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Airline Economics

Re-awakening American

Much has been written about the bankruptcy of American Airlines and its subsequent merger with US Airways – indeed *Airline Economics* has followed this evolution from the 2011 Chapter 11 filing and has also awarded the carrier the 2014 Aviation 100 Debt Deal of the Year award –this article, however, takes a view of the process from a legal perspective.

The story of American Airlines' bankruptcy, subsequent fleet and financial restructuring that culminated in its merger with US Airways is one of success. But it is the airline's refinancing transactions that funded a fleet expansion project that continued throughout bankruptcy, which is the real star turn.

Upon filing for bankruptcy on November 29, 2011, American's aircraft fleet consisted of over 900 aircraft, substantially all of which were leased – often at above-market rates—or encumbered by aircraft mortgages. Consequently, a principal goal of the bankruptcy filing was the restructuring of billions of dollars of obligations under existing aircraft leases and mortgages so as to bring American's obligations more in-line with market rates, permit the return of unwanted equipment, modify lease terms to match current fleet needs and simplify return condition obligations.

At the time of the bankruptcy filing, American was also in the early stages of a substantial fleet renewal program. The airline was scheduled to take delivery of dozens of new aircraft over the coming months with the first such delivery scheduled for only weeks after the petition date. For most of these aircraft, financing was not yet in place. Even where American had entered into financing commitments prior to the bankruptcy, the enforceability of these commitments in bankruptcy was unclear. As a result, at the commencement of the bankruptcy, American was also confronted with the need to raise billions of dollars in new capital to finance the acquisition of new aircraft. No airline (and perhaps no other debtor) has entered bankruptcy with such an ambitious capital raising program.

Nevertheless, American and its advisors – Debevoise & Plimpton, Kelly Hart & Hallman and SkyWorks Capital – achieved both of these goals in a little more than two years emerging from bankruptcy in December 2013.

Since the bankruptcy filing, American has renegotiated or rejected the leases or mortgages on over 400 aircraft, generating savings in excess of $1.8 billion. American also refinanced three existing secured financings aggregating $1.4 billion with above-market coupons that the Bankruptcy Court determined (after lengthy litigation) could be repaid without any make-whole premium. American has, as of the date of emergence, raised approximately $9 billion through capital market, lease and syndicated lending transactions.

"American's fleet renewal program and the related need to raise capital was, of course, well known prior to the bankruptcy filing," says John T. Curry, Chair of Debevoise's Aviation Practice. "Consequently, once the decision was made to file, American's Treasury, Fleet and Legal teams worked, with its outside advisors, to address the airline's fund-raising goals. Inasmuch as new aircraft were scheduled for delivery in the weeks immediately following the commencement of the bankruptcy proceeding, the first order of business was to solidify the commitments of the parties that had agreed prior to the bankruptcy to finance these deliveries through sale-leaseback transactions."

In July 2011, American entered into a sale-leaseback arrangement with AerCap to finance up to 35 737-800NGs, while on November 9, 2011, the airline completed an agreement with International Lease Finance Corporation (ILFC) to purchase and leaseback 15 737-800NGs, which had already been delivered or were scheduled for delivery during 2012.

As it was already a possibility that the carrier could file for bankruptcy in the near future, such lease arrangements were subject to certain terms and conditions.

"In certain transactions American entered into before its bankruptcy filing, counterparties, as a precautionary matter, insisted on provisions intended to allow them to opt out of the transaction upon a bankruptcy filing by American," Richard F. Hahn, Co-Chair of Debevoise's Business Restructuring & Workouts Practice. "The enforceability of these provisions under US bankruptcy law was uncertain. But it never became a significant issue in the bankruptcy. Not only were these provisions not ultimately invoked by any of the counterparties, certain of these parties provided additional new financings to American during the case."

He adds that American's efforts to secure financing arrangements made before filing for bankruptcy were "extremely successful". "The lease financing community was very supportive and American was able to take delivery of the scheduled aircraft without material delay," says Hahn.

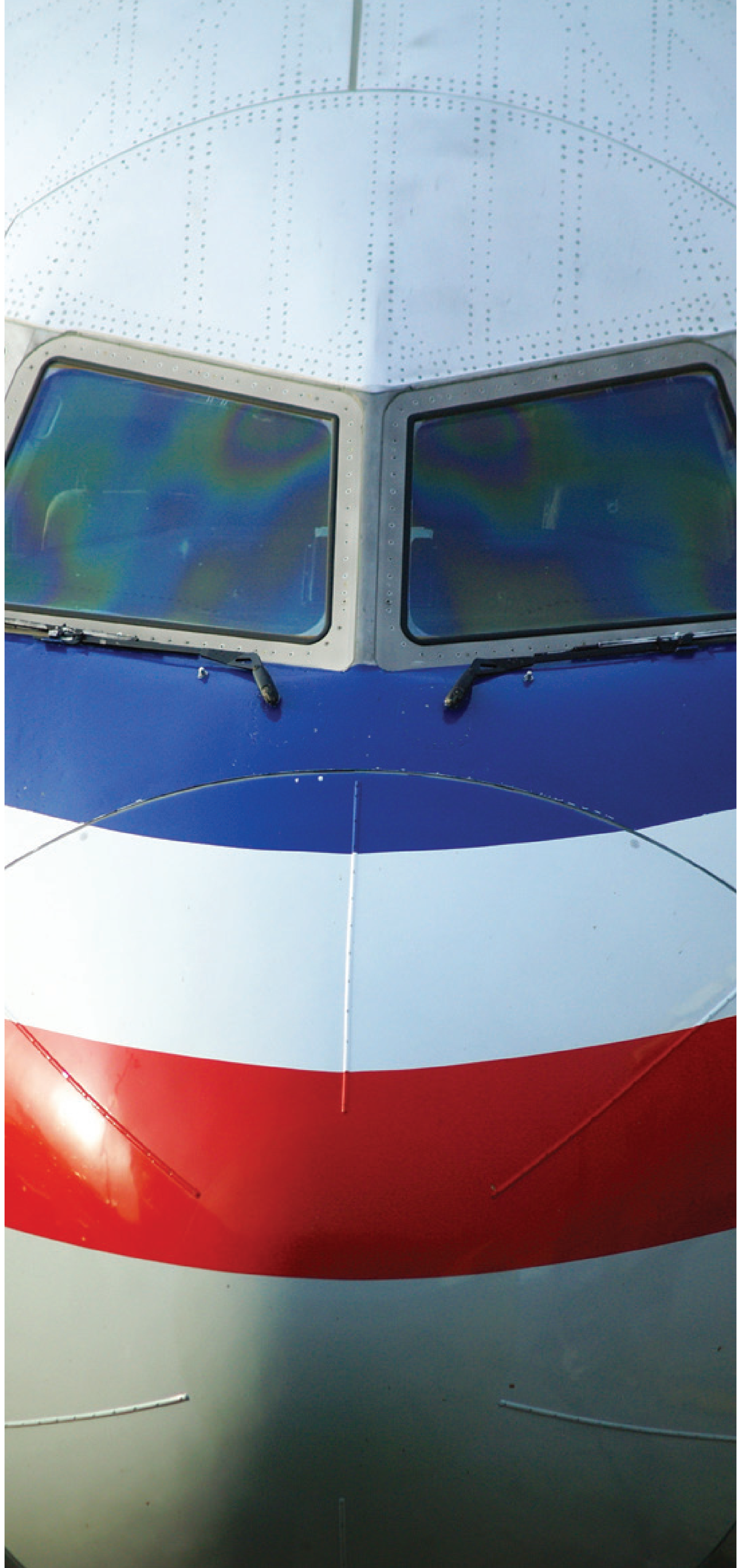
Due to the sheer size of American's fleet renewal project, the carrier also needed to enter into new financings transactions. These included two Enhanced Equipment Trust Certificate (EETC) offerings and a slots, gates and routes (SGR) financing that also included a revolving credit facility.

"The traditional structure of debtor-in-possession (DIP) financings presented an important obstacle to American's capital raising program," explains Hahn from Debevoise. "The vast majority of debtors in bankruptcy raise whatever new financing they will require in bankruptcy in a single financing—typically a credit agreement—entered into at the beginning of the bankruptcy proceeding. These traditional DIP financings contain a variety of terms—most notably, a super priority claim status—which make it difficult, if not impossible, for a debtor to raise additional financing during the bankruptcy without the consent of the original DIP lenders. In order to raise the amount of capital American required and to do so cost effectively, American needed to raise capital in multiple transactions entered into at different times, with different parties and with different structures. To permit this, American and Debevoise worked together to develop non-traditional DIP financing structures that eliminated many of the restrictive terms of traditional DIP financings while at the same time providing the financing parties with the level of security they expected from a debtor. This approach was so successful that American was able to raise a substantial portion of the required funding in capital markets transactions—an option rarely open to debtors in bankruptcy."

On March 16, American Airlines issued a total of $663.378 million EETC with record pricing of 4.000% on the A notes and 5.625% for the B tranche. This was the first EETC offering ever conducted in a bankruptcy, and notwithstanding the bankruptcy, American was able to issue the EETC at market terms and at near-historically low prices.

The $506.7 million Class A certificates, with an expected maturity of 12.3 years and an average life of 8.2 years, were rated BBB+ by Fitch Ratings and BBB- by Standard & Poor's and carry a coupon of 4.000%. The $156.6 million B-tranche, with a final maturity of 7.8 years and average life 5.9 years, carries a B rating from Fitch and S&P at B+ and a coupon of 5.625%. Both coupon and yield priced at par, with an all-in of 4.45%.

Deutsche Bank and Morgan Stanley were lead bookrunners and lead structuring agents. Citi, Goldman Sachs and JP Morgan were active bookrunners. Natixis was co-manager, liquidity provider and the depositary. American Airlines was advised by Debevoise & Plimpton, while Sherman & Sterling advised the underwriters.



The 2013-1 EETC transaction finances 13 aircraft and the notes are secured by eight currently-owned Boeing 737-823 aircraft (seven 2000 vintage; one 2001 vintage) and one currently-owned Boeing 777-223ER aircraft (2000 vintage), each of which aircraft is either unencumbered or is subject to a private mortgage financing, and four new Boeing 777-323ER aircraft delivered to American during the period from April 2013 to July 2013.

This deal represented a number of firsts: the first capital markets financing for the 777-300ER in an EETC; and the first ever EETC issued by an airline in bankruptcy, which was also four times oversubscribed and priced inside of all guidance.

At the end of July 2013, American issued a second EETC that refinanced three previous existing debt deals in the largest single-tranched EETC issued to date. At over $2.1bn this was the largest EETC ever issued either in or outside of bankruptcy in terms of proceeds raised and number of aircraft in the collateral pool (75). This was issued after a lengthy court process in which American successfully defended against litigation brought by the trustees of related existing financings seeking payment of make-whole premiums and after the conclusion of a complex tender offer for the related existing financings.

The $1.408bn Series 2013-2 Class A Certificates are secured against 75 aircraft with an appraised value of $2.6bn as of June 2013. The aircraft portfolio comprises: 41 1999-2000 vintage 737-823s, 14 1999-2001 vintage 757-223s, one 1999-vintage 767-323ER and 19 1999-2001-vintage 777-223ERs– 41 currently-owned Boeing 737-823 aircraft, 14 currently-owned Boeing 757-223 aircraft, one currently-owned Boeing 767-323ER and 19 currently-owned Boeing 777-223ER aircraft.

Proceeds from the issuance repaid three existing financings for the aircraft. These consisted of an EETC entered into by American in July 2009 (2009-1), a secured notes financing entered into by American in July 2009 (2009-2 Secured Notes), and an EETC by American in October 2011 (2011-1).

The A notes priced at 4.95% per annum, with a 9.5 year tenor and a weighted average life of six years. The initial loan-to-value (LTV) ratio was 54.6%. The class A certificates benefit from a dedicated 18-month liquidity facility, provided by Morgan Stanley Bank. Fitch Ratings rated the notes BBB+; Standard and Poor's rated them BBB-.

Deutsche Bank and Morgan Stanley were active bookrunners, with Citi, Credit Suisse, Goldman Sachs, JPMorgan as passive bookrunners.

This transaction was substantially oversubscribed and received over $5 billion in orders. The stable, high-quality orderbook allowed syndicate to tighten pricing by 30bps from the announcement and price 5bps through the tight end of formal guidance with little meaningful drops.

The deal succeeded in replacing over $1.2bn of debt with coupons of 10.375%, 13.00% and 8.625% with new debt with a coupon of 4.95%.

In November 2013, American added a $512 million B tranche to the July EETC (Series 2013-2), which established 2013-2 as the largest EETC on record as well as the second highest B tranche LTV on record.

The B notes carried a coupon of 5.6% per annum, with a 6.6 year tenor and a weighted average life of 4.8 years. The initial loan-to-value (LTV) ratio is 74.5%. The class B certificates have a dedicated 18-month liquidity facility, again provided by Morgan Stanley. Fitch Ratings rated the notes B; Standard and Poor's rated them B+. The notes are secured by the same 75 aircraft as the A notes.

On the B tranche the Joint Structuring Agents were Morgan Stanley and Credit Suisse. Joint active Bookrunners were Morgan Stanley, Credit Suisse, Deutsche Bank, Goldman Sachs, with Citi and JP Morgan as other bookrunners.

This offering also received significant investor demand across both investment grade and high yield accounts, which resulted in $1.5bn of orders.

If that wasn't enough, American added a C tranche to this EETC Series in December, after the airline emerged from bankruptcy. The three-tranched

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EETC is the largest on record in terms of the amount issued.

The $256.1 million C notes carry a coupon of 6% - the third lowest fixed rate coupon for a C-tranche EETC. The notes have a final maturity of 3.1 years and an average life of three years, with an LTV of 84.7%. They were rated B+ by both Fitch and S&P. The orderbook for the C notes was three times oversubscribed with more than 30 accounts submitting orders.

Of all the EETCs American Airlines closed in 2013, the 2013-2 EETC was certainly the most innovative. While the 2013-2 EETC ultimately priced after American's 2013-1 EETC, the 2013-1 borrowed much of the bankruptcy and documentation technology from this transaction. This deal also ultimately refinanced the 2009-1, 2011-2 EETCs and 2009-2 secured notes, which had above-market coupons and which the Bankruptcy Court determined (after lengthy litigation) would be repaid without any make-whole premiums.

American still faced substantial hurdles in its capital raising program – notably its debtor-in-possession/exit financings.

American closed an upsized $2.9 billion slots, gates and routes financing, which included a revolving credit facility available for use upon American's exit from bankruptcy.

In a package of deals, the airline secured a $1bn revolving credit facility and succeeded in repricing and upsizing a term loan to give the airline an ultimate $1.9 billion exit term loan with the low price of 300 basis points. The repricing saves the merged American Airlines Group (AAG) approximately $19 million in interest expense per year.

In June 2013, American Airlines announced a five-year $1bn revolving credit facility and a $1.05bn Debtor-In-

John T. Curry
Chair of Debevoise's Aviation Practice

Richard F. Hahn
Co-Chair of Debevoise's Business Restructuring & Workouts Practice

Possession (DIP) Roll to Exit term loan, secured by slots, gates and routes that support the airline's South American route network (SGR Collateral). Both were arranged by the lead left bookrunner and arranger Deutsche Bank. Joint arrangers and bookrunners were Citi, Barclays, Goldman Sachs, JP Morgan, Morgan Stanley, while joint bookrunners were BAML and Credit Suisse. American was advised by Debevoise, while Sherman & Sterling advised the lenders.

The six-year $1.05 DIP term loan priced at Libor+375 basis points (bps) with a 1.00% floor at 99.5 OID, which traded up to par on the break. Financial covenants on both the term loan and the revolver includes a 1.6x minimum collateral coverage ratio and minimum liquidity of $1.5bn prior to the merger with US Airways and $2bn following the merger.

One month later, American Airlines launched an $850 million add-on to this term loan, again arranged by lead left arranger and bookrunner Deutsche Bank. Citi, Barclays, Goldman Sachs, JPMorgan and Morgan Stanley were joint arrangers and bookrunners, with joint bookrunners BAML and Credit Suisse. The incremental add-on, secured by the same SGR Collateral, was made possible by the market's rebound from the jitters set off in June by concerns over Fed policy. The add-on priced again at Libor+375bps with a 1.00% floor. The financial covenants remained the same.

Finally when American emerged from bankruptcy in December, the DIP term loan was converted in an exit term loan, which was successfully repriced some 100bps tighter. The $1.9bn exit term loan repriced at Libor+300 bps with a 75bps floor.

"With respect to the SGR credit facilities, the deal was structured to convert from a DIP facility into an exit facility upon the occurrence of certain negotiated conditions relating to American's exit from bankruptcy," says Hahn from Debevoise. "At the time of the closing of the SGR facilities, consummation of American's merger with US Airways was not yet certain, and so American had to negotiate and structure dual triggers for this conversion: one trigger that contemplated emergence and merger with US Airways and a second trigger that contemplated emergence as a stand-alone entity. Moreover, the transaction structure and documentation had to be negotiated to include a covenant package with sufficient flexibility to permit American's merger with US Airways and to encompass the scope of American's potential operations, corporate transactions, financing and other activities during both the bankruptcy case and the post-emergence period as either a stand-alone airline or a larger combined entity."

The SGR deal was negotiated prior to both American's emergence from bankruptcy and its merger with US Airways and therefore required anticipatory structuring that would allow sufficient flexibility to permit ongoing bankruptcy activities, the merger, potential combined operations, corporate transactions and financings.

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>
> ***John T. Curry, Chair of Debevoise's Aviation Practice.***

One of the key takeaways from the success of these deals, aside from the professionalism and experience of the American Airlines treasury team, has to be the seemingly unwavering investor confidence that the merger with US Airways would ultimately go-ahead despite all of the delays and impediments to the process, which of course was proven to be correct when the merger was formalised on December 9, 2013. From the legal team's perspective, however, Curry from Debevoise states that the merger was not a significant factor in the success of these deals:

"In fact, with one exception, the possibility of a merger was not a significant factor in the negotiation of the new financings," he says. "The financing transactions American entered into during the bankruptcy were essentially asset driven – aircraft in the case of the EETCs, sale-leasebacks and private mortgage transactions, and slots, gates and routes (SGR) in the case of the syndicated term and revolving credit facilities. The success of these transactions was based primarily on the collateral and structural features of the financings, and less emphasis was placed on the credit of American or its prospects. Once labour issues at American were addressed early in the bankruptcy, it was clear to all that American would continue as an operating entity and that the collateral in these transactions would be core to its business. The financing transactions would have proceeded with or without the merger and, in fact, many of them were commenced and, in some cases, finalized before the announcement of the merger."

He agrees that, from a market perspective, investor confidence in the merger going ahead may have contributed to the favourable pricing. "The SGR financing was, in part, an exception to this pattern," he continues. "Perhaps because of the size of the financing, and because the financing included a revolving credit facility that permitted future additional borrowings, the lenders were concerned about American's balance sheet and prospects post-bankruptcy. While the merger was not determinative of whether the new financings proceeded, some of the optimism concerning American's business prospects post-bankruptcy, taking into account the merger, may have had a favourable impact on the pricing of certain of the transactions."

American, with the assistance of Debevoise, also successfully obtained approval of the Bankruptcy Court for each of these novel transactions.

"The financings American entered into during the bankruptcy were unprecedented in number, variety and size for an airline in bankruptcy," says Hahn from Debevoise. "But American encountered very little resistance to the transactions from the Bankruptcy Court. For each of these transactions, American and Debevoise, through court motions and appearances, explained to the Bankruptcy Court the rationale for the transactions – why American needed the financing, how it would be obtained and at what pricing. The Bankruptcy Court, in each case, agreed that the pursuit of these financings was a sound exercise of American's business judgement and that the transactions were in the best interest of American and its economic stakeholders."

American and Debevoise also worked to enlist the support of the Creditors' Committee in advance of presenting the transactions to the Bankruptcy Court.

"From the start of the bankruptcy, American, Debevoise and SkyWorks worked very closely with the Creditors' Committee and its advisors at Skadden, Arps, Slate, Meagher & Flom, Mesirow Financial and Moelis with respect to American's restructuring and renewal," says Hahn. "American informed the Committee of each potential financing transaction at a very early stage, updating the Committee and its professionals and responding to their questions and concerns as the structure and terms of the transaction were developed. American's mutually-beneficial relationship with the Creditors' Committee was one of constructive cooperation and a factor in the success of American's bankruptcy."

The success of American's financing campaign was a product of the confluence of several factors which might be difficult for another airline to replicate. "It was attributable in significant part to the strength of the financial markets generally and the aviation finance market in particular at the time—strength that appears to be continuing as evidenced by United's 2014-1 EETC and other recent and pending transactions in the aviation sector," says Curry from Debevoise. "In addition, American's success also reflects optimism in the financial markets concerning American's business and prospects post-bankruptcy. Finally, American's achievements during the bankruptcy are a testament to the breadth and depth of relationships American has with the investment community. Over the years, American has developed strong ties with a wide array of funding sources and has often been a pioneer in new financing markets and products. To repeat American's success, another airline would have to build and maintain the same kind of financing network."

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- New financing in bankruptcy, including EETC's, SGR facilities, sale-leaseback transactions and other forms of DIP financing secured by airline collateral.
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- Procedures and issues arising under section 1110 of the Bankruptcy Code.
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KEY CONTACTS

NEW YORK
+1 212 909 6000

Aircraft Finance
John T. Curry III
Paul D. Brusiloff
Le V. Lam
Jaeyong So
Raymond G. Wells

Business Restructuring & Workouts
Richard F. Hahn
Jasmine Ball
My Chi To
Michael E. Wiles

Tax
Vadim Mahmoudov
Burt Rosen
Robert J. Staffaroni

LONDON
+44 20 7786 9000

Geoffrey P. Burgess

MOSCOW
+7 495 956 3858

Alan V. Kartashkin