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**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

In re)	
)	
LATAM Airlines Group S.A., <i>et al.</i> , ¹)	Case No. 20-11254 (JLG)
)	(Jointly Administered)
)	
Debtors.)	Chapter 11
)	

INITIAL OBJECTION AND RESERVATION OF RIGHTS OF SCOTIABANK CHILE TO DEBTORS’ MOTION FOR AN ORDER (I) AUTHORIZING THE DEBTORS TO (A) OBTAIN POSTPETITION FINANCING AND (B) GRANT SUPERPRIORITY ADMINISTRATIVE EXPENSE CLAIMS AND (II) GRANTING RELATED RELIEF AND DEBTORS’ SUPPLEMENTAL MOTION FOR AN ORDER (I) AUTHORIZING THE DEBTORS TO (A) OBTAIN POSTPETITION FINANCING AND (B) GRANT SUPERPRIORITY ADMINISTRATIVE EXPENSE CLAIMS AND (II) GRANTING RELATED RELIEF

Scotiabank Chile (“Scotiabank”), an unsecured creditor of LATAM Airlines Group S.A.

(“Parent”) in these jointly administrated Chapter 11 proceedings, respectfully submits this Initial

¹ The Debtors filing voluntary petitions for relief under chapter 11 of the Bankruptcy Code (the “Chapter 11 Cases”), along with the last four digits of each Debtor’s tax identification number are: LATAM Airlines Group S.A. (59-2605885); Lan Cargo S.A. (98-0058786); Transporte Aéreo S.A. (96-9512807); Inversiones Lan S.A. (96-5758100); Technical Training LATAM S.A. (96-847880K); LATAM Travel Chile II S.A. (76-2628945); Lan Pax Group S.A. (96-9696800); Fast Air Almacenes de Carga S.A. (96-6315202); Línea Aérea Carguera de Colombia S.A. (26-4065780); Aerovías de Integración Regional S.A. (98-0640393); LATAM Finance Ltd. (N/A); LATAM Airlines Ecuador S.A. (98-0383677); Professional Airline Cargo Services, LLC (35-2639894); Cargo Handling Airport Services, LLC (30-1133972); Maintenance Service Experts, LLC (30-1130248); Lan Cargo Repair Station LLC (83-0460010); Prime Airport Services Inc. (59-1934486); Professional Airline Maintenance Services LLC (37 1910216); Connecta Corporation (20-5157324); Peuco Finance Ltd. (N/A); Latam Airlines Perú S.A. (52-2195500); Inversiones Aéreas S.A. (N/A); Holdco Colombia II SpA (76-9310053); Holdco Colombia I SpA (76 9336885); Holdco Ecuador S.A. (76-3884082); Lan Cargo Inversiones S.A. (96-9696908); Lan Cargo Overseas Ltd. (85-7752959); Mas Investment Ltd. (85-7753009); Professional Airlines Services Inc. (65-0623014).

Objection and Reservation of Rights (the “Objection”) to *Debtors’ Motion for an Order (I) Authorizing The Debtors to (A) Obtain Postpetition Financing and (B) Grant Superpriority Administrative Expense Claims And (II) Granting Related Relief* (the “Initial DIP Motion”) [ECF No. 397] and *Debtors’ Supplemental Motion For An Order (I) Authorizing The Debtors To (A) Obtain Postpetition Financing And (B) Grant Superpriority Administrative Expense Claims And (II) Granting Related Relief* (the “Supplemental DIP Motion”, together with the Initial DIP Motion, the “DIP Financing Motions”) [ECF No. 485].²

PRELIMINARY STATEMENT

Scotiabank does not object to the Debtors seeking Debtor in Possession financing and understands the Debtors’ need for liquidity throughout these Chapter 11 proceedings. As a general unsecured creditor of Parent, however, Scotiabank is concerned about the equity conversion feature of the Insider Tranche C Loans (defined below), which provides the controlling shareholders of Parent, solely by virtue of their position as controlling shareholders, with an opportunity to acquire a significant equity stake in the reorganized debtors at a steep discount to the plan value, to the detriment of Scotiabank and the other unsecured creditors of Parent.

BACKGROUND

1. On May 26, 2020, Parent, and the various subsidiaries identified in footnote 1 hereof (collectively, the “Initial Debtors”) filed voluntary petitions for relief under title 11 of the United States Code (the “Bankruptcy Code”). The proceedings in respect of the Initial Debtors are being jointly administered pursuant to that certain order of the Court dated May 27, 2020 [ECF No. 34]. On July 9, 2020, additional subsidiaries of Parent, TAM S.A., TAM Linhas

² Capitalized terms that are not otherwise defined in this Objection have the meanings ascribed to them in the Initial DIP Motion or Supplemental DIP Motion, as applicable.

Aéreas S.A., Aerolinhas Brasileiras S.A., Prismah Fidelidade Ltda., Fidelidade Viagens e Turismo S.A., TP Franchising Ltda., Holdco I S.A., Multiplus Corredora de Seguros Ltda., and Piquero Leasing Limited, filed voluntary petitions for relief under the Bankruptcy Code (the “Subsequent Debtors”, together with the Initial Debtors, the “Debtors”). Pursuant to that certain motion dated July 9, 2020 [ECF No. 482], Parent has sought joint administration of the proceedings in respect of the Subsequent Debtors with those of the Initial Debtors.

2. The Initial Debtors filed the Initial DIP Motion on June 28, 2020. In the Initial DIP Motion, the Initial Debtors sought authorization to enter into a proposed \$2.15 billion debtor-in-possession credit facility (the “DIP Financing Facility”) comprised of three loan tranches; a Tranche A loan of \$500 to \$750 million to be provided by third-party lenders (the “Third-Party Tranche A”), a Tranche B loan of \$500 to \$750 million to be provided by certain government or multinational agencies (the “Governmental Tranche B”), and a Tranche C loan of \$900 million to \$1.15 billion to be provided by certain shareholders of Parent (the “Insider Tranche C”), and the loans made thereunder the “Insider Tranche C Loans”).

3. The Insider Tranche C was the only committed tranche of the DIP Financing Facility as of the date that the Initial DIP Motion was filed. Thus, the Initial DIP Motion sought approval only of the Insider Tranche C and authorization for the Initial Debtors to obtain the Tranche C financing “substantially in the form of the Final DIP Order pursuant to the DIP Loan Documents”, including borrowings under the Insider Tranche C being conditioned on receipt of satisfactory commitments for the Third-Party Tranche A and/or the Governmental Tranche B on terms substantially in accord with the description in the Initial DIP Motion. *See* Initial DIP Motion ¶ 6.

4. By notice dated June 30, 2020, a hearing was scheduled in respect of the Initial DIP Motion for July 28, 2020, and an objection deadline was set for July 13, 2020. See *Notice of the Debtor's Motion for an Order (I) Authorizing the Debtors to (A) Obtain Postpetition Financing and (B) Grant Superpriority Administrative Expense Claims and (II) Granting Related Relief* [ECF No. 423].

5. Subsequently, on July 7, 2020, the Court entered a *Stipulated Scheduling Order* [ECF No. 465], approving a stipulation between the Debtors and the Official Committee of Unsecured Creditors (the "Committee") establishing an initial objection deadline of July 13, 2020 for all parties intending to object to the Initial DIP Motion (*See Stipulated Scheduling Order* ¶ 3) and a final objection deadline of July 20, 2020 for all parties that had timely filed an initial objection. *See Stipulated Scheduling Order* ¶ 6.

6. On July 9, 2020, the Debtors filed the Supplemental DIP Motion seeking to add the Subsequent Debtors as Guarantors under the DIP Financing Facility. *See Supplemental DIP Motion* ¶ 7. The Supplemental DIP Motion also seeks a final order (the "Final DIP Order") approving a \$1.3 billion Third-Party Tranche A of the DIP Financing Facility. *See Supplemental DIP Motion* ¶ 6. Pursuant to the Supplemental DIP Motion, the borrowings under the Insider Tranche C of the DIP Financing Facility are conditioned upon the Court approving the Third-Party Tranche A of the DIP Financing Facility. *See Supplemental DIP Motion* ¶ 36.

7. By the DIP Financing Motions, the Debtors seek to enter into an aggregate \$2.45 billion secured superpriority multi-draw term loan facility comprised of two tranches: the Third-Party Tranche A consisting of commitments of \$1.3 billion provided by Oaktree Capital Management L.P., and the Insider Tranche C consisting of commitments of \$900 million to \$1.15 billion provided by Qatar Airways Investments (UK) Ltd. and Costa Verde Aeronáutica

S.A., both existing shareholders of the Debtors.³ *See* Initial DIP Motion ¶¶ 4–5; Supplemental DIP Motion ¶ 5.

8. The Court has scheduled a final hearing on the Initial DIP Motion on July 28, 2020, at 10:00 a.m. to hear objections to the Insider Tranche C of the DIP Financing Facility. Additionally, the Court has scheduled a final hearing on the Supplemental DIP Motion for July 30, 2020, at 11:00 a.m. to consider entry of the Final DIP Order.

INITIAL OBJECTION AND RESERVATION OF RIGHTS

9. As currently drafted, the Insider Tranche C of the DIP Financing Facility will provide the Debtors’ controlling shareholders with an exclusive opportunity to acquire the equity of the reorganized Debtors at a substantial discount to plan value. *See* Initial DIP Motion ¶ 34. In exchange for subscribing and participating in the Insider Tranche C of the DIP Financing Facility, the Insider Tranche C lenders will receive, upon exercise of the conversion option, an interest premium on the then outstanding balance of the Insider Tranche C Loans, of the greater of (a) 47% or (b) an amount that would correspond to the discount to Final Plan Valuation provided to any other parties in any other equity issuance. In either case, this premium will be in addition to the 14.5% “payment-in-kind” interest rate applicable to the Insider Tranche C Loans. *See* Initial DIP Motion ¶ 34. This means, assuming an effective date of a plan of reorganization for these Debtors of one-year from the date that the Insider Tranche C Loans have been drawn in

³ Pursuant to Section 11.02(b)(ii) of the DIP Credit Agreement, the Insider Tranche C initial lenders may assign the Insider Tranche C loans to Tranche C Eligible Assignees, consisting of Wholly Owned Subsidiaries of such Tranche C Lender, any holder of 10% or more of the Capital Stock of the Borrower as of the Petition Date or any Affiliate thereof, with respect to Qatar Airways, Qatar Group and any of Qatar Group’s Wholly Owned Subsidiaries, with respect to Costa Verde, its Affiliates and, as to Costa Verde and any such Affiliate assignee, to entities controlled by or under common control, of the Cueto Group, the Amaro Group and/or the Eblen Group, and with respect to the Amaro Group and the Eblen Group, to entities which are part of the Amaro Group and Eblen Group definitions as provided in the DIP Credit Agreement. *See* Supplemental DIP Motion, Ex. B-1 at 123.

full, the Debtors' controlling shareholders will be able to acquire at least \$1,610,500 worth of reorganized equity of Parent for each \$1,000,000 of Insider Tranche C Loans advanced.

10. The terms of the Insider Tranche C of the DIP Financing Facility are beyond the bounds of reasonableness. The Debtors' attempt to provide their controlling shareholders with the exclusive opportunity to acquire reorganized equity at such a substantial discount to plan value is perhaps an indication that these entities, whose ownership, management and operations are all located outside of the United States, do not yet fully appreciate their responsibilities as debtors-in-possession in chapter 11 proceedings under the U.S. Bankruptcy Code. Indeed, the debtor in possession's fiduciary duty runs to the bankruptcy estate, and by extension all creditors. *See In re Penick Pharm., Inc.*, 227 B.R. 229, 232–33 (Bankr. S.D.N.Y. 1998).

11. It is well established that pre-bankruptcy equity holders may not contribute new capital and receive ownership interests in a reorganized entity when the opportunity is given to the pre-bankruptcy equity holders solely on account of their pre-existing equity interests. *See Bank of Am. Nat. Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 454–56 (1999). In order to not violate the absolute priority rule, a debtor's pre-bankruptcy equity holders cannot be provided an opportunity to acquire the reorganized equity of the debtor without market testing the subscription price in order to assure that fair value is paid. *See id.*; *see also In re RAMZ Real Estate Co., LLC*, 510 B.R. 712, 718–19 (Bankr. S.D.N.Y. 2014); *H.G. Roebuck & Son, Inc. v. Alter Communications, Inc.*, 2011 WL 2261483, at *7 (D. Md. June 3, 2011).

12. While not contemplated as part of a proposed plan of reorganization, the equity subscription contained in the Insider Tranche C of the DIP Financing Facility has the same effect and at a much earlier point in the proceeding, before the Court can effectively evaluate the impact to creditors. Moreover, as the terms of the conversion of the Insider Tranche C Loans are

clearly at a substantial discount to any proposed plan value, there is no need for a market test to determine that the equity conversion option being afforded to Parent's controlling shareholders is well below fair value for the reorganized equity. Moreover, it is clear that the equity conversion option is being provided to the controlling shareholders solely on account of their existing equity interests.

13. Postpetition DIP financings cannot dictate the terms of a Chapter 11 plan. Indeed, “[t]he bankruptcy court cannot, under the guise of section 364, approve financing arrangements that amount to a plan of reorganization but evade confirmation requirements.” *In re Mid-State Raceway, Inc.*, 323 B.R. 40, 59 (Bankr. N.D.N.Y. 2005); *see also In re Braniff Airways, Inc.*, 700 F.2d 935, 940 (5th Cir. 1983) (explaining that debtors and bankruptcy courts should not be able to “short circuit the requirements of Chapter 11 for confirmation of a reorganization plan” by entering into postpetition transactions that establish the terms of the plan *sub rosa*). While courts recognize that lenders often exact favorable terms in exchange for postpetition financing, some of which may be permitted as a reasonable exercise of the debtor's business judgment, bankruptcy courts “do not allow terms in financing arrangements that convert the bankruptcy process from one designed to benefit all creditors to one designed for the unwarranted benefit of the postpetition lender.” *In re Defender Drug Stores, Inc.*, 145 B.R. 312, 317 (B.A.P. 9th Cir. 1992).

14. It appears the Debtors seek to establish the terms of a plan, one which would ensure that controlling shareholders remain in control of the Debtor entities and acquire that control at a bargain price. Furthermore, it does so without affording creditors the benefit of the protections provided by the Bankruptcy Code through the procedural safeguards of disclosure, solicitation, and acceptance. By embedding the Insider Tranche C conversion option into the

DIP Financing Facility, the Debtors are placing an impeding arms-length third-party competition for alternative sources of financing, including potential exit financing, during the process of negotiating a reorganization plan that prioritizes creditor recoveries.

15. The reorganized equity of an insolvent debtor belongs, in the first instance, to a debtor's fulcrum creditors. It should not be bartered away without such creditors' consent to a debtor's controlling shareholders in the early stages of a case at such a steep discount to plan value.

CONCLUSION

WHEREFORE, for the foregoing reasons, and without prejudice to Scotiabank's rights to supplement this initial objection with other and further objections to the proposed DIP Financing Facility, Scotiabank respectfully requests that this Court deny the Debtors' request to provide the Insider Tranche C equity conversion option of the Insider Tranche C Loans, and grant such other and further relief as the Court deems just and proper.

Dated: July 13, 2020
New York, New York

Respectfully submitted,

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