

LATAM AIRLINES: CHAPTER 11 PLAN OF REORGANISATION TAKES FLIGHT



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“LATAM [demonstrates]... a foreign debtor using the US bankruptcy system to implement a comprehensive, cross-border restructuring [and]... illustrate[s] the speed and flexibility of Cayman Islands restructuring processes to complement [foreign] bankruptcy proceedings”

Introduction

In 2020, in response to the devastating financial effects of the COVID-19 pandemic, Latin America’s leading airline group, LATAM Airlines Group S.A. and various of its affiliates (including LATAM Finance Limited, Peuco Finance Limited and Piquero Leasing Limited, incorporated in the Cayman Islands (the “LATAM CayCos”) filed Chapter 11 cases in the United States (the “LATAM Debtors”), and in respect of the LATAM CayCos, ‘light touch’ provisional liquidation proceedings in the Cayman Islands. More than two years later, as LATAM is poised to emerge from bankruptcy, this article looks back at some of the unique challenges and opportunities that have arisen as a result of these proceedings, and the valuable lessons the case offers to debtors and creditors seeking successfully to restructure cross-border operations while complying with competing corporate and regulatory regimes.

LATAM’s Chapter 11 proceedings

LATAM Airlines Group S.A. (“LATAM Parent”) together with its affiliates (collectively, “LATAM”), comprise the largest passenger airline group in South America (being the number one Latin American airline group and 14th-ranked globally in passengers carried) and one of the largest airline groups in the world in terms of network connections (with 151 destinations across 29 countries in Latin America, Europe, Oceania, the United States and the Caribbean) and offering integrated passenger and cargo operations.

Following the World Health Organization’s declaration of COVID-19 as a global pandemic, numerous countries imposed major travel restrictions and border closures. The impact on the worldwide airline industry, including LATAM, was swift and profound.

In this extraordinary situation, LATAM saw a need to obtain short-term breathing space from its creditors and borrow

additional funds to weather the near-term impacts of the loss of passenger revenue, while also right-sizing its fleet arrangements and other operations and restructuring its indebtedness. Accordingly, on May 26, 2020, LATAM Parent and certain of its affiliates—including special purpose vehicles incorporated in Delaware and the Cayman Islands (i.e. the LATAM CayCos), holding companies, six of LATAM’s eight main passenger airline affiliates and each of its three cargo airline affiliates—each filed a voluntary petition pursuant to Chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”) (the “Chapter 11 Proceedings”) in the US Bankruptcy Court for the Southern District of New York (the “Bankruptcy Court”), with subsequent filings by LATAM’s Brazilian affiliates in July 2020. Pursuing a restructuring through Chapter 11 allowed LATAM to reorganise the group’s various affiliates in a single, coordinated proceeding, despite their incorporation in different jurisdictions. The Chapter 11 Proceedings also provided LATAM with a mechanism to rationalise LATAM’s costs structure which was achieved, amongst other things, through deferring lease payments on aircraft as well as other longer-term contract renegotiations, while the company also pursued various labour cost savings measures and wound down its operations in Argentina.

Cross-border coordination

Proceedings were also commenced in other jurisdictions to protect against creditors taking steps to disrupt or disturb the Chapter 11 Proceedings (for example, by seeking to avoid the moratorium on creditor action whilst the terms of LATAM’s plan of reorganisation were negotiated). Notably, each of the LATAM CayCos, being special purpose vehicles incorporated in the Cayman Islands, presented winding up petitions (a statutory pre-requisite for the appointment of provisional liquidators) and successfully sought the appointment of provisional liquidators on a ‘light touch’ basis pursuant to Section 104(3) of the Cayman Islands Companies Act.¹

¹ Mr Jeffrey Stower and Mr Jason Robinson of Teneo act as joint provisional liquidators of each of the LATAM CayCos.

Provisional liquidation is a flexible restructuring tool in the Cayman Islands which (despite its name) is not a terminal liquidation proceeding, but rather a mechanism by which a restructuring may be pursued or promoted by provisional liquidators with the benefit of a moratorium (or stay) on creditor actions (which cannot be pursued without leave of the Grand Court of the Cayman Islands (the “Cayman Court”). The scope of the powers conferred on provisional liquidators and the powers retained by existing management will be set out in the relevant order of the Cayman Court appointing the provisional liquidators / commencing provisional liquidation.

In respect of the LATAM CayCos, the provisional liquidators were specifically authorised and empowered, amongst other things, to oversee the continuation of the business of each LATAM CayCo under the control of the board of directors (and supervision of the Cayman Court) and to facilitate a reorganisation and/or refinancing of the LATAM CayCo and its business and operations.

From a Cayman Islands perspective, one of the notable features of the provisional liquidation was the approval of a direct cross-border court-to-court communications protocol with the Bankruptcy Court as well as with courts in Chile and Colombia, which provides a framework to address cross-border issues that may arise from time to time in respect of LATAM’s restructuring and which promotes international cooperation and respect for comity (the “Protocol”).

Notwithstanding that the practice of court-to-court communications has been a key feature of international insolvency and restructuring for some time, this appears to be the first occasion that the Cayman Court was asked formally to approve such a protocol to facilitate these communications, which protocol was also formally approved by the other courts. The decision highlights the practical and commercial approach adopted by the Cayman Court in facilitating the effective disposition of cross-border restructurings.

Given the prevalence of cross-border insolvency and restructuring transactions with a Cayman Islands nexus, this has been a welcome development in the jurisdiction to ensure that parallel insolvency proceedings can be managed efficiently and effectively. In respect of LATAM, and in part as a result of the Protocol, the proceedings in the United States, Cayman Islands, Chile and Colombia have been administered in a cost-effective and efficient manner.

Access to debtor-in-possession financing

A key aspect of LATAM’s restructuring efforts has been the group’s ability to obtain funding for its continued operations. Although LATAM’s business operations decreased significantly in early 2020 due to the effects of the pandemic, LATAM planned to continue operating as a “debtor in possession” and required near-term liquidity to do so. Notably, when the LATAM Debtors filed for bankruptcy, they held US\$707 million in cash and cash equivalents (and LATAM as a whole had approximately US\$1.35 billion in funds), but such funds were not expected to be sufficient to fund LATAM for the entire period of the Chapter 11 Proceedings.

Prior to seeking Chapter 11 protection, LATAM reached out to government representatives to inquire if they would provide financing for the group’s operations. Although governments throughout the world have provided support to airlines in response to COVID-19, LATAM was not able to obtain such support (and, to date, no other Latin America-based airline has received government funding). However, LATAM was able to obtain commitments from its major shareholders to provide debtor-in-possession (“DIP”) financing in connection with its Chapter 11 filings, which served as an important anchor to its ability to attract other sources of financing in the bankruptcy. Notably, companies undergoing restructurings often have chosen to seek relief under Chapter 11, even where incorporated outside the United States, given the statutory availability of debtor-in-possession financing, and the well-established market for obtaining such loans, given lenders’ comfort generally with the Chapter 11 process.

In June 2020, LATAM filed a motion seeking authorisation to enter into an agreement for post-petition DIP financing (as well as a supplemental motion in July), for a total of approximately US\$2.45 billion in financing. The financing agreements contemplated three tranches of secured financing; however, LATAM initially only sought approval of two tranches (one to be provided by market lenders, and the other to be provided by certain major shareholders). Following a marketing and negotiation process and accompanying court proceedings, including litigation, the Bankruptcy Court ultimately approved the financing by final order in September 2020.

LATAM was able to attract proposals for such sizable financing, even in an uncertain market, based on the upfront commitment of its shareholders to provide financing (which other lenders found to be a positive indicator of LATAM’s long-term business prospects), the protections of Chapter 11 (which effectively stayed creditor action against the company and enabled it to restructure its aircraft leasing arrangements) and lenders’ familiarity and comfort with the US DIP financing market and processes, including the expectation that LATAM would emerge as a reorganised corporate group rather than being forced to liquidate.

Over the course of the Chapter 11 Proceedings, LATAM was able to modify its DIP financing arrangements to account for various positive changes in circumstances. In October 2021, in light of favourable market conditions, LATAM obtained authorisation from the Bankruptcy Court to enter into the final tranche of financing (which secured for LATAM US\$750 million of financing at a lower cost of borrowing than that available under the existing tranches). Further, in February and March 2022, LATAM negotiated amended terms with new lenders in advance of the DIP’s impending maturity in April 2022 for a loan that provided a longer maturity. Most recently, LATAM received Bankruptcy Court approval to obtain DIP financing under new facilities, which both provided for extended maturities and certain of which will convert to exit financing to help fund the LATAM Debtors’ emergence from bankruptcy under the terms of its confirmed Plan, as discussed below.

LATAM’s ability to obtain financing throughout its bankruptcy proceedings demonstrates the willingness of lenders to

provide financing to companies as debtors in a Chapter 11 proceeding despite their near-term operating losses and substantial loss of revenue, and even widespread uncertainty across their industry and the economy generally.

Fleet restructuring

Another critical aspect of LATAM's reorganisation process has been the restructuring of its fleet arrangements. As of the date of LATAM's filing for bankruptcy, LATAM's fleet included 340 aircraft, nearly all of which were leased or subject to various secured financing arrangements. Throughout the Chapter 11 Proceedings, LATAM has undertaken a comprehensive review of its fleet to develop and determine a strategy that accounts for both current circumstances and expected future needs. During the Chapter 11 Proceedings, LATAM also has been able to reshape its fleet to increase its cargo fleet, including through the conversion of certain of its passenger aircraft.

Leveraging the power to reject unexpired leases under the Bankruptcy Code, LATAM was also able to obtain power-by-the-hour arrangements at the start of the cases, and then to negotiate new lease agreements or lease amendments with numerous lessors with respect to the group's leased and financed aircraft. The terms of these new agreements are better aligned with LATAM's future business plans than the alternatives available from then-existing fleet arrangements or other market alternatives. In particular, the new leases provide for "power-by-the-hour"-based rent for a specified period of time, after which LATAM pays favourable, fixed rent amounts. LATAM also was able to reject other aircraft leases, and to enter into leasing arrangements for other additional aircraft, in furtherance of the restructuring of its fleet.

LATAM's reorganisation

In June 2022, the Bankruptcy Court confirmed LATAM's plan of reorganisation (the "Plan"), representing a crucial step towards the LATAM Debtors' successful emergence from bankruptcy. The Plan, which was first filed in November 2021, is the culmination of many months of negotiation and compromise, which included the solicitation of proposals for the injection of new capital and negotiation with existing creditors, including through a mediation overseen by former bankruptcy judge Allan Gropper. The various plan settlements reached with LATAM's major creditors and shareholders were memorialised in a restructuring support agreement that contained the terms of the group's financial restructuring and recapitalisation and its proposed Chapter 11 plan of reorganisation.

Notably, under the Plan, LATAM will receive more than US\$8 billion of new money from offerings of new common stock and new convertible notes, which offerings are backstopped by certain parties pursuant to backstop agreements negotiated as part of the restructuring support agreement. LATAM's backstop arrangements are unique in that, whereas most backstop arrangements are in place for only a few months, LATAM was able to obtain commitments to backstop the Plan for eight months—at a time when the parties faced significant risk due to overall economic turmoil, the continued effects of COVID-19, and volatile fuel prices. The longer duration of the backstop commitments was

determined to be necessary to enable LATAM to both obtain confirmation (or approval) of its plan from the Bankruptcy Court and to obtain the necessary Chilean shareholder and regulatory approvals of the new securities.

The injection of new money under the Plan will be essential to the debtors' ability to exit bankruptcy well-positioned to continue their reorganisation success. But the road to Plan confirmation involved addressing and reconciling various competing interests, including ensuring that any proposed reorganisation plan would both comply with the requirements of the Bankruptcy Code and the bankruptcy laws of the various jurisdictions in which LATAM operates. In particular, LATAM had to structure the securities offered under the Plan and in connection with LATAM's emergence from bankruptcy to accommodate the Chilean law requirement that holders of existing equity interests have statutory pre-emptive rights to subscribe and purchase their pro rata share of any newly-issued equity and convertible debt, prior to such equity and debt being offered for sale to other parties.

While the Plan addressed these complex international issues through various interwoven plan settlements, LATAM nevertheless received objections to the Plan from certain creditors on discrete issues, including with respect to the reasonableness of fees provided under the backstop arrangements and whether post-petition interest was payable to certain subsidiary creditors. Ultimately, each objection was overruled by the Bankruptcy Court or settled among the parties, as were other challenges that sought to avoid the honouring of certain guaranties of LATAM's financial debt and other individual stakeholder challenges.

Conclusion

Although LATAM has now obtained confirmation of its Plan and is well on its way towards emergence from the Chapter 11 Proceedings, it still must take certain steps to implement the Plan. In the coming months, LATAM will focus on taking all actions necessary to complete the exit from Chapter 11, including obtaining the necessary local corporate and regulatory approvals and carrying out the equity and debt offerings contemplated under the Plan. Among other things, the Plan contemplates a new US\$800 million equity rights offering and an additional \$1.37 billion of new convertible notes that will be offered to LATAM's existing shareholders consistent with their pre-emptive rights under Chilean law, where such offerings also are backstopped by the backstop commitment parties.

Following the ultimate conclusion of these proceedings, the LATAM bankruptcy case will continue to serve as a landmark example of a foreign debtor using the US bankruptcy system to implement a comprehensive, cross-border restructuring during a time of economic uncertainty, and also serves to illustrate the speed and flexibility of Cayman Islands restructuring processes to complement bankruptcy proceedings being principally administered out of other jurisdictions.

Cleary Gottlieb Steen & Hamilton LLP acts as US counsel to LATAM and Walkers acts as Cayman Islands counsel to the LATAM CayCos.