

Airline Insolvency Review: A call for evidence

R3 response

ABOUT R3

1. R3 is the trade association for the UK's insolvency, restructuring, advisory, and turnaround professionals. We represent licensed insolvency practitioners, lawyers, turnaround and restructuring experts, students, and others in the profession.
2. Our members work across the spectrum of the profession, from the global legal and accountancy firms through to smaller, local practices. Our members have direct experience of insolvencies and their impact on the UK economy and insolvent companies' stakeholders, including consumers.
3. The insolvency, restructuring and turnaround profession is a vital part of the UK economy. The profession rescues businesses and jobs, creates the confidence to trade and lend by returning money fairly to creditors after insolvencies, investigates and disrupts fraud, and helps indebted individuals get back on their feet.
4. We have focused our response on those questions and themes in the consultation where we can provide answers based on our members' expertise, including their experience of dealing with insolvent airlines. Specifically we have sought to highlight a number of the key challenges facing office holders in these cases which we believe should be borne in mind as the Government considers changes to the framework around airline insolvencies.
5. R3 would be delighted to meet the Review team to discuss the points raised below in greater detail. If you would like to meet us or if you have any other queries, please contact R3's Public Affairs and Policy Officer, James Jeffreys, at james.jeffreys@r3.org.uk or on 020 7566 4220.

EXECUTIVE SUMMARY

6. The call for evidence is welcome. Airline insolvencies are very complex operations and steps can be taken to manage the risks faced by passengers – and the taxpayer.
7. There are both serious financial and operational challenges which prevent the continued operation of an insolvent UK airline. Only the availability of significant funding or the perception that an airline is 'restructuring' rather than 'insolvent' could circumvent these.
8. The Review should consider airline insolvencies in a wider insolvency context. The focus of the Review is on the impact of an airline insolvency on passengers, but the Review must not forget about other stakeholders to the insolvency, including the airline's creditors. The Review should also be aware of Government proposals for insolvency reform, first made in 2016, which would have a significant impact on how airline insolvencies may be approached.
9. The most appropriate way to resolve some of the problems identified by the Review would be to extend ATOL protection to flights-only purchases. As per paragraph 7, it may be too difficult to allow an insolvent airline to continue to fly itself, but, as Monarch showed, it is possible for advisers, airlines and regulators to work together to arrange the successful repatriation of passengers using alternative aircraft. The extension of ATOL protection would remove some of the burden of paying for this from taxpayers.

INTRODUCTION

10. R3 welcomes the call for evidence on airline insolvencies. While rare, the insolvency of even a relatively small commercial airline can generate considerable public interest and can put passengers in a difficult situation. It is right, following the recent example of Monarch, to look again at the framework of airline insolvencies to consider what changes could be made to ensure the orderly and efficient repatriation of passengers in such cases.
11. While R3 does not take a detailed view on all of the areas in the call for evidence, we wish to highlight a number of the key challenges facing office holders who have been appointed to oversee the insolvency of an airline, as well as other areas we believe the Review should bear in mind as it considers possible changes to the airline insolvency framework.
12. The issues covered in this response include:
 - a. The costs of running an airline and how these can make it difficult for an insolvent airline to operate;
 - b. The operational and associated risks of an airline continuing to operate during an insolvency process;
 - c. Wider insolvency reforms and the wider insolvency context;
 - d. Possible solutions to the issue of funding passenger repatriation;
 - e. Comments on specific ideas raised in the Review.

KEY POINTS

A. The Costs of Airline Insolvencies

13. The fundamental challenge of any airline insolvency is the cost of running an airline. While there is a need to repatriate customers – and, in keeping with the ultimate objective of a UK insolvency procedure, return funds to creditors either through an orderly wind-down or sale – this must be dealt with in the context of the costs of airline operations. These costs are significant and can spiral quickly and unpredictably.
14. Airlines generate huge liabilities on a day-to-day basis. A single delayed plane can lead to immediate cost implications: should the delay be long enough, accommodation for passengers and crew must be arranged; even with a short delay, there is the additional cost of keeping a plane ready on the airport tarmac, and the chance of knock-on delays and the costs that these extra delays will bring. A delay to one flight may mean that the plane is not able to run a scheduled further flight once it has reached its destination, for example.
15. While the costs of running a solvent airline can be problematic, they can be insurmountable with an insolvent one. The fact the airline is insolvent suggests that limited cash will be available to fund the airline's activities, while every additional flight is likely to make the airline's financial position worse.
16. Funding is a perennial issue in UK insolvency processes, and examples of 'trading' administrations are increasingly rare in any sector, not just the air travel industry.
17. In cases where airlines have continued to operate during an insolvency process, a key factor is often the availability of significant government funding. Both AirBerlin and Alitalia were provided with loans by the German and Italian governments, respectively. Whether this

funding is permissible is questionable: Alitalia is subject to investigation by the European Commission, which is seeking to establish whether its government loan amounted to State Aid¹.

B. Operational and Other Risks

18. Funding problems are not the only challenges which can prevent an airline from flying during an insolvency procedure. Even an insolvent airline with access to funding may struggle to resolve a range of operational and other risks.

Licensing

19. In order to operate, UK airlines are required to have a valid Air Operating Certificate, issued by the Civil Aviation Authority (CAA). This licence can be immediately provisionally suspended once an airline enters an insolvency procedure (see, for example, Monarch); this prevents an airline from flying.

Liability & Insurance

20. Insurance costs and liability exposure can play a significant role in the decision to allow an insolvent airline to continue to fly or not.
21. Given the significant costs which would arise from an air disaster, insurance costs in the industry can be significant. Even for a solvent airline with insurance, the costs of an air accident can cause terminal financial problems.
22. An office holder will have, broadly, three options in an airline insolvency: accept the risk of an accident is minimal and allow the airline to continue to fly without insurance; fly with insurance; decide the risk of an accident is too great and insurance too expensive, and opt not to allow flights to continue.
23. The office holder's position is compounded by the fact that the limited liability enjoyed by a solvent company's directors ceases when the company enters an insolvency procedure. Office holders are personally liable for the company.
24. If the office holder is unable to obtain insurance, the costs of an accident would be borne by the office holder. Even if an office holder can obtain insurance, it would likely involve significant premiums, cover limits and excesses, which could still leave the office holder exposed.
25. The risks involved, and the personal liability of the office holder, will have a significant impact on both the available pool of office holders for airline insolvencies, and will limit what the available office holders consider possible during an insolvency.
26. To remove these risks from the office holder, immunity, indemnity, or a comprehensive and robust insurance solution would be needed.

¹ http://europa.eu/rapid/press-release_MEX-18-3506_en.htm

Creditor Actions

27. UK insolvency procedures trigger a moratorium which protects an insolvent company from its creditors taking unilateral enforcement action (such as the seizure of the insolvent company's assets). This can allow an insolvent company to continue to trade effectively, and, by keeping the company's assets under its control (and available for use or sale), helps office holders maximise returns to creditors. While this moratorium is effective in the UK (where breaches can be resolved quickly), it can be difficult to enforce overseas.
28. As an EU Member State, the UK is covered by the European Insolvency Regulation and other relevant regulations which ensure that UK insolvency appointments and judgments are automatically recognised across the EU. Theoretically, these regulations mean that a UK insolvency moratorium applies automatically in other EU countries. In practice, however, European creditors may not be aware of the UK moratorium's existence or may not believe in its validity and may, therefore, take enforcement action regardless.
29. According to R3 members with experience of airline insolvencies, the safe operation of a commercial flight can involve anything up to one hundred or so separate suppliers, including fuel suppliers, cleaners, maintenance providers, and airports. It would be relatively simple for any of these suppliers to take enforcement action: for example, suppliers may prevent a plane's departure (by blocking its path or other means) until the office holder repays them the debts they are owed (to the detriment of other creditors). This type of creditor can be referred to as a 'ransom' creditor by UK insolvency practitioners. While the UK moratorium would be likely to be upheld in European courts, this process can be relatively time consuming and expensive, both in terms of the legal costs and the costs of delayed flights. This type of delay could cause severe problems to both passenger and plane safety, and to the financial viability of running the insolvent airline.
30. Given the risk posed by overseas creditors, office holders have a strong incentive to make sure an airline's main assets (such as its planes) remain in the UK where the protection provided by a moratorium is near-immediate and unquestioned. Indeed, Monarch's administration order was made when all aircraft were back in the UK.
31. It should be noted that automatic reciprocal recognition only applies to UK and EU insolvencies (so a UK moratorium does not automatically extend outside of the EU). And, while the UK is currently covered by the relevant European regulations, this will not necessarily be true once the UK leaves the EU. Without automatic reciprocal recognition of insolvency procedures between the UK and EU, it would not be guaranteed that a UK moratorium would be upheld by a court in the EU.

Leasing

32. It is very common for airlines to lease their aircraft, and when an airline becomes insolvent lessors are understandably very keen to regain control of their asset. The longer it takes for a lessor to do this, the greater expense is involved in the process, so lessors will seek to act quickly.
33. Aircraft waiting at UK airports (and elsewhere) will begin to accrue 'parking' and other charges on a daily basis (varying by airport), which will have to be paid before a plane can be released (back to its lessor).

34. Additionally, the CAA acts as the collection agent for Eurocontrol (the European air traffic controller) and NATS (the UK air traffic controller), and a plane can be detained by the CAA until all of a *fleet's* liabilities to Eurocontrol and NATS are paid (a 'fleet lien'). Alternatively, if a lease is terminated before the plane is detained, the lien is limited to liabilities accrued by *that plane* (a 'tail lien'). In order to limit the risk of a 'fleet lien', there is an incentive for the lessor to terminate a lease and move its plane outside of the jurisdiction of the CAA and Eurocontrol as soon as possible. The loss of an airline's planes is a clear obstacle to its continued operation.

Crew Wellbeing

35. The safe operation of an aircraft relies on its crew's wellbeing. While airline staff are professional and well-trained, there is always a risk that the stress and uncertainty of an insolvency process – particularly where the airline's survival is unlikely and where jobs are at risk – may lead to crew errors. These risks may be factored in to an office holder's assessment of whether an insolvent airline should be allowed to continue to operate.
36. Even if a special administration regime were to be introduced for the airline industry, the above factors would make it difficult for an airline's own planes and crew to be used for repatriation – unless significant new funding was made available to generate confidence that the airline could continue and debts would be paid. Even then, some of the above challenges may remain.

C. The Wider Context

37. There are a number of wider issues in UK insolvencies which the Review may wish to consider.

Don't Forget Creditors

38. The Review focuses on the impact of an airline insolvency on its passengers, but it is important to note that these are one of many important stakeholders in an insolvency procedure. Other stakeholders include secured creditors, employees, and assorted unsecured creditors, including HMRC and trade creditors.
39. UK office holders have a duty to maximise returns to an insolvent company's creditor body as a whole. Continuing to run an airline in order to repatriate passengers may severely reduce what can be repaid to the creditor body. Absent the ability to fund the repatriation without using the airline's own funds, a significant reduction in creditor returns from airline insolvencies could have serious consequences: secured creditors may become averse to lending to airlines if there is a chance they will not see their money back after an insolvency (damaging the airline sector as a whole); the taxpayer could see a significant loss on any unpaid tax bills; trade creditors could be left even more out of pocket than they would have been, jeopardising their own survival.
40. The needs of passengers must be balanced against the needs of other creditors. While stranded passengers' situations may be high profile and acute, they are not the only stakeholder group significantly affected by an insolvency.

Other Insolvency Reforms

41. In 2016, the Government proposed a series of reforms to the UK's corporate insolvency framework². Included in these proposals are a number of new procedures or potential changes which could have a significant impact on airline insolvencies and could address some of the current difficulties.
42. Progress towards the implementation of these reforms has been hampered by the Government's focus on necessary Brexit legislation. The Review should consider calling for the acceleration of these reforms.
43. Among the proposed reforms are:
 - a. A short moratorium against creditor enforcement which would leave a company's directors in charge and would give the company time to develop a rescue or turnaround plan. This moratorium may be followed by an insolvency process or a non-statutory agreement with creditors.
 - b. New rules to protect an insolvent company's access to supplies essential to its business (which would stop creditors or suppliers holding a business rescue to 'ransom').
 - c. A new court-based restructuring tool, similar to the US Chapter 11, which would allow companies to bind creditors into a restructuring agreement at an earlier point than now.
 - d. Rescue finance reforms, which would incentivise investors and lenders to provide funding to insolvent companies in exchange for priority repayments in an insolvency procedure.
44. Among the advantages of these reforms are the impact they may have on 'perception' and funding. As above, the ability to fund an insolvency or rescue procedure is crucial; these reforms may improve funding options for struggling companies. Meanwhile, one of the key factors of the US Chapter 11 in its use in airline rescues is that it is not seen as a terminal 'insolvency' procedure but as a 'restructuring' tool. This allows funding sources and other creditors and stakeholders to have more confidence in trading and dealing with the insolvent company. While not exactly the same as Chapter 11, some of the above reforms may help insolvent – but viable – companies continue to trade and turn themselves around, and could help improve creditor and stakeholder confidence.

D. Options for Funding Passenger Repatriation

45. Without a major reconfiguration of the existing insolvency and restructuring framework, or a severe reduction in the amount of money which can be returned to an insolvent airline's creditors (and the consequent impact on lenders' and suppliers' willingness to invest in, trade with, or lend to airlines), insolvent airlines should not be relied on to fund and facilitate passenger repatriation.
46. In R3's view, the most appropriate means of providing the funding necessary for repatriation could come from an expanded ATOL scheme. As the Review document notes, the scheme currently covers only combined flight and accommodation packages. The ATOL cover should be expanded to flights-only purchases, too.

² <https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework>

47. This would ensure the risk burden of the need for repatriation falls on passengers and not the taxpayer.
48. As above, there would, without wider reforms, be risks involved in using the insolvent airline's own planes for repatriation. These risks would appear difficult to resolve.
49. However, as the Monarch case showed, it is possible, at short notice and with the right planning, to arrange a successful repatriation using alternative aircraft and crew.

E. Specific Issues Raised in the Review Consultation

50. On page 22, the consultation makes reference to "amendments to the airline licensing regime, which might enable regulators to intervene earlier or which ensure passenger funds are handled differently when an airline is at greater risk of insolvency." There is a risk that any special rules for airlines in financial difficulty could make insolvency a self-fulfilling prophecy: their activation would signal to the market that an airline is in serious financial trouble, potentially causing a loss of confidence.
51. On page 22, the consultation says that "changes could also be made to the legal framework surrounding the insolvency of airlines to ensure there is access to the data and airline systems needed to run these operations effectively and efficiently in administration." In the case of Monarch, data access did not prove to be a significant issue for the administrators. Additionally, the administrators charged the CAA for access to the data, which offset the cost of running Monarch's IT systems.
52. On page 22, the consultation says that "changes could also be made to place the emphasis on those administering an insolvent airline to ensure passengers' welfare." As above, this suggestion should be approached cautiously: an over-emphasis on passenger welfare and the office holder's responsibilities towards passengers could have unintended consequences, especially in terms of the funds which can be redistributed to creditors. While responsibilities could be extended, it may be appropriate to limit this extension to a requirement to help find alternative flights or accommodation for passengers in need of repatriation, rather than requiring office holders to provide or fund this support. More clarity on this suggestion from the Review would be welcome.