

# Live and let fly: Turbulence lands SAS in Chapter 11

David H. Conaway reports on two recent cases where European companies have chosen Chapter 11 over insolvency proceedings in other countries



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**O**n 5 July 2022, SAS AB and 13 affiliates filed for Chapter 11 protection in the Southern District of New York. Owned 44% by the Kingdoms of Denmark and Sweden, SAS encountered financial turbulence resulting from increased debt, reduced revenue, labour shortages and strikes, common in the aviation industry that has been heavily impacted by the pandemic and struggles to scale back up in 2022.

According to the First Day Declaration of Erno Hilden, SAS's Executive Vice President and Chief Financial Officer, the following points are notable:

1. SAS's revenues fell 56% in 2020 and 70% in 2021, primarily due to the COVID-19 pandemic.
2. To address a "severe liquidity challenge", in 2020, SAS recapitalized its capital structure. The recapitalization included issues of shares and rights for approximately \$1.2 billion, and conversion of approximately \$220 million of debt to equity.
3. The recapitalization required cost-cutting measures including reconfiguration of its fleets, and anticipated a rebound in passenger demand. However, SAS's EBIT for 2020 and 2021 was negative \$1.5 billion.
4. In late 2021, SAS engaged restructuring professionals and developed the SAS FORWARD plan. The main elements included:
  - \$750 million annual cost savings;
  - \$2 billion debt to equity

- conversion;
  - \$950 million new capital; and
  - A redesigned fleet and network.
5. Notable problems:
    - SAS has been unable to renegotiate above market aircraft leases with its lessors. SAS has surplus aircraft in its fleet. SAS's aircraft lease and finance liabilities were about \$2.5 billion. In addition, SAS has contracts for new Airbus aircraft of \$1.8 billion.
    - Approximately 80% of SAS employees are members of unions, and almost all pilots are. SAS has been unsuccessful negotiating with labour, resulting in a 900 pilot strike by SAS Scandinavian pilots' union. SAS estimated disruption of 50% of its flights, costing \$10-13 million a day.
    - As a result of these issues, SAS concluded it could not complete its debt-for-equity conversion or attract new equity.

## The Chapter 11 solution

### Jurisdiction

Chapter 11 allows foreign corporations to file Chapter 11 if they have a domicile, principal place of business, or principal assets in the district of filing. Virtually all global airlines have assets and property in the US. The bar is very low in establishing jurisdiction in the US for Chapter 11 filings.

### Capital markets access

Unfortunately, the SAS FORWARD plan of early 2022 did not generate the interdependent creditor concessions or the capital infusion needed. Prior to Chapter 11, Seabury Securities, LLC ("SEB") and Skandinaviska Enskilda AB ("SEB"), on behalf of SAS, solicited over 90 private and state funding sources for \$950 million in new capital, which did not materialize due to apparent investors' "cold feet" regarding SAS's labour issues and lack of progress on the aircraft leases. The access to bank funding and private equity funding is well-established in the US, with a complement of legal and financial advisors with airline industry experience.

### Labour Issues

For SAS to succeed, it must resolve its labour disputes and avoid disruptions caused by pilots or other employees. To that end, SAS needs to terminate, or more likely modify existing collective bargaining agreements between SAS and its unions.

A debtor may obtain the bankruptcy court's approval to unilaterally reject or modify the collective bargaining agreement pursuant to section 1113 of the Bankruptcy Code. Section 1113 requires that the debtor make a proposal to the union "which provides for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all affected parties are treated fairly and equitably".



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Section 1113 also provides that the bankruptcy court shall approve an application for rejection of a collective bargaining agreement if the union refuses to accept the proposal without good cause and the balancing of the equities favours a rejection. The power of section 1113 usually promotes modifications to the collective bargaining agreement necessary for the debtor to restructure. SAS clearly needs the provisions of section 1113 to successfully deal with its labour issues, which will in turn facilitate a capital infusion and DIP financing, and thus a successful restructuring.

#### **Aircraft leases**

The Bankruptcy Code provides debtors the right to elect to assume or reject executory contracts and unexpired leases. If a debtor rejects an executory contract, the non-debtor party receives a general unsecured claim for damages arising from the debtor's "breach" of contract. Thus, a debtor escapes the contract with little cost. On the

other hand, the debtor also has the right to assume or assign a contract. In this instance, the Bankruptcy Code requires that the debtor "cure" the contract by paying existing defaults. Presumably, debtors would assume contracts that they deem to be valuable, either because they ensure an uninterrupted supply of goods or contain favourable pricing or terms.

The Bankruptcy Code requires that the non-debtor party to an executory contract must continue to perform its obligations under the contract pending the debtor's decision to assume or reject such contract, and provided that the debtor is in fact performing its obligations of the contract post-petition.

In a "First Day" motion, SAS sought and obtained a bankruptcy court order that provided:

*"... notwithstanding any contract or lease provision or applicable law, an executory contract or unexpired lease of the Debtors may not be terminated or modified, and*

*any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the Debtors' chapter 11 cases solely because of a provision in such contract or lease that is conditioned on (i) the insolvency or financial condition of any or all Debtors or (ii) the commencement of the Debtors' [C]hapter 11 cases".*

#### **World-wide automatic stay**

In its pleadings filed in the Chapter 11 case, SAS noted that they have assets located in at least 34 countries in the world. In addition, SAS noted that they are largely incorporated under the laws of non-US countries, including Denmark, Ireland, Norway, and Sweden. Also, key contracts are governed by the laws of non-US jurisdictions. Accordingly, one of SAS's many "First Day" motions was a motion to enforce the automatic stay of section 362 of the Bankruptcy Code, resulting in a bankruptcy court order to enjoin any action

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by any person against any of SAS's assets or operations, throughout the world. Such world-wide injunction provides SAS the “breathing spell” that is essential to a successful reorganization.

However, in *Kumtor Gold Company CJSC, et al.* (“Kumtor”), a Chapter 11 proceeding in the Southern District of New York, the section 362 automatic stay was challenged by a foreign creditor. In fact, the foreign creditor filed an objection to Kumtor’s motion for a section 362 stay, and filed lawsuits to seize Kumtor’s assets outside the US, ignoring the section 362 stay. Kumtor has sought sanctions against the creditor for the foreign lawsuits against Kumtor. However, there are no bilateral or multilateral treaties that would enforce the SDNY judgment in the foreign country. In fact, Kumtor illustrates the potential practical problem of enforcing the section 362 “world-wide” automatic stay.<sup>1</sup>

#### **Management control**

Chapter 11 management almost always stays in control during the Chapter 11 proceeding. In rare circumstances, debtor’s management can be supplanted by a Chapter 11 trustee for fraud, gross mismanagement or if in the best interest of creditors. Most significant financing contracts provide for a default of the agreement, in the event of a management change, appointment of a Chapter 11 trustee or change of control. Having such agreements at risk is rarely in the best interest of creditors. Lenders or private equity interests often steer filings to Chapter 11, so their relationships with management are not interrupted by the insolvency proceeding.

#### **Joint administration**

SAS benefits from the Chapter 11 provisions allowing for the joint administration of SAS and all of its 13 affiliates. This means one insolvency proceeding, one judge, one set of debtors’ counsel, one set of financial advisors and

investment bankers, one consolidated creditors’ committee, and one restructuring plan. Even though jointly administered, SAS and its affiliates are NOT substantively consolidated, which is rare in Chapter 11. While Chapter 11 is expensive, the ability to jointly administer an entire company group, wherever located, in a single unified insolvency proceeding provides unparalleled efficiency.

#### **Apollo Management loan to Own**

US-based Apollo Group Management agreed to provide SAS \$700 million in DIP financing, approved by the court on 31 August 2022, at per annum interest of SOFR + 9%, and a break-up fee of 1% (\$7 million). Also, the DIP provides Apollo a Call Option to subscribe for equity in the reorganized debtors based on an enterprise value of \$3.2 billion. It is projected that Apollo will ultimately own 22%-30% of SAS. Apollo and Denmark will collectively own approximately 50% of SAS.

Though not novel, the Apollo DIP transaction demonstrates the incredible versatility of Chapter 11 as a forum to not only restructure, but to also facilitate an acquisition, essentially in one transaction. The equity lenders receive all of the super-priority, fees, controls, protections, and other perks of DIP lending, for an option to be a significant equity owner of the reorganized debtors, if successful in the restructuring. Chapter 11 thus encourages the capital markets to engage with creative solutions.

#### **Coda: LATAM Airlines and Lumileds Holding B.V.**

SAS is not the only airline to choose Chapter 11 over insolvency proceedings in other countries. On 26 May 2020, Latin American airline LATAM Airlines Group S.A. filed Chapter 11 in the Southern District of New York. LATAM chose Chapter 11 as its insolvency proceeding for reasons similar to SAS’s. As part

of its “First Day” motions, LATAM filed a motion for joint administration of the numerous Chapter 11 proceedings of LATAM’s affiliates. LATAM also filed a motion to enforce the section 362 automatic stay as a “world-wide” injunction. In his “First Day” declaration, LATAM’s CFO also telegraphed LATAM’s intent to utilize Chapter 11’s favourable provisions regarding “Executory Contracts” to reject aircraft leases to right-size its fleet in the aftermath of the COVID-19 pandemic.

Lumileds Holding B.V., a Dutch manufacturer of lighting for 1 out of 3 automobiles globally, filed Chapter 11 in the SDNY on August 29, 2022. According to the First Day Declaration of Lumileds’ CFO, Johannes Paulus Teuwen, Lumileds filed Chapter 11 to effect a balance sheet restructuring via a pre-packaged plan of reorganization. Specifically, Lumileds seeks to reduce first lien debt from \$1.7 billion to \$400 million, in a debt for equity conversion. In addition, Lumileds needed liquidity to continue operating, pursuant to a \$275 million DIP facility.

Unlike SAS, Lumileds’ Chapter 11 seeks only a balance sheet restructuring. Notably, Apollo Management is involved in both SAS and Lumileds. In SAS, Apollo provided DIP financing as part of a strategy to significantly increase its equity stake. In Lumileds, Apollo will lose equity control, in favour of the first lien lenders. Presumably, Apollo influenced SAS and Lumileds to pursue restructurings in Chapter 11 for access to capital markets, fast-track restructurings, and virtually unlimited flexibility of solutions. ■

#### **Footnote:**

<sup>1</sup> For more on the Kumtor case, see, by this author, “Over the Hills and Far Away” Eurofenix (Winter 2021/2022) 36-37.