Aviation briefing

Come hell or high water?
Rent obligations overturned in the High Court

The decision of the Commercial Court in London in *ACG Acquisition XX LLC v Olympic Airlines SA* in a judgment delivered on 21 April 2010 will have sent shockwaves through the operating lessor community. The court refused to grant summary judgment to the lessor (A) in a claim for unpaid rent where it was arguable that the aircraft had not been delivered to the lessee (O) in the required condition.

What were the facts?

In April 2008 O performed an initial inspection of the Boeing 737 aircraft in respect of which it had agreed outline terms for leasing from A (but had not yet entered into a lease agreement) and found some problems with the airframe. These were notified to A which agreed to have them fixed. In May 2008 the lease agreement was signed and further inspections were performed. O oversaw the “C Check” on the aircraft performed for A by an independent maintenance contractor. In August 2008 the aircraft was delivered in Singapore, having been further inspected by O and been subject to a test flight, and an acceptance certificate was signed by O accepting the aircraft. This acceptance certificate (AC) provided that the aircraft was accepted by O and was in accordance with the terms of the lease, subject to certain specified discrepancies, which were listed.

The aircraft was then operated for approximately 14 days at which time it was noted that the spoiler cables were corroded and the aircraft had to be withdrawn from service. These cables had previously been noted by O during its earlier inspections in April 2008 as requiring rectification work but had not been identified in the AC as discrepancies. Additional defects were then uncovered and the Greek civil aviation authority withdrew the aircraft’s certificate of airworthiness as a result (having previously issued this certificate).

It became clear as a result of investigation that the aircraft was worth less than it would cost to make such repairs as would enable it to regain its certificate of airworthiness. O never paid any rent or maintenance reserves and eventually A issued proceedings for recovery of rent and damages. O issued counter-proceedings alleging that A was in breach of the lease agreement as a result of the aircraft not being in the required condition at delivery and claiming damages.

A contended that the AC signed by O prevented O from claiming breach of contract and that the terms of the lease requiring rent to be paid should override O’s claim. In turn O contended that its claim against A was sufficient to defeat A’s claim against it on the basis that its entitlement, in return for its agreeing to make payment of rent, was for A to deliver an aircraft in an airworthy condition and not for mere possession of an aircraft.

What was the judgment?

(1) It would be remarkable for O to be precluded from maintaining its claim against A. Clear words in the lease agreement would be required to release A from liability for the aircraft not being airworthy. O's acceptance of the aircraft was only conclusive proof that it had accepted an examined and investigated aircraft, and that the aircraft and documents were satisfactory. The lease agreement did not exclude A's liability to provide an aircraft in compliance with its obligation to ensure it was airworthy, as it could have. Accordingly, O was entitled to maintain its claim that A had failed to deliver an aircraft in a condition that was in accordance with the lease agreement.

(2) The instant case was extreme. The failure to deliver an aircraft in airworthy condition was fundamental. O had a good arguable case that A had fundamentally failed to perform its side of the lease agreement. Moreover, the obvious purpose of the lease was not to give O possession of an aircraft but use of a useable aircraft. Thus, if O was obliged to pay A rent, its claim in damages would increase correlatively.

What implications does this result have for operating lessors?

Although the facts of this case are fairly extreme in that the time between the aircraft's delivery to O and its withdrawal from service was very short, this is nevertheless a judgment with worrying implications for operating lessors as it overturns a number of established expectations.

1. The lease provided that the aircraft was delivered to O (using industry standard wording): "as is where is and in the condition specified in Schedule 2", meaning that O took the aircraft as it found it, having had the opportunity to inspect the aircraft (which it did) and that before O was required to accept the aircraft that it had to be in the agreed condition. The assumption hitherto has been that the acceptance of an aircraft by the signing of the acceptance certificate confirms the lessee's agreement that the aircraft is in the delivery condition and that, if there are any discrepancies noted on the certificate for the lessor to fix or to pay to have fixed and the lessor breaches this undertaking, that the lessee's remedy is a claim for damages rather than to stop paying rent. This judgment provides that where the aircraft is not airworthy, this is no longer the case.
2. The defects that led to the revocation of the aircraft's certificate of airworthiness were not listed on the acceptance certificate and, even though some had allegedly previously been identified by O and one might have expected O to have specifically checked the aircraft for their rectification, this did not prevent O from defeating A's claim.
3. This result raises issues over the effectiveness of the "hell or high water" clause in an aircraft operating lease, the clause requiring payment of rent by the lessee no matter what. In this lease the clause provided that rent payments were unconditional regardless of a range of matters including the airworthiness of the aircraft. Whilst it has been recognised for some time that this clause may not always deliver what it promises there will be shock that lack of airworthiness now appears as a justification for a lessee to stop paying rent. This will be of particular concern as an operating lessor's obligations to continue making loan repayments, where the aircraft is financed, does not cease when a lessee stops making its rental payments.
4. Under the lease O acknowledged that A gave no representations and warranties as to the condition of the aircraft, including as to its airworthiness and confirmed that O had not relied on any representation or warranty given by A in entering into the lease. Notwithstanding this clause, which again is a standard clause in aircraft operating leases, the judgment specifically referred to the aircraft being delivered in an airworthy condition as being fundamental.

What solutions might there be?

The judgment makes it clear that had the lease been drafted differently O might well not have succeeded. This does at least offer some comfort to operating lessors in the future. What appears to be required is very clear wording in the acceptance certificate that a lessee confirms that, notwithstanding its acceptance of the aircraft and confirmation that the aircraft is in the required condition, the aircraft may not in fact be in such condition and that it will continue to pay rent if this is in fact the case.

Leave to appeal was not granted but an application may be made to the Court of Appeal in London by A.

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