Aerospace

May 2012

ACG V OLYMPIC AIRLINES, REVISITED

The unsuccessful summary judgment application in *ACG Acquisition XX LLC v Olympic Airlines SA* back in April 2010 drew attention mainly for disapplying the "hell or high water" provision in a lease, albeit temporarily and under a rather unusual set of circumstances.

Unsurprisingly, the case then went to trial, and the eagerly anticipated judgment was handed down on 30 April 2012, finding that (i) notwithstanding the fact that ACG was in breach of its contractual obligation to deliver an airworthy aircraft, Olympic was estopped from alleging that the aircraft did not comply with the delivery condition under the lease and (ii) that, as a consequence, the airline was not allowed to withhold payments any longer, nor was it entitled to counterclaim damages for ACG's breach. In addition, this judgment presents the first ever consideration by an English Court of the term "airworthiness".

As readers may recall, the factual background of this dispute was as follows:

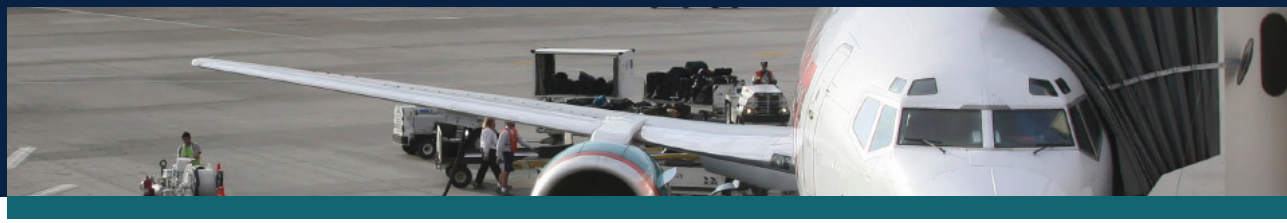
1. ACG leased, and Olympic took on an operating lease, of one B737 aircraft for a period of five years.

2. The lease required ACG to deliver the aircraft in an "airworthy" condition, but also provided that a signed certificate of acceptance was conclusive proof of the aircraft being in delivery condition.

3. ACG delivered the aircraft to Olympic, but soon thereafter it transpired that the aircraft was not airworthy and it was grounded. Olympic stopped paying rent and withheld maintenance reserves payments.

4. ACG issued proceedings for recovery of rent and damages. Olympic counterclaimed, alleging that ACG had breached the lease agreement and claimed damages, stating that its breach amounted to a total failure of consideration.

At trial, Teare J considered the meaning of the word "airworthy" and concluded that it



depended on *"its true construction in the context of the lease in which it is found, having regard to the factual background of which both parties are aware. The lease in this case is of an aircraft intended for the safe carriage of passengers. In that context the ordinary and natural meaning of airworthy is […] fit or safe for the carriage of passengers by air. Whether a particular defect renders an aircraft unfit or unsafe for flight will depend upon the function of the part in question and the severity of the defect. It will not depend upon whether the operator of the aircraft knows of the defect or not".*

Consequently, the judge found that, as a matter of fact, the aircraft was not airworthy at delivery and, as such, ACG was in breach. Notwithstanding this, Teare J considered that breach in the context of the acceptance certificate that Olympic had signed and, in particular, the clear and unequivocal representation in it that the aircraft complied in all respects with the lease and concluded that it created an estoppel which prevented Olympic from using the actual aircraft condition in furtherance of its defence and counterclaim.

It is worth noting that, in reaching these conclusions, Teare J was heavily reliant on the fact that Olympic was a major airline who would have been well within its right to inspect the aircraft more thoroughly than it did and to record any adverse findings as "discrepancies" in the acceptance certificate or even to reject it. It is therefore at least conceivable that this judgment could have had a different outcome had the airline in question been smaller and with more limited resources and technical expertise, especially when compared with those of a major lessor such as ACG.
On the summary judgment application by ACG, the court had allowed Olympic to withhold rent and reserves payments pending the full hearing, despite the fact that the lease was a "net lease" and contained the unusual "hell or high water" wording requiring it to make payments come what may. The right to withhold payments under the lease, which was primarily predicated by Olympic's contention that ACG's failure to deliver an airworthy aircraft amounted to a total failure of consideration, and therefore no money was in fact payable nor due, was rejected at trial on the same grounds leading to the estoppel mentioned above and Olympic was ordered to settle ACG's claim.

The interrelation between the lease provisions and the acceptance certificate which gave rise to the estoppel, as well as the extent to which the circumstances of this case might have constituted a total failure of consideration, are likely to be further debated on appeal, permission for which we understand has been sought and is likely to be granted. Till then at least, lessees - and arguably purchasers of aircraft - should exercise extra caution when handling aircraft delivery processes. In particular, lessees should create or review their existing aircraft delivery procedures to ensure that:

- Aircraft deliveries are categorised as a "critical" task within the organisation.
- Lease provisions that deal with aircraft deliveries receive proper attention during lease negotiations to ensure that lessee's internal acceptance procedures are reflected, or at least properly allowed for in the lease, and lessee's other interests that may be affected by this process remain protected.
- Teams performing each aircraft delivery are appropriately staffed in all respects.
- Aircraft deliveries are managed and overseen by a person who is sufficiently experienced and senior, with clear reporting lines into management.
- Acceptance certificates are carefully drafted, reviewed and completed to ensure they properly record all discrepancies and the agreed manner in which they would be treated or remedied.
- Each aircraft delivery will be coordinated with other sections of the airline, such as fleet planning and aircraft procurement, so that inspections can be planned in advance and start sufficiently early to avoid having to rush them through under pressure to get the aircraft financed and/or into service.
- Post delivery debrief sessions will be arranged to identify any shortcomings in the process to make sure that they are avoided in future deliveries.

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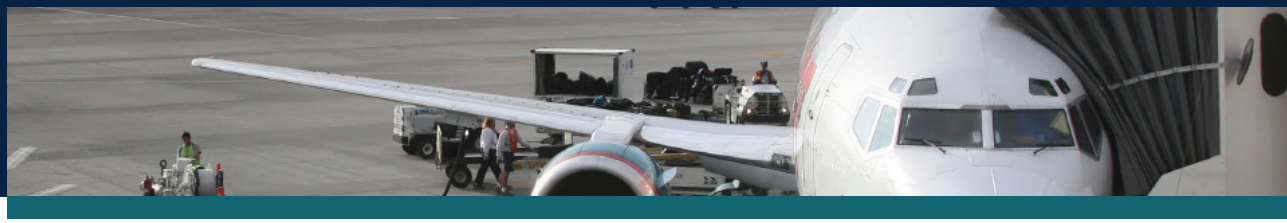

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