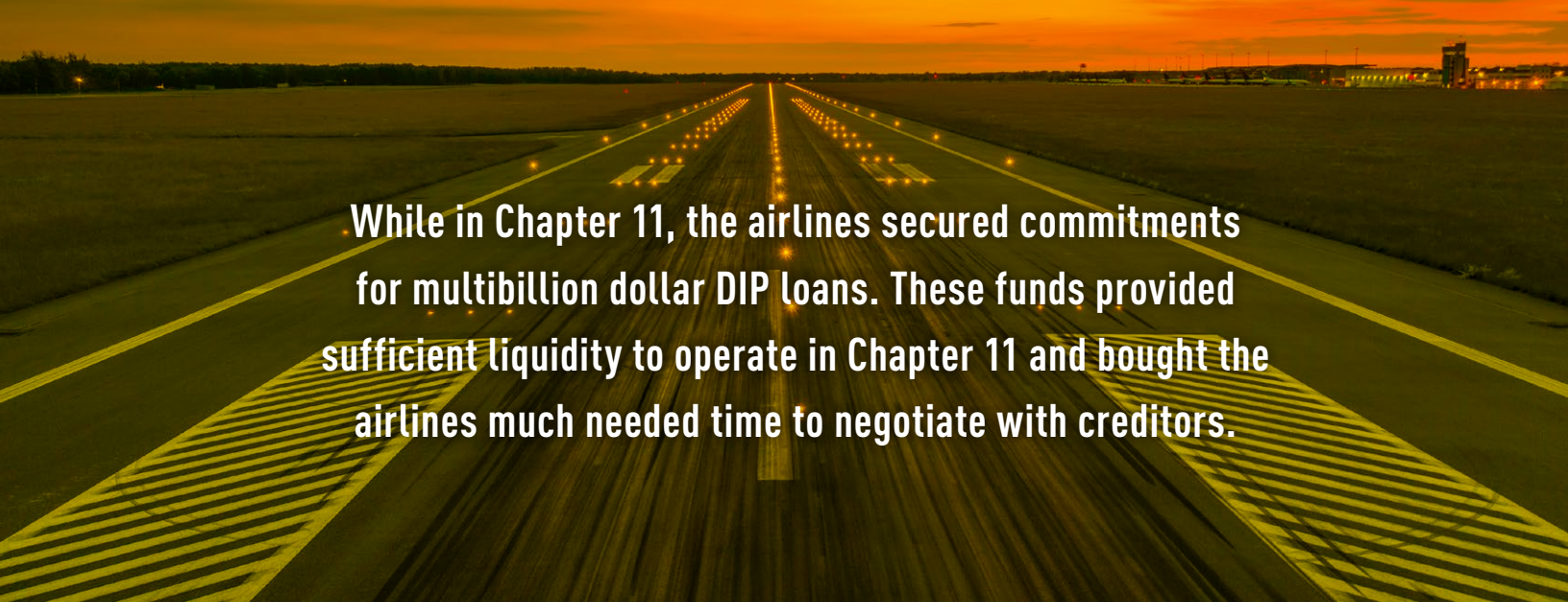
Sometimes companies experiencing distress have the luxury of liquidity and

time to negotiate with stakeholders out of court, but perhaps need to access a formal or in-court proceeding to implement the terms of that deal. At other times, companies are in extreme distress, facing liquidity walls, defaults, and/or creditor enforcement actions, and need the protections of a filing to have time to develop and document a restructuring plan. Chapter 11 can easily accommodate all of these scenarios.

A company at imminent risk of running out of cash, defaulting on obligations,

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and/or confronting creditors collecting significant overdue payables can file for Chapter 11 to prevent creditors from exercising remedies against the company and its property. By accessing the breathing spell afforded by the automatic stay, the business can maintain the status quo, conserve cash, and even access additional funding while it designs, negotiates, documents, and implements a restructuring strategy. This type of filing is referred to as a traditional or free fall filing and involves a debtor that enters Chapter 11 without agreement with its key stakeholders.

Examples of traditional filings in the aviation industry include Colombia-based Avianca, Chile-based LATAM, and Mexico-based Aeroméxico. Each of these Latin American airlines filed for Chapter 11 in mid-2020 after the onset of the COVID-19 pandemic grounded nearly all passenger flights, severely restricting the ability of the airlines to generate revenue. Prior to filing, Avianca, LATAM, and Aeroméxico each implemented cost-savings measures to preserve liquidity, such as payment deferrals, postponing or canceling delivery of new aircraft, and salary reductions, but due to the uncertainty surrounding the end of the pandemic and a return to normal flight operations, all three ultimately chose to file for Chapter 11.

Both LATAM and Aeroméxico cited a need to prevent creditors from exercising remedies against their assets, including their fleets, as a

motive for their Chapter 11 filings.<sup>4</sup> In addition, LATAM and Avianca filed in advance of having to make large debt payments. At the time of its filing, LATAM had \$130 million in debt servicing obligations coming due,<sup>5</sup> and Avianca filed the same day that approximately \$65 million in unsecured notes matured.<sup>6</sup> Furthermore, LATAM filed two days prior to having to make a dividend payment of approximately \$57 million to shareholders that was mandatory under Chilean law.<sup>7</sup>

Avianca and Aeroméxico have since confirmed reorganization plans and emerged from Chapter 11. Both airlines successfully used Chapter 11 tools to achieve their reorganizational goals. While in Chapter 11, the airlines secured commitments for multibillion dollar DIP loans.<sup>8</sup> These funds provided sufficient liquidity to operate in Chapter 11 and bought the airlines much needed time to negotiate with creditors.

The Chapter 11 plans for each of Avianca and Aeroméxico were approved by almost every impaired class of creditors entitled to vote.<sup>9</sup> Avianca's confirmed plan eliminated approximately \$3 billion of debt from the company's consolidated balance sheet and allowed the company to raise approximately \$1.7 billion in new investments.<sup>10</sup> Aeroméxico similarly eliminated approximately \$1.1 billion of debt and raised approximately \$1.5 billion in new investments.<sup>11</sup>

In addition to balance sheet adjustments, Avianca and Aeroméxico also successfully used the leverage available in Chapter 11 (including to

reject surplus aircraft leases and leave lessors with significant remarketing and reconfiguration costs) to rework their fleets and network strategies. Both Avianca and Aeroméxico successfully renegotiated leases during their Chapter 11 cases, including getting lessors to agree to "power-by-the-hour" rent terms. In addition, Avianca and Aeroméxico reduced the size of their fleets by approximately 25% and 15%, respectively. These trimmed down fleets better fit the airlines' go-forward business plans.

On June 18, 2022 the U.S. Bankruptcy Court confirmed LATAM's Chapter 11 plan, which provides for a capital raise of approximately \$800 million as part of a fully backstopped equity rights offering, approximately \$9.66 billion from the issuance of three series of new convertible notes, and \$2.75 billion in exit financing.<sup>12</sup> In addition, LATAM has right-sized its fleet by renegotiating certain of its existing aircraft leases to provide for power-by-the-hour-based rent terms, assuming 65 aircraft leases, rejecting leases for 42 other aircraft (many of which were then re-leased to LATAM at lower fixed rent), and exercising its right to purchase certain other aircraft on favorable terms.<sup>13</sup>

More recently, Scandinavian Airlines (SAS) accessed Chapter 11 after facing significant uncertainty and liquidity strain imposed by a labor strike.<sup>14</sup> In the immediate aftermath of the onset of the pandemic, SAS instituted various measures to stabilize the business, including raising liquidity through a recapitalization of its capital structure and implementation of cost-cutting

measures.<sup>15</sup> However, the emergence of COVID variants caused passenger demand—and business travel, in particular—to recover at a much slower pace than anticipated.<sup>16</sup> This, coupled with mounting competition, disruptions due to the war in Ukraine, and spiking jet fuel prices, forced SAS to develop a revised and more aggressive restructuring plan, targeting (among other things) debt-to-equity conversions, a redesigned fleet and network, lessor and labor concessions, and an approximately \$950 million equity capital raise.<sup>17</sup>

SAS made progress in out-of-court negotiations and was in advanced discussions with DIP financing parties to provide liquidity to implement the revamped restructuring through Chapter 11 when the labor action forced SAS to seek Chapter 11 relief earlier than anticipated, and without key stakeholder deals in hand, to maximize its liquidity runway and preserve its prospects for reorganization.<sup>18</sup> SAS has indicated it hopes to use Chapter 11 as an organized and efficient forum in which to reach agreements

with key stakeholders, restructure the company's debt obligations, reconfigure the fleet, and emerge with a significant capital injection.<sup>19</sup>

At the opposite end of the spectrum are prearranged and prepackaged Chapter 11 cases. In a prearranged case (sometimes referred to as prenegotiated), a debtor files for Chapter 11 after reaching a deal with certain of its key stakeholders on the major components of a reorganization plan, which is filed either with the Chapter 11 petitions or shortly thereafter. The Chapter 11 process is then utilized to solicit votes on and implement the plan, and may be used to fix operations (e.g., by rejecting burdensome contracts or leases, selling assets, etc.).

A prepackaged Chapter 11 case is similar, except in a prepackaged case the debtor solicits votes on the plan prior to filing Chapter 11 and generally is unable to use Chapter 11 to implement operational changes. Companies often use prearranged and prepackaged cases to implement restructurings where significant portions of stakeholders have

consented, but certain components of the plan cannot be accomplished out of court, such as binding or cramming down on dissenting creditors.

Prearranged and prepackaged cases are typically of shorter duration than traditional cases. For example, Philippine Airlines filed a prearranged Chapter 11 case in September 2021 that allowed it to exit bankruptcy within four months. This filing followed approximately one year of negotiations with creditors on a restructuring plan documented in dozens of restructuring support agreements (RSAs) with almost all of the airline's lenders, aircraft lessors, original equipment manufacturers, and maintenance, repair, and overhaul providers, as well as almost all holders of funded unsecured debt.<sup>20</sup>

The RSAs and accompanying plan term sheet provided for the elimination of approximately \$2.1 billion in aircraft-related obligations, re-optimization of Philippine's fleet, a \$150 million

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exit facility, and a commitment for \$505 million in DIP financing.<sup>21</sup> In addition, to have the time and flexibility to negotiate a restructuring plan, Philippines negotiated \$100 million of bridge financing before filing its Chapter 11 case, without which it would have had to file a free fall Chapter 11.<sup>22</sup> Philippine's plan was confirmed in December 2021 and resulted in more than \$2 billion in balance sheet reductions and a 23% reduction in the airline's fleet capacity.<sup>23</sup>

Multiple aircraft leasing and financing companies also recently have sought to reorganize their businesses in Chapter 11. In December 2021, two subsidiaries of Japanese aircraft leasing company JP Lease filed traditional Chapter 11 cases to halt a secured creditor from foreclosing on its collateral.<sup>24</sup> While in Chapter 11, these debtors consummated a sale of substantially all of their assets, including their interests in two Airbus 350 aircraft and associated leases, for approximately \$210 million. The sale paid the secured creditors in full and resulted in a \$5 million dividend to JP Lease, as equity interest owner.<sup>25</sup>

Denmark-based Nordic Aviation Capital (NAC), the sixth-largest commercial aircraft lessor in the world, also filed for Chapter 11 in December 2021. NAC filed a prearranged case with a proposed restructuring plan supported by more than 88% of its capital structure (with increased support garnered during the Chapter 11 case). NAC's plan, confirmed in June 2022, reduced NAC's funded indebtedness by more than \$4 billion and raised more than \$500 million in

new capital, while returning aircraft collateral to certain creditor groups that elected to exit from the NAC business.<sup>26</sup>

The ability to access Chapter 11 and utilize it to implement a restructuring at various stages and circumstances sets Chapter 11 apart from other restructuring regimes. While other regimes have some similarities and their own benefits, and in appropriate circumstances may be helpful on a standalone basis or coupled with a Chapter 11 filing, they do not equip debtors with all the same tools as Chapter 11 and, therefore, may provide less flexibility.

For example, English and Irish schemes of arrangement do not come with an automatic stay, so creditors are not enjoined from pursuing enforcement actions. Moreover, neither an English nor Irish scheme of arrangement can be crammed down on dissenting classes. In addition, certain insolvency regimes, including an Irish examinership, carry time limitations, which make it challenging in situations where a company with a complicated capital structure and operations needs emergency access to relief and significant time to develop a restructuring strategy. Furthermore, the ability to offer priority claims and priming liens to financing sources that are willing to fund a company's operations and restructuring expenses while it goes through its restructuring process is unique to Chapter 11.

### Accessible Boarding

In addition to its flexibility, Chapter 11 is easily accessible. Companies based outside the United States can access

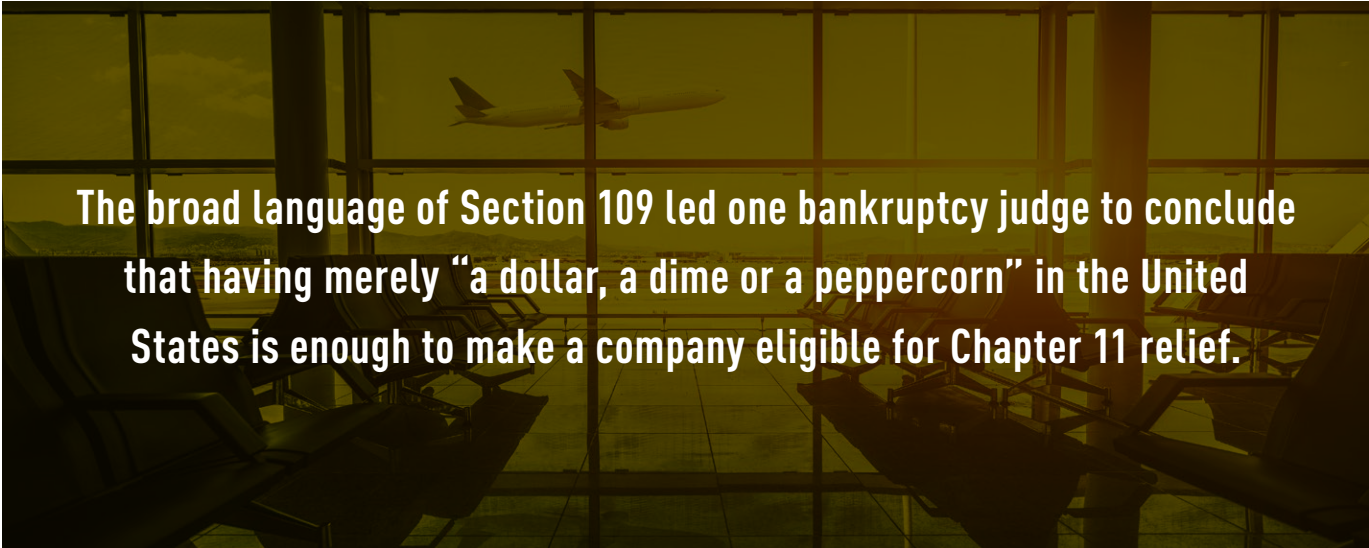
Chapter 11 due to debtor-friendly eligibility standards. Section 109 of the Bankruptcy Code permits an entity to file for Chapter 11 as long as it has a domicile, place of business, or property in the United States. The broad language of Section 109 led one bankruptcy judge to conclude that having merely "a dollar, a dime or a peppercorn" in the United States is enough to make a company eligible for Chapter 11 relief.<sup>27</sup> This may include, for example, gates or slots at U.S. airports, a reservations office located in the U.S., U.S. dollar-denominated debt, U.S.-law governed contracts, or even undrawn legal retainers maintained in U.S. bank accounts.<sup>28</sup>

While these companies often have significant creditors outside the U.S., there are many ways to bind such creditors to a Chapter 11 process, including through the threat of sanctions in the U.S. for violating the automatic stay or a U.S. federal court order.

### Beyond Chapter 11

It is worth mentioning that Chapter 11 is not the only option available to debtors looking to use the U.S. Bankruptcy Code to implement a restructuring. Chapter 15 offers a process by which a debtor may seek recognition and enforcement in the U.S. of a restructuring proceeding in another jurisdiction. Multiple aviation companies have successfully utilized Chapter 15 to reinforce their restructuring plans.

For example, Norwegian Air Shuttle ASA obtained Chapter 15 recognition of a restructuring plan embodied in a scheme of arrangement and a



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reconstruction plan confirmed in Ireland and Norway, respectively.<sup>29</sup> In 2020, NAC successfully obtained Chapter 15 recognition of an Irish scheme of arrangement, which provided a period of relief prior to its more recent Chapter 11 filing.<sup>30</sup>

## Conclusion

The U.S. Bankruptcy Code offers companies a variety of tools to right-size their balance sheets and implement operational changes. These tools are available to businesses located outside the U.S. and can be accessed at various stages of a restructuring process. As such, Chapter 11 has become a more attractive option for companies in sectors currently experiencing distress, such as the aviation industry. Indeed, Chapter 11 has become so well known as an effective restructuring process that in some situations the threat of it—bolstered by the announcement of hiring well-known U.S. Chapter 11 counsel—will drive parties in negotiations to reach a deal outside of court and avoid a filing.

It is anticipated that airlines and aviation companies will continue to experience distress in the coming years and will look to the U.S. Bankruptcy Code as a potential fix for their financial woes. There are many cases that stand out as helpful precedent for consideration by potential future filers and demonstrate the flexibility and benefits Chapter 11 has to offer. ■



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de C.V., No. 20-11563 (Bankr.S.D.N.Y. Dec. 10, 2021), ECF No. 2294.

<sup>9</sup> [Avianca Voting Certification], *In re Avianca Holdings S.A.*, No. 20-11133 (MG) (Bankr. S.D.N.Y. Oct. 19, 2021), ECF No. 2239; [Aeroméxico Voting Declaration], *In re Group Aeroméxico, S.A.B. de C.V.*, No. 20-11563 (Bankr. S.D.N.Y. Jan. 11, 2022), ECF No. 2464.

<sup>10</sup> Avianca Disclosure Statement, at 3.

<sup>11</sup> Aeroméxico Disclosure Statement, at 2-4.

<sup>12</sup> [LATAM Disclosure Statement] at 3-5, *In re LATAM Airlines Group S.A.*, No. 20-11254 (JLG) (Bankr. S.D.N.Y. Mar. 25, 2022), ECF No. 4777; [LATAM Plan], *In re LATAM Airlines Group S.A.*, No. 20-11254 (JLG) (Bankr. S.D.N.Y. May 25, 2022), ECF No. 5501; [LATAM Confirmation Order], *In re LATAM Airlines Group S.A.*, No. 20-11254 (JLG) (Bankr. S.D.N.Y. June 18, 2022), ECF No. 5754.

<sup>13</sup> LATAM Disclosure Statement, at 42-44.

<sup>14</sup> See [SAS First Day Declaration] ¶ 15, *In re SAS AB*, No. 22-10925 (Bankr. S.D.N.Y. July 5, 2022), ECF No. 3.

<sup>15</sup> *Id.* at ¶¶ 6-8.

<sup>16</sup> *Id.* at ¶ 9.

<sup>17</sup> *Id.* at ¶¶ 10-11.

<sup>18</sup> *Id.* at ¶¶ 12-15.

<sup>19</sup> *Id.* at ¶ 16.

<sup>20</sup> [Philippine Airlines First Day Declaration] ¶¶ 9-10, *In re Philippine Airlines, Inc.*, No. 21-11569 (SCC) (Bankr. S.D.N.Y. Sept. 6, 2021), ECF No. 25.

<sup>21</sup> *Id.* ¶ 11.

<sup>22</sup> *Id.* ¶ 7.

<sup>23</sup> [Philippine Airlines Disclosure Statement]

at 17, *In re Philippine Airlines, Inc.*, No. 21-11569 (SCC) (Bankr. S.D.N.Y. Nov. 12, 2021), ECF No. 261.

<sup>24</sup> See [JPA First Day Declaration] ¶¶ 29-37, *In re JPA No. 111 Co.*, No. 21-12075 (DSJ) (Bankr. S.D.N.Y. Dec. 17, 2021), ECF No. 3.

<sup>25</sup> See [Sale Motion] ¶ 20, *In re JPA No. 111 Co.*, No. 21-12075 (DSJ) (Bankr. S.D.N.Y. Dec. 31, 2021), ECF No. 21.

<sup>26</sup> See [NAC First Day Declaration] ¶ 5, *In re Nordic Aviation Capital Designated Activity Co.*, No. 21-33693 (KRH) (Bankr. E.D. Va. Dec. 20, 2021), ECF No. 6.

<sup>27</sup> *In re McTague*, 198 B.R. 428, 432 (Bankr. W.D.N.Y. 1996).

<sup>28</sup> See *In re U.S. Steel Canada Inc.*, 571 B.R. 600, 611 (Bankr. S.D.N.Y. 2017) (“[C]ourts in the Second Circuit and elsewhere recognize professional retainers as property under section 109.”); see also [Opinion and Order Resolving Motion to Dismiss] at 11, *In re JPA No. 111 Co.*, No. 21-12075 (DSJ) (Bankr. S.D.N.Y. Feb. 1, 2022), ECF No. 97 (“[F]unds that are held in the United States to pay for law firm services for a debtor constitute a debtor’s property that is located in the United States, and that thus satisfy the requirements of Section 109.”).

<sup>29</sup> You can read more about Norwegian’s innovative restructuring plan here: [restructuring.weil.com/chapter-15/weil-represents-norwegian-air-in-obtaining-chapter-15-recognition-of-successful-cross-border-restructuring/](https://restructuring.weil.com/chapter-15/weil-represents-norwegian-air-in-obtaining-chapter-15-recognition-of-successful-cross-border-restructuring/)

<sup>30</sup> [Recognition Order], *In re Nordic Aviation Capital Designated Activity Co.*, No. 20-11410 (MEW) (Bankr. S.D.N.Y. July 24, 2020), ECF No. 29.