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NEW AVIATION INSOLVENCY RULES SUGGESTED IN WAKE OF MONARCH COLLAPSE

In the early hours of the morning on 2 October 2017, Monarch Airlines flight ZB3785 from Tel Aviv to Manchester touched down. It was to be the Airlines' last flight, just under 50 years since its first, when its Bristol 175 Britannia 300 turboprop landed in Madrid.

The collapse of the company resulted in the largest ever peacetime repatriation exercise, during which the Government and the Civil Aviation Authority, (the "CAA" •), brought 110,000 stranded passengers back to the UK, running 700 flights over a two-week period. Commenting on the operation, Chris Grayling, Secretary of State for Transport, said that *"[t]he CAA has essentially set up one of the UK's largest airlines to conduct it"* • .

The Government has wasted no time in suggesting that the time has come to revisit the rules governing insolvency in the aviation sector. This article discusses these possible reforms.

The collapse of Monarch

Monarch Airlines was formed on 5 June 1967, as a subsidiary of Globus Getaway Holdings, being funded largely by the Mantegazza family. It expanded steadily until the 2000s, during which the company's disappointing turnover forced the board to reconfigure many of the company's operations. Despite these efforts, a pre-tax loss of £32.3 million was announced in the financial year ending in 2009.

Although reporting a modest profit in 2010, the company lost £45 million in the year ending October 2011. After a failed £75 million rescue package in 2011, the airline was bought for the nominal sum of £1 in 2014 by private equity firm Greybull Capital.

A particular concern prior to the takeover was the company's pension scheme, which was reportedly carrying a deficit of some £158 million. As part of the takeover, the pension scheme was separated from the company under an agreement with the Pension Protection Fund, (the "PPF" •), which was approved by the Pensions Regulator. Under the terms of the agreement, the former owners made a £30 million mitigation payment into the company and demonstrated that the company's other creditors had made â€œsignificant compromisesâ€ • on their claims. Greybull Capital gave the PPF a 10% equity stake in the restructured company as well as a £7.5 million secured loan note,[1] allowing the PPF to gain from any turnaround in the company's fortunes.

Notwithstanding these efforts, reports emerged in September 2017 that the company was facing difficulties with its CAA Air Travel Organiser's Licence, ("ATOL" •), owing to severe financial difficulties. The airline had faced similar problems the year before, but managed to renew its licence following a quick cash injection from shareholders. Without its ATOL, the airline would have been unable to sell package holidays, rending many of its operations defunct.

On 30 September 2017, the CAA extended Monarch's licence, leaving it with 24 hours to settle its financial affairs. On 1 October, however, the airlines' late night flights to Ibiza were cancelled at the point of boarding as the deadline for its licence extension loomed. At 4:00 BST the following morning, the CAA confirmed that Monarch Airlines had ceased all operations and had entered administration, leaving 110,000 passengers overseas and over 300,000 future bookings cancelled.

The insolvency rules

On 3 October 2017, the company's Chief Executive, Andrew Swaffield, publicly blamed the applicable insolvency rules for the company's collapse. He explained that there was a detailed rescue plan in place, under which the airline was to sell its short-haul business and switch to long-haul flights using a fleet of new Boeing 737 Maxs. The new model's fuel efficiency would have given the company a clear cost advantage over competitors.

However, the grounding of the airline by the CAA apparently made the search for an appropriate buyer impossible.

He told BBC Radio 4:

"The UK's insolvency framework doesn't allow airlines to continue flying, unlike in Germany or Italy, where we see both Air Berlin and Alitalia continuing in administration . . . We couldn't figure out a way of reducing those losses significantly, either by selling the short-haul airline or by improving it" • .

The suggestion seems to be that the company could have survived were it not for the immediate suspension of operations. The comments have resulted in speculation as to the appropriateness of the UK's insolvency rules in the aviation sector.

Suggested reforms

On 9 October, Chris Grayling made a statement on the collapse of Monarch to the House of Commons. He said:

"Of course, right now our efforts are rightly focused on getting employees into new jobs and getting passengers home. After that, our effort will turn to working through any reforms necessary to ensure that passengers do not find themselves in this position again.

"We need to look at all the options--not just ATOL, but whether it is possible to enable airlines to wind down in an orderly manner and look after their customers themselves, without the need for the government to step in. We will be putting a lot of effort into that in the months ahead" • .**[2]**

Exactly how the Government foresees enabling airlines to *"wind down in an orderly manner and look after their customers themselves"* • remains to be seen. It seems that the policy behind any reform, however, will be to allow airlines to continue trading as long as possible and to avoid collapse as far as possible. This may mean more relaxed ATOL licensing requirements, or a grace period during which companies can trade, and hopefully stabilise, before entering administration.

Although no concrete steps have yet been taken, the preliminary comments on suggested reform have been welcomed by industry experts.

Following the statement to the House of Commons, Adrian Hyde, President of the Association of Business Recovery Professionals, ("R3" •), commented that:

"The transport secretary's interest in airline insolvency rules is welcome. The air industry is one of a number of parts of the economy where sector-specific rules on insolvency can make orderly wind-downs or business rescue tricky. Key licences can often be withheld from insolvent companies, for example. More structured wind downs could help improve outcomes for employees, creditors, and customers.

"Although the thinking behind some of the rules in various sectors is understandable, the rules can sometimes make rescue all but impossible--leading to avoidable job losses or creditors being left out of pocket--or can significantly alter the way the insolvency is handled. R3 would welcome the opportunity to work with the government and regulators to introduce constructive and positive reforms, as they have in other specific sectors" • .

Watch this space

Whether or not "positive reforms" • are made, Mr Grayling's comments arguably commit the Government to a reconsideration of the insolvency framework applicable to the aviation sector. Following the controversies surrounding the Government bailout of the banks following the 2008 financial crisis, reform to the insolvency rules that would allow companies to cease trading in stages, mitigating losses and encouraging rescue, seems a positive and workable policy.

The collapse of the company also raises questions following the involvement of the PPF. On 9 October, Frank Field, Chair of the Work and Pensions Committee, wrote to Alan Rubenstein, Chief Executive of the PPF, asking whether the Fund has received any payments from Monarch in respect of the secured loan note and where it ranks in order of creditor preference.[3]

Commenting on the letter, Mr Field stated:

"How can it be that once again, mega rich individuals could walk away from a collapsed company with a bumper profit while ordinary people pick up the bill? This massively supports the case for the law to change, to robustly protect pension schemes against owners seeking to line their pockets while avoiding their responsibilities, in line with our recommendations".

[1] A secured note is a form of loan that is backed by the borrower's assets. In the event of default by the borrower, the assets can be sold as collateral to repay the loan.

[2] https://hansard.parliament.uk/commons/2017-10-09/debates/D27444A9-86D6-4E2B-A675-8D7A1DD15FF8/MonarchAirlines.

[3] http://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/Letter-from-the-Chair-to-CEO-of-The-Pension-Protection-Fund-relating-to-Monarch-Airlines-retirement-benefits-plan-9-October-2017.pdf.

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