



Norwegian Airlines examinership: the big question

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In December 2020, the Irish High Court placed Norwegian Air's registered parent company Norwegian Air Shuttle into examinership, following a difficult period for the airline throughout the COVID-19 pandemic.

Assuming the Court will extend this examinership for another 50 days, the question remains: will Norwegian Air be permitted by the Court to hand back 36 aircraft to their owners?

It is the biggest question in this examinership and it is likely to be the most significant question to be determined in any examinership to date - not least because of the sums involved.

But for the reasons set out later in this note there is a strong likelihood that, in the end, the Court will not be asked to answer this question at all.

Background

Travel consumers in Ireland became used to seeing Norwegian Air's livery on the tarmac at Dublin airport and elsewhere as it sought to take on the transatlantic market. In 2017, 2018 and 2019 revenues at the airline increased to €4 billion, €3.2 billion of which was in ticket sales.

Two significant catastrophic events then occurred. First, the grounding of the Boeing 737 Max in 2019, and second, the onset of the COVID-19 pandemic in 2020.

Business downturn

Bookings fell by 99% in the second quarter of 2020. Between January 2020 and November 2020 Norwegian carried 6.3 million passengers versus 28.62 million for same period in 2019 a fall of 78%. Third-quarter revenue fell 91% to €119 million from €1.13 billion for same period in 2019. Annual revenue at the date of the petition to appoint the examiner in November 2020 was down by 76%. Operating losses for the year had quadrupled.

Pandemic survival strategy

Norwegian Air's strategy shifted from growth to survival. Between April and May 2020 it converted €1.2 billion of debt and leasing commitments to equity. It adjusted lease rentals to market by reference to the value of aircraft. The airline also introduced so-called "power by the hour" arrangements whereby aircraft owners were paid only for the time the aircraft was in the air. It postponed operations outside Norway until the COVID-19 pandemic eased. It raised €37 million in new cash and equity through a public offering.

All of this allowed the airline to avail of Norwegian State Aid in the form of loan guarantees of €278 million and achieve further savings in restructuring negotiations with aircraft owners. All of this meant that by the time Norwegian Air applied to have an examiner appointed in November 2020, the company had sufficient liquidity to see it through to the end of Q1 2021. But only if it got the protection of the Irish High Court through the appointment of an examiner.

Why the airline sought court protection

With all of this work in train, what were the immediate catalysts requiring Norwegian Air to seek Court protection?

Before we list them, remember - in Ireland, a company can't apply to have an examiner appointed if:

- a. a liquidator has already been appointed; or
- b. if a receiver has already been appointed for longer than three days.

If either of these things look likely then an applicant should approach the High Court. An enormous amount of work has to be done before an applicant can petition the Court to appoint an examiner.

On 6 November 2020 Aviation Capital Group received a judgment against Norwegian Air for \$6.287 million in the UK and that was going to have to be paid by 18 December 2020. On 9 November 2020 the Norwegian Government confirmed that it was not going to give Norwegian any more support. Leasing company Wings Capital issued claims and default notices for \$2.2 million. Several other lessors served termination notices reserving their rights generally. And Boeing was holding significant advance payments for undelivered aircraft - according to Norwegian Air. All of these things combined led Norwegian Air to take the step to appoint the examiner when it did, which it had been planning to do for a long time as is readily apparent from the papers filed in Court.

The Independent Expert Report

The most significant of these and the most significant document in any examinership (apart from

any judgments, obviously) is the Independent Expert Report (IER). Its purpose is to set out the reasons why the company is insolvent and why the company is likely to be able to survive as a going concern once the Court approves a scheme of arrangement with its creditors.

In this case the IER stated that as a going concern Norwegian would have positive net asset position of \$2.4 billion. By contrast its deficit on liquidation would be a startling \$7.1 billion. This anomaly between its negative and positive asset position determined by solvency is largely driven by a value attributable to "right of use" assets. This is an accounting treatment of leased aircraft which depreciate over the term of the lease. This value is not realisable by the relevant companies, regardless of the value of the aircraft. The IER noted however that Norwegian would run out of working capital in January 2021.

The IER outlined a survival plan which required the achievement of several objectives:

- adjust aircraft leasing payments to market value
- longer term "power by the hour" deals to conserve cash while aircraft were parked
- an extension of existing power-by-the-hour agreements beyond Q1 2021
- adjusting future aircraft orders to future operating requirements
- deferrals and restructured payments for loans secured by necessary aircraft.

The Independent Expert was of the view that "it is expected that the process of restructuring the overall operating fleet, and raising new capital, will be interdependent as both fleet creditors and potential new capital providers will want to know that the other is committed to the business going forward".

He also explained that, in his view, Norwegian had a realistic prospect of survival if:

- court protection was granted
- lessors provided support during and after the examinership
- it secured additional working capital in the form of fresh capital investment
- it restructured its long-term obligations under aircraft acquisition contracts including arrangements for advance payments
- the High Court confirmed proposals for a scheme of arrangement.

Now leaving aside the industry specifics, these are standard requirements in any IER. In all successful examinerships creditors are required to support the company. In this case it now transpires the major support from its major creditors, the aircraft owners, is for them to take back

their aircraft. That wasn't immediately obvious when the petition was presented. The application to repudiate the leases was only made in early January and caused, as you can imagine, quite a stir.

Repudiation of leases

I wrote about the repudiation of leases previously. The repudiation of leases was the central issue in the New Look Examinership. The difference between that case and this one is that the issue was live from the get go in New Look. But it has only recently popped its head up in this one, more than 70 days after kick-off.

Repudiating leases isn't automatic. It's well known that examinership is the only way known to Irish Law to repudiate an onerous lease. But just because you have a lease or several under which you are paying above market rent, that doesn't automatically entitle you to avail of the protection of the court. The lease must be onerous, that is to say have a materially adverse impact on your ability to survive. You must have evidence setting out in full how it is that the leases jeopardise the success of the scheme of arrangement.

Also, as the legislation describes the onerous contract as being one "under which some element of performance other than payment remains to be rendered both by the company and the other contracting party" - that is to say, not just payment of the rent - then it is necessary to explain what that is. Some other element, such as the carrying out of works or the performance of services must be outstanding in order for the court to entertain the application. Obviously, it assists greatly if the examiner concurs with the view. As we now know from the New Look case, before you seek the protection of the court from your landlords you need to have first tried to negotiate with them. In New Look the court dismissed the petition seeking the appointment of an examiner.

Two possible outcomes

The big question in this case then is whether the court will permit Norwegian Air to repudiate its leases and hand the 36 aircraft back to their owners. If the question has to be determined by the court then there are two probable alternative outcomes.

First, Norwegian is permitted to hand the aircraft back in which case the aircraft owners are going to be licking their wounds and going to their own funders for further help. Some of them might even have to seek the protection of the Court themselves in time. Second, Norwegian is not permitted to hand the aircraft back. Well then it seems it won't survive at all and so the aircraft owners are going to have to take them back anyway.

When so much is riding on a binary outcome determined by someone else, in this case a judge, sensible people talk so that they determine the outcome.

Last Friday there were 105 lawyers online attending the Norwegian examinership interim hearing representing Norwegian, the Examiner and many dozens of creditors. That means we could be looking at the mother and father of all settlement negotiations resulting in the mother and father of all settlement agreements which will allow an agreed scheme of arrangement to be put before the court in early April. Even then, the court is under no obligation to approve any scheme of arrangement and it has complete discretion.

So, it seems that hundreds of legal fingers, earnestly blistered from frenzied drafting efforts to agree a deal, will be anxiously chewed while the court decides if the deal is ok after all.

For advice in financial services, insolvency and restructuring, contact Ronan McGoldrick.

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