AIRCRAFT REDELIVERY DISPUTES 'TAKING-OFF'

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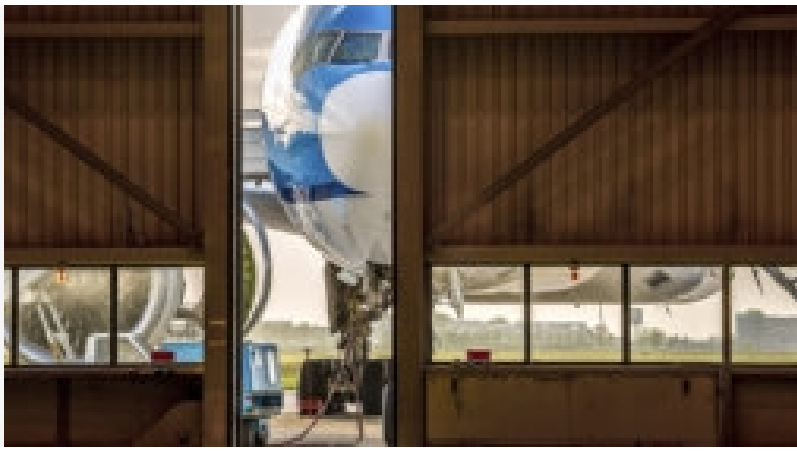

AIRCRAFT REDELIVERY DISPUTES ARE BECOMING MORE FREQUENT, INTENSE AND, AS A CONSEQUENCE, MORE COSTLY.THEY FREQUENTLY ARISE FROM A MISALIGNMENT OF INTERESTS UNDER THE STANDARD OPERATING LEASE STRUCTURE, TECHNOLOGICAL ADVANCES RENDERING EXISTING AIRCRAFT OUT-DATED AND CHANGING MARKET CONDITIONS.THE TENDENCY IS MORE PREVALENT IN CONNECTION WITH WIDEBODY AIRCRAFT.

In this briefing we discuss the most common redelivery disputes, why they arise and how they can be dealt with in commercial negotiations.Aircraft redelivery is a minefield. It becomes even more contentious if new employment for aircraft cannot be found.Operating lease terms vary in length. For new wide-bodies, 10 to 15 year leases is not unusual. Over such a long period, technological advancement may mean that previously sought-after models are less versatile, cost-efficient and environmentally friendly. The business model of the industry, together with savage competition, adds to the tension.The non-alignment of the interests of operators and lessors can result in the return condition of the aircraft coming under particular scrutiny on redelivery.

THE REDELIVERY CONDITION

Generally speaking, to achieve readiness for redelivery, the lessee must put the aircraft in a condition which meets the requirements set out in the lease, i.e. the 'redelivery condition'.Precisely what this means will vary.The redelivery condition might include, for example, the suitability and back-to- birth traceability of 'all' aircraft components and other relevant documents.Alternatively, it might only concern catalogue-listed ('AIR') components and documents required for airworthiness. The redelivery condition will, however, rarely, if ever, be solely contingent on airworthiness.In stringent cases the lessee might arguably be prevented from redelivering if there are no 'repair or indemnify' provisions at the lessee's option (a frequent occurrence). This contrasts with the position in the shipping sector where the remedy for redelivery in sub-par condition is generally damages rather than rejection.Whilst the lessee may seek to rely on the 'insignificance' of non-compliance to assert that defects should not prevent redelivery, whether such reliance is well- placed will be a question of degree, contract drafting and possibly industry practice. Non-materiality is not the type of argument that most lessees are happy to rely on.We have come across situations where redelivery has been rejected based on dirty carpets, damaged bathroom mirrors or scratched galley surfaces. Whilst such arguments are of disputed merit, they can have considerable sway in commercial discussions with the threat of daily 'escalating rent' looming for late redelivery. As an aside, in relation to the 'escalating rent' (also commonly known as 'penalty rent' in the industry) there are serious questions as to whether such provisions are in fact enforceable under English law. In the right circumstances, for example, there are likely to be good arguments that a 200% penalty rent provision is not enforceable. We will be discussing this subject in more depth in an upcoming briefing.

DOCUMENTARY COMPLIANCE

Apart from the physical condition of the aircraft, close attention should also be paid to the documentary requirements for redelivery.For instance, a stipulation for parts and documents to be EASA 'compliant' or 'equivalent', may rise to questions as to whether documentation should be in the specific 'EASA format', or whether an equivalent form from a recognised aviation authority would suffice. The implications of such a distinction can be significant in terms of redelivery time and cost.

DISCRIMINATION

An age-old concern of lessors is that operators take redelivery as an opportunity to cannibalise aircraft to divest older parts. This may be addressed by inserting 'as good or better' provisions in leases. However, is the bench-mark for the test the 'original' part, or the 'replacement' part? If the latter, this would impose an 'ever-improvement obligation' on the operator, which may not be what was intended. A further mechanism for lessors to ensure fair treatment is the imposition of anti- discrimination provisions. Under English law the anti-discrimination clause would prevent the lessee from treating the return aircraft in a substantially worse manner than 'other aircraft' in its fleet. However, this does not necessarily rule out any discrimination at all. As long as the operator has an objective justification for a particular decision, discrimination arguably does not apply. The question is: "what is 'objective justification'"? For example, should an operator be required to embody an optional service bulletin relating to operating conditions not applicable to that aircraft whilst employed by the operator? Should an operator be required to replace a fully- functioning component with an upgrade detailed in an optional service bulletin if such is only installed on other aircraft on an attrition basis? Does the proximity of the lease expiry amount to objective justification to discriminate? Depending on the circumstances, this is certainly arguable. In any event, the policing of discrimination provisions is frequently hampered by limited disclosure obligations imposed in the lease. Such issues are best addressed at the lease drafting stage, rather than redelivery, as is frequently the case.

PREVENTION

A legal concept increasingly encountered in the aviation sector in the context of late redelivery rent claims is the 'prevention principle'. The prevention principle, well known in the construction arena, has been described as the 'silver bullet' to kill liquidated damages claims (which, it is submitted, escalating rent provisions essentially are). The essence of the prevention principle, is to avoid a party profiting from its own wrongful conduct. The prevention principle may operate to defeat liquidated damages claims in circumstances where the lessor prevents the lessee from achieving redelivery by the redelivery date if the an act of prevention is not addressed by a corresponding extension of time provision. Thus, if the lessor causes critical delay to redelivery, and the lease does not provide for an extension of time to cover the particular eventuality, then: (i) the obligation to redeliver by the redelivery date is no longer applicable, but is replaced with an obligation to redelivery within a 'reasonable time', whatever that means; (ii) liquidated damages can no longer be applied; and (iii) the lessor is only able to claim such damages as can be proved.

Further, once lost the entitlement to claim liquidated damages is lost forever.The prevention principle has frequently taken people by surprise. Indeed, as stated by Lloyd LJ: *[…] I was somewhat startled to be told […] that if any part of the delay was caused by the employer, no matter how slight, then the liquidated damages clause in the contract […] becomes inoperative*."1 It is worth noting that acts of prevention may include agreed variations, such as the agreed embodiment of additional, non-mandatory, service bulletins.The prevention principle is a matter that can readily be dealt with at the drafting stage.

CONCLUSION

Given the risks and costs associated with aircraft redelivery, careful thought should be put into drafting the redelivery conditions and procedure during contract negotiation to minimise misinterpretation and disputes between lessees and lessors.For parties preparing for redelivery, it is never too early to start looking at the lease agreement to ensure that the aircraft and documents are maintained and kept in- line with the contractual requirements. Identification of a potential problem early on could save the parties both time and costs in the redelivery process. As for parties that are about to enter into a new lease, attention should be drawn not only to the commercial terms but also the redelivery conditions to ensure that the terms are as clear and unambiguous as possible.

ABOUT US

Watson Farley & Williams ("WFW") is a market leading law firm for the aviation industry, working across all segments of the sector and providing a full range of legal services, including in relation to dispute resolution, corporate, finance, tax, employment and regulatory law.

Our dispute resolution lawyers have significant aviation experience including pursuing claims under finance and commercial documents, lease terminations, grounding aircraft, recovery, repossessions and insolvency situations.

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