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CAPE TOWN CONVENTION LEGAL ACTIVITY ANALYSIS[1]

Produced by the Legal Advisory Panel to the Aviation Working Group

Initial posting: [_____[2]**]**

Reference: Malaysia case 1 of 2021		
Date of Judgment:	**19 February 2021**	
Case:	**In the matter of AirAsia X Berhad v BOC Aviation Limited and 14 others, and in the matter of a proposed Scheme of Arrangement and in the matter of s.366 Companies Act 2016**	
Relevant CTC/Protocol (IR Rules and Procedures)	**Alternative A; Article I (2)(m); Article XI (1), (2), (7), (10) (11) of the Protocol** **Articles 1, 5, 10 and 13 of the Convention**	**IR Rules and Procedures** **None**
Relevant CTC Jurisdictions	**Malaysia**	
CTC Facts, Conclusions and Analysis		

I. <u>Facts:</u>

1. On 7 October 2020, AirAsia X Berhad (**'Applicant'**) filed an application to the Kuala Lumpur High Court in Malaysia (the **'Court'**) for leave to, inter alia, convene meetings of certain classes of Applicant's creditors, to consider and approve a scheme of compromise or arrangements to be proposed by the Applicant formulated under s.366(1) of the Companies Act 2016 in Malaysia (the **'Scheme'**).

2. On 19 February 2021, the Court granted the leave sought by the Applicant.

3. The Scheme proposed a 99.7% haircut of the total estimated debts and liabilities of the Applicant.

[1] Unless otherwise indicated, Articles references in Arabic numerals are to those the Convention on International Interests in Mobile Equipment (**Convention**), and in Roman numerals are to those on the Protocol on Matters Specific to Aircraft Objects (**Protocol**). The Convention, as modified by the Protocol, is referred to as **CTC**.

[2] See part IV, if applicable, containing annotations based on subsequent legal developments.

4. The Scheme further provided for the termination of leases by the Applicant as permitted by Article XI(11) of the Protocol. The Scheme did not seek to interfere with the lessor creditors' remedy under Article XI(7) to repossess their aircraft upon termination of the leases.

5. The Court was asked to consider (i) whether the Scheme constituted an 'insolvency-related event' under Article XI(10) of the Protocol and (ii) whether the prohibition on modifying 'obligations under the agreement' without the consent of the creditor in Article XI(10) of the Protocol means that the obligations of a debtor to make rental payments under a lease cannot be subject to a 'cram down' under the Scheme without the lessor's consent.

II. Conclusions

6. The Court held that the Scheme is an 'insolvency-related event' under Article XI of the Protocol. The Court's conclusion was based on its analysis that the Scheme: (i) had been formulated in the context of an insolvency procedure; (ii) is an arrangement that is 'collective' in that it is 'concluded on behalf of creditors generally or such classes of creditors as collectively represent a substantial part of the indebtedness'; and (iii) the Court's approval is required for its implementation.

7. The Court further held that the prohibition in Article XI(10) of the Protocol on modifying 'obligations of the debtor under the agreement' without the consent of the creditor, includes a prohibition on modifying the obligation of a debtor to pay rentals under the agreement. The Court concluded that, when read together, Articles XI(7), (10) and (11) of the Protocol provide protection to a creditor. It concluded that, in circumstances where a debtor chooses not to terminate an agreement under Article XI(11) when an insolvency–related event has occurred or the creditor does not exercise its right to repossess the aircraft under the Article XI(7) of the Protocol, 'the obligations under the agreement including the obligations to pay the rentals cannot be modified by the debtor unless with the consent of the creditor'.

8. The Court further held that, as the Scheme provided for the termination of leases (as the Applicant was entitled to do under Article XI(11) of the Protocol), the lessor creditors were left with the remedy of repossession of their aircraft as provided for in Article XI(7) of the Protocol. It noted that the Scheme did not interfere with that right.

9. The Court further held that, with the termination of the leases, apart from the right to repossess their aircraft, the lessor creditors have the right to claim against the Applicant for damages. Such a claim for damages would comprise both the accrued unpaid rentals and the future rentals under the lease subject to the duty to mitigate such losses.

10. The Court held that the claim for damages arose on the termination of the leases and as such was the same claim the lessor creditors would make on a liquidation of the Applicant where they would have to share *pari* passu with other unsecured creditors in the assets of the Applicant.

11. The Court held that as the claim for damages arose as a result of the termination of the leases, the claim was 'nothing to do' with an 'obligation of a debtor under the agreement' as contemplated in Article XI(10). The Scheme was seeking to compromise the claim for damages not the obligations of the Applicant under the leases and as such the Applicant did not require the consent of the lessor creditors to the 'cram-down' of their claim for damages in the Scheme in the form of a 99.7% haircut on their claims.

III. Analysis

[Applicability of CTC]

12. Malaysia is a Contracting State and has made a declaration under Article XXX(3) of the Protocol to adopt the Alternative A insolvency regime under Article XI of the Protocol. The Court's decision is compliant with the purpose and intent of CTC.

13. The Court concluded that the issue on applicability of the CTC was based on 2 issues: (i) whether a Scheme of Arrangement under s.366 of the Malaysian Companies Act 2016 (an '**SOA**') is an 'insolvency-related event' under Article XI(10) of the Protocol; and (ii) whether Article XI(10) of the Protocol means that the debtor's obligations to make payments (under the lease agreement) cannot be subject to the 'cram down' provisions under a SOA without the consent of the lessor creditors.

14. In drawing its conclusion that an SOA is an 'insolvency-related event', the Court had regard to the definitions of 'insolvency-related event' in Article I(2)(m) of the Protocol and of 'insolvency proceedings' in Article 1(k) of the Convention; to the provisions of Article 5(1) and (2) of the Convention on Interpretation and applicable law concluding that the question whether a SOA is an 'insolvency proceeding' needs to be settled in accordance with the principles underlying the Convention and not based on national law.

15. The Court further had regard to the expert opinion of Professor Jennifer Payne; the expert opinion of Professors Louise Gullifer and Riz Mokal; and, noting that the 4th Edition of the Official Commentary to The Cape Town Convention does not address the issue of whether a scheme of arrangement is an 'insolvency proceedings', to Professor Sir Roy Goode's Annotation to the Official Commentary which confirms (I) that schemes of arrangement fall within the definition of 'insolvency proceedings' where they are '(i) formulated in an insolvency context or by reason of actual or anticipated financial difficulties of the debtor company; and (ii) collective in that they are concluded on behalf of creditors generally or of classes of creditor that collectively represent a substantial part of the indebtedness'; (II) that a reorganisation arrangement in which a court acts to facilitate a statutory process and where the court's approval is required for its implementation, constitutes insolvency proceedings where the assets and affairs of the debtor are subject to control and supervision by a court for the purposes of reorganisation and (III) addressing Article XI(10) that in a reorganisation arrangement falling within the definition of 'insolvency proceedings', a modification of the debtor's obligations without the consent of the creditor is inconsistent with Article XI(10) of the Protocol where declared and implemented.

16. The Court concluded that (i) there was no doubt that the Scheme was formulated in the context of an insolvency; (ii) the Scheme was collective in that it was concluded on behalf of creditors generally or such classes of creditors as collectively represent a substantial part of the indebtedness and (iii) the Court's approval was needed for its implementation.

17. The Court was of the view that Professor Jennifer Payne's expert opinion put too restrictive an interpretation on the meaning of the words 'in which the assets and affairs of the debtor are subject to the control and supervision of the court' in the definition of 'insolvency proceedings' in Article 1(k)) of the Convention. In the Court's view, the Convention 'does not state that the entire assets and affairs of the debtor must be covered under the scheme. Neither does it matter that outside the scheme, possession and management of the company remain with the management. All that is required is that the proceedings being a collective proceedings is such that it involves assets and affairs of the debtor being subject to the control or supervision of the court. In the present case, there is no doubt that the Scheme

involves 'assets and affairs' of AAX'.

18. The Court further rejected the expert opinion of Professor Jennifer Payne that the role of the court is merely to 'facilitate the compromise or arrangement put forward by the parties'. In the Court's view, 'the fact that the Scheme must receive the sanction from this Court and AAX and the creditors must also comply with directions from the Court on the implementation of the Scheme, to my mind, meets the requirement of 'control or supervision by a court.' ' The Court cited the expert opinion of Professors Gullifer and Mokal as fortifying its view.

19. In rejecting Applicant's counsel's assertion that the meaning of 'obligations' in the Convention is restricted to *in rem* matters and accordingly 'obligations of the debtor' in Article XI(10) of the Protocol should be restricted to *in rem* rights, the Court said that Article XI(10) is 'unambiguous….to restrict the meaning of the word 'obligations' to only obligations relating to *in rem* matters is to read into the Articles words that are simply not there'. It noted that there was nothing in the Convention to suggest that is should be interpreted narrowly to cover only *in rem* rights. It cited the reference to 'obligations' in Article XI(7) saying that 'there is little doubt that the word 'obligations' in this Article XI(7) must include the *in personam* obligation to pay rentals under the agreement' to support its view. It would be 'incongruous that the same word in Article XI(10) bears a different and indeed a narrow meaning as suggested…'

20. The Court agreed with counsel for the 4th intervener that the prohibition under Article XI (10) on the debtor modifying the obligations under the agreement without the consent of the creditor is consistent with the purposes of the Cape Town Convention – to promote and reduce the costs of asset-based financing for airline equipment.

[Timing]
21. Application for leave to convene creditor meetings was filed on 7 October 2020. Leave was granted on 19 February 2021 including the Court's determinations on matters relating to CTC, a period of 4 months and 12 days.

IV. <u>Annotations Reflecting Subsequent Legal Developments:</u>

22. Creditors meetings were held and the Scheme was approved by creditors on 12 November 2021. The Court sanctioned the Scheme on 16 December 2021. The Scheme became effective on 16 March 2022 when the order of the Court sanctioning the Scheme was lodged on the Companies Commission of Malaysia. Intervening restraining orders preventing creditors taking legal action against the Applicant had been granted but had, in recognition of the Lessor creditors' rights under CTC, carved out from the restraining order, the Lessor creditors' rights to terminate their leases and recover possession of their aircraft.