International Corporate Rescue

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

www.chasecambria.com

Annual Subscriptions:
Subscription prices 2017 (6 issues)
Print or electronic access:
EUR 730.00 / USD 890.00 / GBP 520.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

ARTICLE

If a Tree Falls in the Forest … Shouldn't the Saplings in the Clearing Benefit?

Thomas Macey-Dare QC, Barrister, Quadrant Chambers, London, UK

Synopsis

In an important judgment delivered in November 2017,[1] the English Court of Appeal has decided that an airline's right to be allocated take-off and landing slots at UK airports under the EU Slots Regulation survives as a valuable asset which can be realised for the benefit of the airline's creditors after it ceases to operate and enters administration. The judgment is significant in that it prioritises the interests of creditors, ahead of the stated goal of the Slots Regulation of promoting competition within the airline industry, by allowing a failed airline to receive an allotment of slots and sell them to the highest bidder, rather than requiring those slots to be reallocated fairly among other airlines, including new market entrants who would otherwise be entitled to receive half of the slots. The judgment turns on the construction of the Slots Regulation and is therefore significant, not only in the UK, but throughout the whole of the EU.

Background

At the beginning of October 2017, Monarch Airlines collapsed with debts of £630 million, of which £466 million was unsecured. At the time, Monarch was the UK's 5th largest airline, and the 26th biggest in Europe, operating a fleet of 35 aircraft, serving 43 destinations and carrying many millions of passengers each year. Its failure came after years of mounting financial pressures, caused by competition from other low cost carriers, the long-term decline of the traditional package holiday, increasing operating costs, terrorist attacks and the depreciating value of Sterling. Some 3,500 people lost their jobs. Around 110,000 holidaymakers were stranded overseas, and had to be brought home in what was dubbed Britain's biggest ever peacetime repatriation. A further 750,000 customers were reported to have paid for flights which they were not able to take.

Monarch's collapse was by no means unique. Over 250 global airlines have failed in the last decade alone.

Administrators were appointed on 2 October 2017, not with a view to running Monarch's airline business or selling it as a going concern, but in order to realise the value of the company's assets in the optimal way for the benefit of its creditors. Specifically, they intended to complete a series of transactions with other airlines, whereby Monarch's take-off and landing slots at airports including Gatwick and Luton would be exchanged for less valuable slots plus significant payments. By the time Monarch entered administration, these Gatwick and Luton slots were its most valuable assets, and were reported by the press to be worth around £60 million.

On the same day that Monarch entered administration, the Civil Aviation Authority (CAA) provisionally suspended Monarch's Air Operator Certificate (AOC) and commenced the procedure for revoking it. It also commenced the procedure for revoking or suspending Monarch's Operating License.

Slots and slot trading

Slots are an important class of assets for commercial airlines. They are not route-specific. There is great competition among the airlines for the most valuable slots. Within the EU slots are allocated in accordance with the Slots Regulation: Council Regulation (EEC) No. 95/98 on Common Rules for the Allocation of Slots at Community Airports, as amended. A slot is defined in the regulation as the permission given by a public body, the 'coordinator', to an air carrier to use the full range of airport infrastructure necessary to operate an air service at a 'coordinated airport' on a specific date and time for the purpose of landing and take-off. All major airports in the EU are 'coordinated' airports. In the UK, the designated 'coordinator' is Airport Coordination Ltd ('ACL').

Under the Slots Regulation, for the purpose of allocating slots, each year is divided into two 6-month scheduling periods: winter and summer. Slots are allocated semi-annually, a number of months before the start of each scheduling period.

Notes

1 *R. (on the application of Monarch Airlines Ltd (in Administration)) v Airport Coordination Ltd* [2017] EWCA Civ 1892.

Article 8(2) of the Slots Regulation – the 'grandfather rights' or 'historic precedence' provision – states that an air carrier who has been allocated a particular series of slots in one scheduling period, and has utilised them to a sufficient extent, is entitled to be awarded the same series of slots again in the equivalent scheduling period of the following year. Article 8a, entitled 'Slot mobility', permits air carriers to exchange slots with each other on a one-for-one basis, subject to the approval of the slot coordinator.

Monarch's administrators intended to rely on these provisions in order to renew the valuable slots which Monarch had previously been operating at Gatwick and Luton Airports, for the summer 2018 scheduling period, and then exchange them with other airlines in return for other, less valuable slots, plus substantial cash payments. Monarch had applied to renew their slots a few days before it went into administration. Monarch's administrators had no intention, and no means, of operating the slots they were to receive under these exchange transactions.

ACL was due to allocate slots for summer 2018 by 26 October 2017. On 24 October it informed Monarch's administrators that it considered that it had no obligation to allocate any slots to Monarch; but that it intended to reserve its decision pending the outcome of the CAA's procedure to revoke or suspend Monarch's Operating License. Two days later Monarch's administrators applied for judicial review of ACL's decision, seeking an order requiring ACL to allocate it slots for summer 2018 in accordance with its grandfather rights under the Slots Regulation.

R v ACL ex parte The States of Guernsey Transport Board

The kind of slot trading envisaged by Monarch's administrators is perfectly permissible, at least outside an insolvency situation, and is an accepted and important part of the international airline business. The International Air Transport Association ('IATA') has for many years operated a semi-annual Schedule Coordinating Conference, following each slot allocation process, in order to facilitate such transactions; and ACL itself sometimes acts to facilitate slot exchanges between carriers, by issuing 'dummy slots' with no utility save as an item of exchange. This reflects the fact that, under the Slots Regulation, bilateral exchange of slots is permitted but unilateral transfer is not.

The practice of exchanging slots in this manner was approved by the English High Court in the earlier case of *R v ACL ex parte The States of Guernsey Transport Board* [1999] Eu. L. R. 745, which was decided under the original, unamended, Slots Regulation.

In that case, Air UK wished to terminate its unprofitable service between Heathrow and Guernsey. It agreed to exchange its valuable Heathrow slots with British Airways, in return for an equal number of much less attractive slots at Heathrow, plus (as was 'at least highly probable' according to the judge) a cash payment. BA did not intend to use the Air UK slots for a Guernsey service, but for other, more profitable, routes. Air UK did not intend to use the BA slots at all. It intended to return them, unused, to the 'pool' so that they could be re-allocated to other airlines under the Slots Regulation.

ACL, the slot coordinator for Heathrow, confirmed the exchange. The Guernsey Tourist Board, anxious to preserve direct flights between Heathrow and Guernsey, challenged ACL's decision by way of judicial review, arguing that the transaction was, in reality, not an exchange of slots, but a disguised transfer of slots by Air UK to BA, which was not permitted under the Slots Regulation.

Maurice Kay J dismissed the Guernsey Tourist Board's claim. He held that the exchange of slots was valid and lawful within the Slots Regulation, notwithstanding the accompanying payment, and notwithstanding that Air UK did not intend to utilise the slots it received. In so deciding, he observed (*obiter*) that the role of the slot coordinator under the Slots Regulation did not extend to conducting investigations into matters such as the value of the slots exchanged, whether monetary consideration had been passed, and whether the recipient of the slots actually intended to utilise them. He noted that imposing such a duty on the coordinator would be unworkable and undesirable, in that it would frustrate the rapid and efficient exchange of slots, and risk 'the fossilising of schedules to the detriment of customers and others.'

This reasoning in the *Guernsey Tourist Board* case emphasises the benefits to consumers and competition of maintaining a highly liquid secondary market for allocated slots. Promoting competition and removing barriers to market entry is, indeed, one of the central aims of the Slots Regulation. The recitals to the regulation state that it is 'Community policy to facilitate competition and to encourage entrance into the market', and that 'these objectives require strong support for carriers who intend to start operations on intra-Community routes.' Article 10 provides that all new slots, and all slots over which 'grandfather' rights are not asserted, are to be placed in a 'pool' and distributed among applicant air carriers, with 50% of them being first allocated to 'new entrants' as defined in Article 2.

It is easy to see how, under normal conditions, a liberal slot trading régime tends to further these goals, by preventing ossification in the market. But where an airline has collapsed, and has no realistic prospect of utilising its own slots, or anyone else's, these objectives are best served by returning the airline's slots to the pool, from where the coordinator can redistribute them fairly to new entrants or other airlines, and not necessarily to the highest bidder with the strongest market position.

This consideration lay at the heart of the ACL's refusal to renew Monarch's slots for the summer 2018 scheduling period.

The key legal question

The key legal question in *Monarch* was whether, at the time that ACL came to decide on the allocation of slots for summer 2018, Monarch was still an 'air carrier' within the meaning of the Slots Regulation. Only an 'air carrier' is entitled to be allocated slots under the Slots Regulation. An 'air carrier' is defined by Article 2(f)(i) of the Slots Regulation as 'an air transport undertaking holding a valid operating license or equivalent at the latest on 31 January for the following summer season …'

Operating license and AOC

Within the EU, the grant of an Operating Licence is governed by the Licensing Regulation, (EC) No. 1008/2008, Article 4 of which provides that an undertaking shall be granted an Operating License by the competent licensing authority of a Member State provided that it meets certain conditions, including that (a) its principal business is located in that Member State, (b) it holds a valid (AOC) issued by the national authority of that Member State, (c) it has one or more aircraft at its disposal, (d) its main occupation is to operate air services, and (g) it meets certain specified financial conditions. An AOC is defined in Article 2(8) of the Licensing Regulation as a certificate confirming that the operator has the professional ability and organisation to ensure the safety of the operations specified in the certificate.

The Licensing Regulation contains provisions which allow the competent licensing authority to suspend or revoke an air carrier's Operating License in the event of, among other things, financial difficulties. In particular Article 9(2) requires the competent licensing authority, in the event of clear indications of financial distress or insolvency proceedings, to proceed without delay to make an in-depth assessment of the financial situation and on the basis of its findings to review the status of the Operating License within a time period of three months. Article 9(5) of the Licensing Regulation requires the competent licensing authority to suspend or revoke an Operating License immediately if an air carrier's AOC is suspended or withdrawn.

The competent licensing authority in the UK, where Monarch had its principal place of business, is the CAA. It is responsible for issuing AOCs as well as Operating Licenses. Within the UK, the Operation of Air Services in the Community Regulations, SI 2009/41, contains detailed procedural rules governing the process by which the CAA may revoke or suspend an Operating License, including rules as to hearings and appeals.

The rival arguments

Monarch argued that it was still an 'air carrier' within the meaning of the Slots Regulation because, despite being in administration and no longer operating any aircraft, it still held an Operating License, albeit the CAA was in the process of considering whether to suspend or revoke that license.

ACL argued that this was unrealistic: Monarch was not an air carrier as it had ceased to be a functioning airline and any suggestion that it could resume the operation of air transport services was no more than a theoretical possibility. According to ACL, the test could not simply be whether Monarch held a current Operating License: that would make a failed airline's entitlement to slots depend on how quickly the competent licensing authority concluded the process of deciding whether to suspend or revoke it, which might vary from one Member State to the next in an arbitrary way; and it would go against the aim of encouraging competition, which required slots which were no longer needed to be redistributed among other airlines in a fair manner.

At first instance, the Divisional Court (Gross LJ and Lewis J) accepted ACL's arguments. That decision was unanimously reversed, however, by the Court of Appeal (Floyd, Newey and Asplin LLJ).

The decision of the Court of Appeal

The Court of Appeal noted that an undertaking does not inevitably cease to be an air carrier for the purposes of the Slots Regulation whenever it becomes unable to operate air transport services. For example, a temporary inability to operate would not have that effect.

That being so, where was the line to be drawn, between a temporary inability to operate and one which was sufficiently final to justify the conclusion that the undertaking was no longer an air carrier? The Slots Regulation provided no guidance on that question.

Moreover, assuming that an appropriate test could be identified, the slot coordinator was hardly in a position to apply it. For example, there might be a question mark over whether an airline in financial difficulties had a realistic prospect of being sold as a going concern or emerging from restructuring and resuming trading. The slot coordinator did not have the powers or the procedural framework to carry out the kind of investigation that might be required to resolve that kind of issue, and the Slot Regulation gave no indication that he should undertake that role.

Matters relating to an airline's financial circumstances were best left to the licensing process, where the competent licensing authority (the CAA in the UK) would have the resources to undertake the necessary investigations within the appropriate procedural framework.

The Court of Appeal concluded that Monarch remained an 'air carrier' within the Slots Regulation, notwithstanding that it had no real prospect of ever resuming air transport services. That conclusion left no room for any argument that Monarch should be denied an allocation of slots on the basis that that would be inconsistent with the purpose of the Slots Regulation. The court also rejected a submission that it should refuse to grant Monarch the relief it sought as a matter of discretion.

Monarch's slots

ACL decided not to pursue a further appeal to the UK Supreme Court. In due course, Monarch received its allocation of slots for summer 2018. It proceeded to exchange the most valuable Gatwick slots with IAG, and the Luton slots with Wiz, in each case for undisclosed sums.

Discussion

The Court of Appeal in *Monarch* construed the Slots Regulation in a manner which reflects the anti-deprivation principle, a rule of UK public policy according to which an insolvent entity (and, by extension, its creditors) ought not to be deprived of property by reason of having become insolvent: *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2011] UKSC 38 per Lord Collins of Mapesbury at [1-5]. In so doing, it rejected the construction preferred by the Divisional Court, which reflected and gave effect to the stated aim of the Slots Regulation of improving competition and market access.

The Court of Appeal based its decision, however, not on the competing policy considerations, but on the language of the Slots Regulation and on practical considerations. In particular, it was concerned that the Regulation should be given a construction which was consistent with the functions and resources which the relevant parts of the Community acquis allocate to the different regulatory bodies in the aviation field, and which was both clear and workable. The effect of that construction is, however, is to deprive slot coordinators like ACL of an important power and, with it, the chance for new market entrants to obtain highly sought-after slots in the event of an airline collapse. These slots will now inevitably tend to come to into the hands of the biggest and most established players. That is surely not what the framers of the Slots Regulation intended.

This is an issue which will need to be rectified by legislation. Such legislation is long overdue. As the Court of Appeal observed in *Monarch*, when the Slots Regulation was being amended for the third and final time, in 2004, the European Commission proposed that Article 8a(1)(d), which permits exchange of slots, should be amended to provide that slots may be exchanged only 'where both air carriers involved undertake to use the slots received in the exchange.' Had this proposal been adopted, it would have abolished the practice of exchanging slots which one party does not intend to use altogether. This proposal was not, however, adopted. The reason given was that the Council was concerned that the whole issue of market access should be considered in the wider context of a more thorough review of the slot allocation rules which could be the subject of separate Commission proposals in the future (see Common Position (EC) No. 22/2004). Fourteen years later, these new proposals are still awaited. The Court of Appeal's decision in *Monarch* might provide the nudge which the Commission requires.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

Alongside its regular features – Editorial, US Corner, Economists' Outlook and Case Review Section – each issue of *International Corporate Rescue* brings superbly authoritative articles on the most pertinent international business issues written by the leading experts in the field.

International Corporate Rescue has been relied on by practitioners and lawyers throughout the world and is designed to help:

- Better understanding of the practical implications of insolvency and business failure – and the risk of operating in certain markets.
- Keeping the reader up to date with relevant developments in international business and trade, legislation, regulation and litigation.
- Identify and assess potential problems and avoid costly mistakes.

For more information about *International Corporate Rescue*, please visit www.chasecambria.com