HOW TIGHT ARE YOUR DELIVERY CONDITIONS? MITIGATING RISKS FOR LESSORS IN AIRCRAFT DELIVERY PROVISIONS

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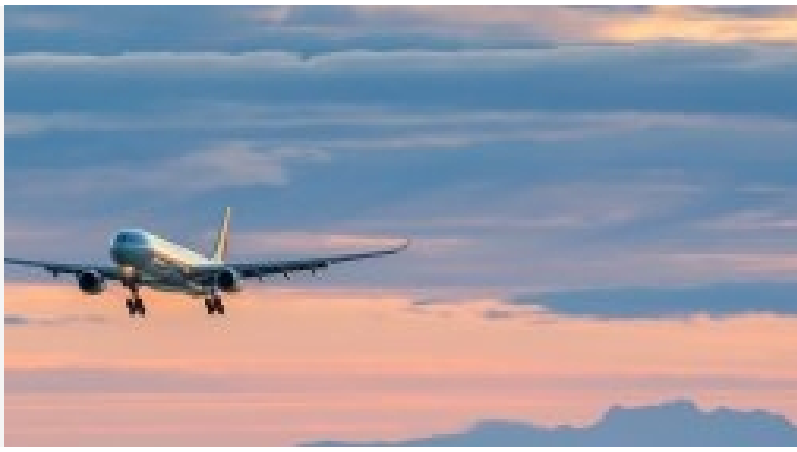

The recently decided case (the "Case") between Peregrine Aviation Bravo Limited (the "Lessor" among others) as claimant and Laudamotion Gmbh (the "Lessee" among others), as defendant is an extensive and detailed judgment. Its circumstances will be familiar to many lessors and airlines as the dispute has its genesis in negotiations over rent deferrals and the delivery of remarketed/second-hand aircraft scheduled during the first few months of the Covid-19 pandemic. The judgment considers a number of issues in dispute, but the most striking is that the court rejected the Lessor's claim that the Lessee was in breach as it failed to accept the aircraft on delivery where the former believed it had validly tendered such. Although potentially adverse for lessors, the detail provided in the judgment offers them some consolation as it provides them with an opportunity to assess their own standard forms and how to potentially ensure a different outcome in similar circumstances.

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In this article, we take the opportunity to discuss the background to delivery provisions in leases and the facts and rulings of the case. We conclude with some considerations, including suggestions for modifications to standard form leases which may mitigate the risk of a lessor finding itself on the wrong side of a judgment in a similar scenario.

DELIVERY OF AN AIRCRAFT

Every lease, operating or finance, contains a provision setting forth the agreement between lessor and lessee for delivery of an aircraft. Whilst the leasing industry has streamlined this process over the years, it remains complex. For example, an aircraft often needs maintenance before, or between, redelivery from the original airline/lessee and delivery to the new airline/lessee. Lessors will aim to shorten this period of time as much as possible, with redelivery and new delivery potentially occurring simultaneously.

THE ANATOMY OF A DELIVERY CLAUSE

A standard delivery clause will provide that, provided the lessor tenders the aircraft for delivery in the agreed condition (which includes the provision of the correct technical documents) at the agreed location and the agreed time, the lessee is contractually obliged to accept the aircraft and execute the acceptance certificate. Due to the potential complexities of delivery however, a delivery clause often provides further detail in these respects:

i) the parties will agree a target delivery date, usually a month during which delivery is anticipated to occur and, in the event of delay due to the aircraft not being in the delivery condition, a longstop date pursuant to which, if the aircraft is not delivered by such, either party can terminate (provided either is not in breach). The remedy for the lessee is simply a right to terminate (a "walk away" right). The lessor would not typically accept liability for the airline's losses and the airline would not be entitled to any financial compensation;

ii) the parties often agree to cooperate, consult, commit to use best efforts or to act in good faith with respect to various matters, such as those which cannot be ascertained with a sufficient level of certainty when the contract is entered into; and

iii) the parties often agree a materiality threshold with regards to the delivery conditions. If the aircraft does not comply with the delivery conditions, but the deviation is immaterial or can be easily rectified, the lessee is often obliged to accept the aircraft notwithstanding such deviation, but the lessor agrees to pay financial compensation to the lessee or the item is corrected at a later date after delivery.

These complexities and uncertainties can often be a source of disputes, which are nevertheless usually resolved commercially before going to trial. In the Case however, given the overbearing pressures and impact of the Covid-19 pandemic, the delivery clause in the lease (the "Lease") between the Lessor and the Lessee in respect of the A320 bearing manufacturer's serial number 3361 (the "Aircraft"), which was one of the aircraft and leases which formed part of the claim by the Lessor, came under particular scrutiny.

THE CASE

The facts of the Case, abbreviated for our purposes and focussed on the Lease and the Aircraft, are thus:

i) The Lease provided for the following:

a. the delivery of the Aircraft was to occur during March 2020. The Lessor agreed to notify the Lessee "in a timely manner" of the precise date on which it expected delivery of the Aircraft (the "Delivery") to the Lessee to occur (the "Delivery Date"), and the Lessor agreed to "consult with the Lessee" prior to making a determination of such precise Delivery Date, as well as to provide "Lessee with reasonable notice in respect of such date";

b. the location of Delivery would be at the maintenance facility where the Lessor was also to accept redelivery by the previous airline/lessee (the "Prior Lessee"). One of the conditions to the Lessor's obligation to Delivery was that such redelivery had occurred;

c. the Lessor agreed to notify the Lessee if Delivery was to be delayed beyond the longstop date (the "Final Delivery Date"), in which case either party could terminate within 10 business days on essentially a no fault/no liability basis. If neither party exercised such termination right, it was waived and the Lessor and Lessee agreed to cooperate to minimise the delay beyond the Final Delivery Date;

d. the Lease contained detailed provisions with respect to the required condition of the Aircraft at Delivery, as well as the technical records (the "Delivery Conditions"). If the Aircraft deviated from any material Delivery Condition, the Lessee was not obliged to accept Delivery unless the Lessor corrected such at the Lessor's cost. If said deviation had not been corrected by the Final Delivery Date, the parties had the same rights as described above. If any deviation was immaterial, the Lessee was obliged to accept Delivery and the Lessor would pay the Lessee appropriate financial compensation;

e. the Lease contained standard documentary conditions precedent to be delivered by the Lessor to the Lessee as a condition to the Lessee's obligation to accept Delivery including an export certificate of airworthiness (the "ECoA"); and

f. if the Lessee failed to accept Delivery within five business days of the Aircraft being validly tendered, an event of default would occur.

In all material respects, the above described provisions of the Lease could be described, as far as such could be determined from those excerpts contained in the judgement, as market standard;

ii) The parties began preparing for Delivery during late 2019 at the Delivery Location, before any news of Covid-19 had broken. The Aircraft was to undergo maintenance so it was in the Delivery Condition for March 2020 (the month originally scheduled for Delivery) so the Lessee could take Delivery well in advance of the anticipated profitable summer of 2020;

"In amongst the claims of the Lessor and the counterclaims of the Lessee, the judgment provides findings on a number of issues."

iii) By March 2020, the Lessee had examined the Aircraft's technical records and had provided the Lessor with a list of discrepancies in respect thereof, the Aircraft was painted in the Lessee's livery and the Aircraft was available for physical inspection by the Lessee. The parties had also exchanged conditions precedent documents and preparations had been made for resolution of discrepancies in the technical records. Correspondence between the parties indicated each had contemplated a potential delivery date of 23 March, with a demonstration flight shortly before. However, by this time of course, the pandemic had emerged, the impact on the aviation industry was comprehensive, and the outlook very uncertain;

iv) From mid-March 2020, there followed extensive correspondence between the parties. The Lessor insisted the Lessee should take Delivery, albeit it was willing to agree potential deferrals of rent. The MRO confirmed it could facilitate sufficient access at the delivery location to accomplish Delivery. Correspondence from the Lessee indicated a preference to delay Delivery, mainly due to the extreme level of uncertainty;

v) By the end of March 2020, correspondence suggested there was potentially an understanding that Delivery would occur during June 2020 and evidence demonstrated the Lessor continued to prepare for Delivery. During late April 2020 however, the Lessee notified the Lessor in writing that it would not accept Delivery, albeit the Lessee contended during the hearing that this was stated as part of a wider negotiation strategy with respect to all the aircraft at said time on lease by the Lessee from the Lessor and the co-claimants and further aircraft which were due to be delivered. The Lessee instructed consultants working on the delivery process to cease work. The Lessor responded that it would tender the Aircraft for Delivery and served a notice on the Lessee on or around 1 May 2020 that said date would be 7 May 2020; and

vi) The Aircraft was tendered for Delivery on 7 May 2020, but it was not accepted by the Lessee. The Lessor therefore declared an event of default under the Lease as a result of the failure of the Lessee to take delivery of the Aircraft when validly tendered, which the Lessee contested, including on the basis that, as was required pursuant to the Lease:

a. the Lessor had not consulted with the Lessee prior to its determination of the Delivery Date;

b. the Lessor had not provided reasonable notice of the Delivery Date; and

c. there were material deviations with the Delivery Conditions, including due to the absence of the ECoA.

In amongst the claims of the Lessor and the counterclaims of the Lessee, the judgment provides findings on a number of issues, including on the following points relevant for when considering delivery clauses in leases and also the approach a lessor might take if it fears a lessee may renege on a commitment to take delivery of an aircraft:

i) **Had the Lessor performed its obligation to consult with regards to, and provide reasonable notice of, the Delivery Date as required pursuant to the Delivery Provisions and was it required to?** The court held that the Lessor had not provided the Lessee with reasonable notice of the Delivery Date. The Lessor seemed to accept that the period of notice (a matter of days) was very short, but as the Lessee had disengaged from the delivery process, had ceased to cooperate on Delivery, and it had stated its intention not to take Delivery, the Lessor contended it was irrelevant whether the notice period was reasonable. Likewise, the Lessor claimed this as a basis for failing to consult the Lessee with regards to the Delivery Date. These claims by the Lessor were rejected by the court. The court held that the Lessor was obliged to consult the Lessee on this matter and the Lessee was entitled to reasonable notice. That the Aircraft had been ready for Delivery, and was originally envisaged being delivered, in March 2020 was irrelevant and this did not constitute any constructive notice that satisfied the requirement for reasonable notice of the Delivery Date. Furthermore, the lack of cooperation from the Lessee was irrelevant. There was no express duty to cooperate and the court will only imply such where necessary. The Lease required the Lessor to consult and provide reasonable notice of the Delivery Date to provide the Lessee with the opportunity, but not the obligation, to perform pre-Delivery tasks, such as a demonstration flight. It mattered not whether the Lessee was likely to exercise these rights, or whether it showed any intention to exercise them or not; and

ii) **Was the Lessee required to accept delivery notwithstanding the Lessor had failed to provide all documents required as set forth in the Delivery Conditions, in particular the ECoA?** The Lessor contended that the obligation to provide documents such as the ECoA was to be performed on the Delivery Date and since the Lessee had expressed its intention not to accept the Aircraft, there could be no Delivery Date and there was no requirement for the Lessor to provide such documents. That such documents were not provided would in circumstances with a cooperative lessee constitute a material non-compliance, but in this situation such deviation was non-material, because the documents were capable of being provided, and would have been if the Lessee had been cooperative. The court rejected this claim by the Lessor. This was on the basis that the intention was clearly that the provision of these documents was a condition to the Lessee's obligation to accept the Aircraft. Otherwise a reluctant lessee could be forced to accept an aircraft which does not comply with a material delivery condition on the basis that the lessor states simply they will be provided promptly thereafter and then potentially avoid providing such on the basis of the unconditional acceptance/waiver clause that is usually contained in a lease. Furthermore, the Lease expressly permitted the Lessor to remedy material deviations and this deviation was very much capable of remedy. However, the Lessor instead chose to terminate the Lease after the Lessee had notified the Lessor of the deviation.

"The Case considered many other points which arose in the dispute between the Lessee and Lessor including events of default and where a lessee expresses an intention to not pay its debts, what can be claimed under an event of default indemnity and lessors' rights under cross default clauses."

Although the court dismissed the Lessor's claims in this respect, some parts of the judgment provided clarity on some clauses which are noteworthy and provide some comfort for lessors:

i) **As the Aircraft was still on lease to the Prior Lessee at the time of tender for Delivery, was the Lessor in the position to lease the Aircraft to the Lessee?** The Lessee claimed it was not required to accept Delivery as the Aircraft was at such time still on lease to the Prior Lessee and the Lessor was not in the position to deliver the Aircraft. This claim was rejected by the court as such leasing was terminable at any time by the Lessor and these were not valid grounds for the Lessee to refuse to accept Delivery; and

ii) **What did the Lessee need to demonstrate in terms of deviation from the Delivery Condition?** The Lease provided that the Lessee was not obliged to accept the Aircraft if it "was able to demonstrate" a deviation from the Delivery Condition, in which case the Lessee contended it did not actually need to demonstrate deviations, just that such existed and it is capable of demonstrating such. The court rejected this claim by the Lessee and a lessee does actually need to provide some specific detail as to deviations to the lessor in order to afford the lessor with an opportunity to rectify them.

TAKEAWAY POINTS FOR LESSORS:

i) **Obligations to consult and provide reasonable notice**: if the delivery provisions contain an obligation on the lessor to consult with the lessee, especially on a matter as specific as the actual delivery date, the lessor should demonstrate that it has at least attempted to do so. Likewise, if a lessor is required to provide reasonable notice, it must do so. If the lessee fails to engage in the delivery process, then it is not entitled to rely on such failure as a basis to refuse its obligation to take delivery because, for example, it has not been able to establish whether the Aircraft is the delivery condition. Notwithstanding a lack of engagement and even an express intention to not take delivery from the lessee, if the lessor states its intention to tender the aircraft for delivery, it has to follow the agreed process and timelines set out in the lease. As an alternative, the lessor might consider stating that it will not tender the aircraft for delivery on the basis of anticipatory breach, but this is a remedy with different considerations (and which we do not address in this article). Also, a lessor may be well advised to consider replacing 'reasonable notice' with a specific agreed number of days for reason of certainty and clarity. The lessor can introduce some flexibility with an agreement to vary such time period with the written agreement of the lessee;

ii) **Delivery Conditions**: leases are often drafted on the basis that the lessor will use reasonable endeavours to procure that the aircraft conforms with the delivery conditions and it is the lessee's right to refuse to accept if there are material deviations. If the lessor forces the issue with an uncooperative lessee and tenders the aircraft for delivery, it needs to ensure the aircraft is in the delivery condition regardless of whether the lessee expressed an intention to not accept the aircraft in any circumstances. Otherwise, the lessor should explore the possibility of terminating the agreement in anticipatory breach which, as stated above, requires other considerations beyond the scope of this article;

iii) **Drafting**: the value of dispensing with words in a clause which do not seem to add value is always worth consideration. The Lessee was able to construct an argument that it did not need to demonstrate the existence of any deviations from the Delivery Condition to the Lessor, but that it was sufficient that such just exist. The word 'able' in this relevant clause in the Lease did not just fail to add value, it also potentially gave the Lessee the ability to construct an argument adverse to the Lessor which was clearly not in the Lessor's contemplation when entering the agreement; and

iv) **Timing redelivery with delivery**: if an aircraft is leased pursuant to a prior lease up to and even at the time an aircraft is tendered for delivery pursuant to a new lease, this cannot be used as grounds for a lessee to refuse to accept an aircraft, provided the lessor can terminate the prior lease at the very latest simultaneous with delivery pursuant to the new lease. Therefore, the case does not impact on lessors' ability to manage redeliveries to coincide with new deliveries.

The Case considered many other points which arose in the dispute between the Lessee and Lessor including events of default and where a lessee expresses an intention to not pay its debts, what can be claimed under an event of default indemnity and lessors' rights under cross default clauses. Lessor may, in light of the issues we have considered with regards to whether the Lessee was obliged to accept the Aircraft when tendered for Delivery, consider to revisit the delivery clause in their standard form lease, but also the case provides a good reference for a lessor's approach to a dispute where it has grounds to believe a lessee may not have any intention to accept an aircraft when tendered for delivery.

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