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Due to the ongoing COVID-19 pandemic and the resulting economic malaise, lenders and investors are seeing a flood of requests from borrowers and issuers for relief on debt service payments. For private financings where there is generally a small syndicate of participants or group of investors, such requests are often obliged, for any number of reasons, including concern that a borrower or issuer will purposely default. Holders of publicly traded securities, on the other hand, have historically been immune to such requests.

Enhanced equipment trust certificates (EETCs, pronounced “double-E-T-C”), which are publicly traded airline-issued and aircraft-secured debt securities, are likewise generally immune to such requests. Lawyers in the Vedder Price Global Transportation Finance Team, nevertheless, have been fielding questions from clients about the likelihood of airline issuers seeking debt relief, including forbearances, on their EETCs, whether in or outside of bankruptcy proceedings. We have been counseling our clients that it is nearly impossible for airline issuers of EETCs to obtain debt relief from the holders of the EETC securities. We explain the rationale for that conclusion in this Article.

I. EETC Background
By way of background, EETCs are a type of debt security issued by individual airlines to finance portions of their fleet of aircraft. The securities that are sold to the investors are pass through trust certificates (PTCs), which represent beneficial interests in pass through trusts that hold promissory notes issued by an airline issuer and relating to a particular aircraft. To secure the airline issuer’s obligations under those promissory notes, the issuing airline grants security interests in the related aircraft as collateral. The promissory notes issued by the airline issuer for each aircraft are issued in tranches, representing senior and subordinated secured positions in the aircraft collateral. Accordingly, all promissory notes that are issued on a senior basis will be placed into one particular pass through trust, and one or more series of promissory notes issued on a subordinated basis will be placed in a different pass through trust for each series. Thus the investors will hold, through their PTCs, interests in a pool of secured aircraft promissory notes in respect of either senior or subordinated securities. The airline issuer, in turn, will use the proceeds of the PTC offering to finance the aircraft in its fleet.

Historically, airlines issuing EETCs have typically been U.S. airlines. The EETCs’ success is keyed to the fact that aircraft financings by U.S. airlines have had the benefit of Section 1110 of the U.S. Bankruptcy Code (Section 1110). In a nutshell, Section 1110 requires a U.S. airline that has been subject to a Chapter 11 bankruptcy either to agree to perform its aircraft-secured financings (and cure any past defaults) or return the financed aircraft to its financier, in each case within 60 days of its bankruptcy filing. The critical feature of this Section is that it overrides the bankruptcy stay that would otherwise be applicable to the airline’s creditors, enabling the aircraft’s financers to get their collateral back on a timely basis (or to restore their financings to a performing status). We should mention that there is a third option under Section 1110 for the bankrupt airline and its aircraft financier, which is for them to agree that the airline may keep the aircraft subject to amended terms of the financing agreement. This would occur if the financier does not want to take its aircraft back (the usage of this option is commonly known as the Section 1110(b) option).

With the advent of the Cape Town Convention on International Interests in Mobile Equipment and its Protocol on Matters Specific to Aircraft Equipment (the Cape Town Convention), which offers the Section 1110-equivalent Alternative A for aircraft registered or debtors situated in countries participating in the Cape Town Convention and electing Alternative A, non-U.S. airlines have also utilized EETCs. Some non-U.S. airlines based in jurisdictions that are not signatories to the Cape Town Convention but that have particularly favorable creditors’ rights as a matter of law have also been able to utilize the EETC product.

II. EETC Enhancements

As reflected in its name, the first “E” in EETC is the word “Enhanced.” What makes these PTCs enhanced over an ordinary equipment trust certificate is that they have the following features:

A. Tranching. The PTCs and promissory notes are tranched, providing improved loan-to-value (LTV) ratios for more senior tranches and subordination rights against the more junior tranches. With respect to an aircraft being financed, the airline issuer
will issue one promissory note for each tranche, to be held by or on behalf of a pass through trust, which holds all the promissory notes of the same tranche under the EETC financing.

**B. Cross-Default.** If the issuer defaults on its obligations under any of the promissory notes, it will be deemed to have defaulted under all of the promissory notes, permitting the exercise of the remedies provided in each promissory note across the entire EETC financed fleet. This a very powerful tool for EETC investors insofar as it does not allow the airline issuer to cherry-pick among the financed aircraft – it is an all-or-nothing approach. So, the airline issuer is faced with a stark choice: either it cures the defaults on all related promissory notes secured by each of the EETC aircraft or it may be obligated to return to the subordination agent all of the EETC aircraft (which may constitute a material portion of its fleet or a core operational portion of its fleet and/or in which the airline may have built up an equity position).

**C. Cross-Collateralization.** In addition to the grant of security in a particular aircraft to secure the promissory notes related to that aircraft, a security interest is also granted in all the aircraft that secure the other promissory notes. If an aircraft is sold, any net proceeds from that sale in excess of the debt related to that aircraft will be available to cover any shortfall with respect to the other outstanding promissory notes.

**D. Cross-Subordination.** Related to the cross-collateralization, in furtherance of the enhancements provided for more senior promissory notes, more senior tranches of notes enjoy priority in payment ahead of more junior tranches when a remedy is exercised against any aircraft regardless of the promissory note under which the shortfall has occurred.

**E. Section 1110/Cape Town Convention Protection.** A key factor in the enhanced aspect of a EETC, and why its use has been, for the most part, limited to U.S. airlines, is that secured creditors of U.S. airlines can benefit from the provisions of Section 1110 of the U.S. Bankruptcy Code, which allow them to repossess the aircraft collateral during a Chapter 11 proceeding if the airline does not cure its defaults (other than the bankruptcy filing) and certain other conditions are satisfied. These rights (as well as comparable rights under the Cape Town Convention) provide greater certainty to EETC investors as to the ability to repossess the financed aircraft (or be given assurances of continued performance of the airline’s obligations under the related promissory notes) if an airline files for bankruptcy.

**F. Liquidity Facility.** As an additional means to enhance the credit ratings of a EETC, a liquidity facility is put in place for one or more classes of the PTCs and sized to provide for timely payments of interest on the PTCs for up to 18 months (or sometimes a longer period in the case of certain airlines based in non-U.S. jurisdictions). Each liquidity facility allows the related pass through trust to continue to make timely interest payments for the relevant period of time in a variety of scenarios, including if the airline issuer were to stop making debt service payments. The 18-month period (or other relevant time frame) is the time period that the rating agencies that rate EETCs have determined is the maximum amount of time it should take to repossess the aircraft, given the certainties of Section 1110 or the Cape Town Convention (or other applicable law), as the case may be. In this regard it
is worth noting that EETCs are rated on the basis of the ability of the EETC to pay current payment of interest and ultimate repayment of principal at legal maturity. The “current payment of interest” is supported by the issuer’s ability to pay the same, or the liquidity facility provider in lieu of the issuer, and the “ultimate repayment of principal” is supported by the issuer’s ability to pay the same, or, absent issuer wherewithal, the ability to repossess and liquidate the aircraft collateral within the applicable repossession period (18 months or otherwise).

III. EETC Documentation

The terms and conditions of EETCs are quite standardized across the market (that is, from airline to airline) and, as to any single airline issuer, will usually be nearly uniform across its EETC-financed fleet. EETC contracts can be thought of in two groups. One group consists of the aircraft financing documents, which typically include a Note Purchase Agreement, a Participation Agreement, an Indenture and Security Agreement for each aircraft (an Indenture) and the promissory notes. The other group consists of the documents associated with the PTCs or trust-level documents, which include an Underwriting Agreement, a Pass Through Trust Agreement, Trust Supplements (which create the trusts for each tranche of PTC), PTCs, Revolving Credit Agreements (liquidity facilities), Intercreditor Agreements and, for pre-funded facilities, Deposit Agreement(s) and Escrow Agreement(s). For purposes of this discussion, we will focus on the Indenture, the Pass Through Trust Agreement and the Intercreditor Agreement.

The Indenture

It is under an Indenture that the airline issuer incurs the debt evidenced by promissory notes, covenants to pay interest on and principal of the promissory notes and grants a security interest in an aircraft subject to the EETC to the loan trustee acting for the PTC holders. The payment obligations of the airline issuer under an Indenture may only be amended or modified with the consent of each affected promissory noteholder. Each promissory note issued under an Indenture is issued to and in the name of the subordination agent acting for the related pass through trustee. Tracing through the chain of beneficial ownership of the PTCs, each holder of a beneficial interest in the PTCs would need to consent to the amendment of payment obligations in order for such an amendment to become effective, as further discussed below.

The Pass Through Trust Agreement

The Pass Through Trust Agreement (together with the Trust Supplements) creates a number of rights in favor of the PTC holders as well as provides for the administration of the PTCs. Of note, the PTC holders have a right to receive periodic distributions of payments from the trust property (which includes payments received on the promissory notes), which payment cannot be impaired or affected without the consent of each of the affected PTC holders.

With respect to the particulars of the identity of the holders of the PTCs, the issuance mechanism largely shields their identities from the airline issuer. Pursuant to the Pass Through Trust Agreement, the PTCs are not issued as physical or
“definitive” certificates but rather as book-entry certificates deposited with a clearing agency, typically Depository Trust Company (DTC). The pass through trustee will register the PTCs issued under the pass through trust in the name of Cede & Co. (DTC’s nominee). Thereafter, only a DTC participant having an account with the DTC may hold a beneficial interest in a PTC, receiving a credit on DTC’s records. A DTC participant’s position in the securities may represent a combination of beneficial interests for its own account or for the account of one or more of its customers. With respect to the purchase and sale of a PTC, DTC only records the identity of the DTC participants to whose accounts the PTCs are credited, and DTC has no knowledge of the actual purchasers of beneficial interests in the PTC. The DTC participants are solely responsible for keeping account of their holdings on behalf of their customers. It is not possible for a pass through trustee to determine the identities of the beneficial interest holders. Although the pass through trustee can request a DTC position listing that will provide a snapshot as to which DTC participants hold beneficial interests in the PTCs as of a particular date and time, the DTC position listing will not reveal the identities of the ultimate beneficial interest holders. Additionally, as with all securities sold in the capital markets, the actual investors of any particular EETC issuance may change from day to day as a result of secondary trading in the securities.

The Intercreditor Agreement

Intercreditor Agreements utilized in EETCs provide, among other functions, the payment waterfalls for distributions and, most pertinent to the present discussion, the control of remedies in the case of a default by the airline issuer. In the case of a default by the airline issuer, it is a majority of the holders of the PTCs of the most senior class who dictate the exercise of remedies.

IV. Why It Is Difficult to Amend EETC Documentation

Taking into consideration the requirements to amend an Indenture under both the Indenture and the Pass Through Trust Agreement, as well as the difficulty of identifying the holders of the PTCs, let us now walk through the necessary steps to amend an airline issuer’s payment obligations under an Indenture (this could occur in the context of a workout or Section 1110(b) option) or a request for a forbearance:

1. The airline issuer would request the loan trustee to agree to such an amendment.
2. The loan trustee would then notify the subordination agent, which is the registered holder of the promissory notes, acting as agent for the affected class of PTC holders.
3. The pass through trustee of the applicable class would then notify Cede & Co., the registered holder of the PTCs of the relevant class.
4. Cede & Co./DTC would then transmit the amendment request to the DTC participants holding beneficial interests in the PTCs of the relevant class.
5. Each DTC participant would then transmit the amendment request to each person that holds a beneficial interest in the PTCs of the relevant class that are beneficially owned by that DTC participant.
6. Ultimately, then, the pass through trustee of the relevant class would have to obtain consent from each PTC holder of that class. The notice to the PTC
holders asking for the debt relief proves to be quite a difficult feat because, as previously mentioned, the pass through trustee’s only point of contact is DTC and DTC only maintains records of its participants, not the actual PTC holders. Further, even if it were possible to identify every beneficial interest holder in the PTCs of the relevant class, given the nature of secondary trading in DTC securities, the PTC holders of today might not be the PTC holders of tomorrow, and it would be extremely unlikely that each PTC holder would give consent at one time. Finally, the lack of a mechanism to identify PTC holders means that it is necessarily impossible to find a counterparty with whom to negotiate; one would expect that an amendment of debt service payment terms of a EETC would not be a one-way arrangement – the airline issuer would have to give something back in return. Without being able to identify the holders, the airline issuer would be stabbing in the dark with concessions as it proceeds with its request.

We should also note that airline issuers seeking debt relief might also seek a forbearance agreement from the PTC holders of its EETC – that is, an agreement from the investors not to exercise remedies against the aircraft collateral or the airline issuer for a prescribed period. As noted above, the Intercreditor Agreement provides that, generally speaking, a simple majority of the most senior class of EETC investors controls the exercise of remedies, so it is this majority that could conceivably agree to a forbearance. While a smaller group for this purpose is required (i.e., a simple majority of the most senior class), given the reasons identified above, the difficulty in soliciting such a consent would be significant.

The lack of visibility of PTC holders for the airline issuer seeking an amendment or forbearance in a EETC context further complicates the process for seeking such an amendment or forbearance in contrast to what would happen in a private deal. This is because when an airline seeking debt relief goes out to its creditors seeking concessions, it typically follows up with phone calls and in-person meetings with the creditors to explain why its request is appropriate and reasonable, and seeks to pressure the creditors with cajoling rhetoric and personal pleas. Accordingly, this lack of visibility presents a structural impediment in obtaining debt relief.

V. Reasons Why EETC Investors Would Not Grant Relief to Airlines

Even if an airline issuer can identify all affected PTC holders (to effect an amendment to the payment terms) or the holders of a majority of the most senior class (to effect a forbearance), there is little incentive for any PTC holder to grant its consent. The following reasons create such disincentives:

1. The lower LTV ratios and the over-collateralization, which are enhancement features of EETCs, create a disincentive for the holders of the most senior tranche (who control the EETC remedies) to agree to any concessions. At issuance of a EETC, the LTV ratio for the most junior tranche might range from 70% to 80% and the most senior, around 40% to 60%, based on appraised base values. Even with a significant deterioration of aircraft values, this most senior class should be able to achieve 100% recovery in any liquidation of the aircraft collateral. The overcollateralization of this class of investor (which may be enhanced by secondary market purchases of PTCs at discount) has the effect of
making them complacent – happy to ride out the affected airline’s troubles because their exposures would be covered in any aircraft collateral liquidation.

2. The time when an airline EETC issuer is most likely to seek concessions from its PTC holders is when that airline is facing financial difficulties. At such times, in the face of a threat of a default by that airline, our experience has been that credit ratings on that airline’s EETCs get downgraded and many of the original PTC holders trade out from their positions at a discount to hedge funds and other “vulture” investors. These new investors, by virtue of their discounted purchases, have improved LTV ratios and thus are likely to be more content with their collateral position.

3. These hedge funds and other investors are oftentimes viewed as very difficult counterparties from which to obtain concessions.

VI. Reasons Why Airlines Might Not Voluntarily Default on EETC Payments

As previously mentioned, airlines primarily use EETCs to finance their core fleet, often with dozens of aircraft included in a single EETC financing. Because the aircraft in a EETC financing are cross-defaulted and cross-collateralized, if an airline issuer defaults under any of the promissory notes for any tranche, the subordination agent is permitted to exercise remedies under all the promissory notes related to all of the aircraft financed with that particular EETC transaction. Such an ability to effectively ground and repossess a chunk of the airline’s fleet could significantly adversely affect that airline issuer’s ability to operate its business. Further, insofar as the obligations of the promissory notes issued by the airline are direct recourse obligations of that airline, a failed debt service payment by the airline would enable the subordination agent to sue for payment on the defaulted notes, which could result in an attachment on the airline’s valuable cash resources or force the airline into bankruptcy. The risk for that airline related to remedial action and repossession is heightened by the secured party’s rights under Section 1110 of the U.S. Bankruptcy Code or the Cape Town Convention, as applicable.

Finally, even if an airline went into bankruptcy and was of the mindset to substantially reduce its fleet, the airline may be reluctant to voluntarily default under a EETC issuance because it may not want to impair the EETC product for its own future use. EETCs are a very attractive form of financing to airlines. Airlines enjoy pricing advantages on the senior-most tranches of a EETC because of their investment grade credit rating, thanks to the structural enhancements previously discussed. Also, given the capacity of the capital markets into which EETCs are issued, airlines can finance in a single financing upwards of $1.5 billion of aircraft debt, which can cover dozens of aircraft and a wide range of aircraft types, saving the airline’s treasury staff the trouble of going out to large numbers of financial institutions to finance a significant number of aircraft, such as a year’s-worth of new aircraft deliveries. Since the product was developed in 1994, over $100 billion of EETC securities have been issued. A bankrupt airline might be cautious to take any action that could diminish that source of capital by harming the market reputation of EETCs (and therefore potentially diminishing investor appetite) or rating agency views of the product.
VII. Conclusion

Having set forth how difficult it may be for an airline to amend payment provisions under EETC documentation or obtain forbearance relief, as well as the considerations that might affect investor incentives to give consent, one can now see why, despite this unprecedented occasion with material threat of bankruptcy for many airlines, an airline would not seek relief under a EETC by seeking to modify the payment terms or seeking a forbearance, unlike in a private debt context. Even if an airline files for bankruptcy, that airline would have multiple reasons compelling it to continue to perform under its EETCs.

1 This might occur if the airline wants to include its EETCs in a general cash preservation program, and is seeking to defer payment on account of the EETC for a finite period during which it is seeking to ride out whatever economic dislocation has occurred.

2 An airline in this position might be desperately seeking to avoid bankruptcy.

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