Flynn O’Driscoll Legal Update

ACG Acquisition XX LLC v Olympic Airlines SA
An important lesson for lessees on delivery condition of an aircraft

Background

In May 2012 the English High Court outlined their decision in the case of ACG Acquisition XX LLC v Olympic Airlines SA. The case surrounded the circumstances in which the defective condition of a leased aircraft might entitle the airline to refuse to pay rent. Understandably the case attracted a great deal of interest from the international aviation community, in particular lessees as the High Court awarded judgment in favour of the Lessor. The High Court granted leave to appeal and the Court of Appeal have now delivered their judgment. The judgement has once again been given in favour of the Lessor, thus emphasising the risks for lessees in signing a certificate of acceptance.

Brief Facts

In 2008 ACG Acquisition XX LLC (the “Lessor”) entered into an operating lease (the “Lease”) with Olympic Airlines SA (the “Lessee”) pursuant to which the Lessee agreed to lease a Boeing 737-300 aircraft (the “Aircraft”) for a period of five years.

The Lease contained an undertaking from the Lessor that upon delivery, the Aircraft would comply with the detailed delivery conditions specified in the Lease (the “Delivery Conditions”).

The Lessee signed a certificate of acceptance on delivery of the Aircraft on 19th August 2008 (the “Certificate of Acceptance”) and the Aircraft was put into operation on 23 August 2008. Just 15 days later, the Aircraft was grounded as cables which controlled the flaps on one of the wings were discovered to be damaged. The Aircraft was sent for repair and during the repair the Lessee discovered 14 categories of defects which were considerable enough that the Hellenic Civil Aviation Authority withdrew the Aircraft’s certificate of airworthiness (“CofA”), thereby grounding the Aircraft.
In September 2009 the Lessor issued proceedings against the Lessee for payment of outstanding rent and maintenance reserves and for damages. In response, the Lessee issued a claim against the Lessor seeking damages for breach of the Lease, in particular the provisions relating to the Delivery Condition of the Aircraft.

The Lease
The three important clauses of the Lease considered in the case are outlined below.
Clause 4.2 obliged the Lessor to deliver the Aircraft “as is, where is” and in the condition required in Schedule 2, which set out the Delivery Conditions.

Clause 7.9 specified that the Certificate of Acceptance would be “conclusive proof” that, amongst other things, the Aircraft and the Aircraft documents were satisfactory to the Lessee.

The certificate of acceptance included a confirmation from the Lessee that the Aircraft complied in all respects with the condition required at delivery under Section 4.2 and Schedule 2.

The Legal Arguments
It was argued by the Lessor that the execution of the Certificate of Acceptance by the Lessee in respect of the Aircraft indicated that the condition of the Aircraft conformed to the requirements of the Lease and was in an airworthy condition. They further argued that if the Aircraft was not in an airworthy condition, the Lessee was estopped from asserting that it was not delivered in accordance with the Lease by the terms of the Certificate of Acceptance which the Lessee had executed. It was also argued that the Lessee’s non-payment of lease rentals was a repudiatory breach of the Lease.

In response, the Lessee argued that the Aircraft was not delivered in the specified Delivery Condition, the Aircraft was not airworthy and that it was not estopped from making its claims by virtue of the terms of the Certificate of Acceptance. Furthermore, the Lessee argued that there had been a total failure of consideration or the Lease was frustrated by the suspension of the Aircraft’s CofA. It argued that as a consequence of these facts, the Lessee had never been obliged to pay lease rentals and could claim damages for breach of the Lease.

High Court Judgment
As mentioned above, in the High Court Justice Teare found in favour of the Lessor. Although he accepted that the Lessor was in breach of the Lease as the Aircraft was not in an airworthy condition on delivery, he held that by virtue of the fact that the Lessor had relied upon the confirmations given in the Certificate of Acceptance, the Lessee was prohibited from making its claim for damages and its claim that it was not obliged to pay rent or maintenance reserves. It also found that the Lease was not frustrated by the withdrawal of the Aircraft’s CofA.

The Judge found that it would be inequitable for the Lessee to be permitted to allege that the condition of the Aircraft on delivery did not comply with the Delivery Conditions set out at Schedule 2 of the Lease, contrary to the
clear and unequivocal representation in the Certificate of Acceptance. Further, the Judge noted the fact that the Lessee was aware that the Certificate of Acceptance would be signed before the Lessor accepted redelivery of the Aircraft from the previous lessee, Air Asia, and of the Lessors reasons for adopting such a procedure. The Lessor then relied on this representation and in so doing, it acted to its detriment in giving up its right to refuse to accept redelivery of the Aircraft from Air Asia on account of the Aircraft’s condition.

The Judge did not agree with the Lessor’s argument that the conclusive proof clause as drafted precluded a claim for damages for breach by the Lessor of its obligation to deliver the Aircraft in Delivery Condition. In the absence of a direct reference to clause 4.2 and Schedule 2 of the Lease in the conclusive proof clause, the Court held that that clause operated only as a waiver of any right the Lessee might otherwise have to refuse to accept the Aircraft, as opposed to the right to claim damages for breach of the Lease.

Interestingly, in the absence of any prior legal authorities in relation to the definition of “airworthy”, the Judge drew a parallel with “seaworthy” and provided the following legal formulation: ‘Would a prudent operator of an aircraft have required that the defect 3 should be made good before permitting the aircraft to fly, had he known of it. If he would, the aircraft was not airworthy. It is therefore a question of fact and does not depend on whether any defect was known.

**Court of Appeal Judgment**

From The Court of Appeal reassessed the effect of the conclusive proof clause and held that having regard to both the conclusive proof clause together with the Certificate of Acceptance, the Lessee had conclusively agreed that the Aircraft was in Delivery Condition.

The Court of Appeal highlighted the fact that it is commonplace for parties to “strive to achieve finality in relation to allocation of risk and responsibility”, particularly in circumstances where neither could be certain of an Aircraft’s condition at the point at which the lessee is called upon to accept delivery and the ongoing risk.

The Court of Appeal appears to have taken the view that the role of a lessor is largely financial in nature, specifically to raise finance to acquire and lease out aircraft; and a lessor does not typically undertake maintenance of the aircraft other than during any hiatus of operational inactivity between one lease and another. By contrast, in the view of the court, lessees operate and maintain aircraft and a lessee will generally have the opportunity to inspect the aircraft and, if it is not in Delivery Condition, either to reject it or to list material discrepancies and to accept the aircraft subject to their correction.

**Conclusion**

From a practical perspective the judgement highlights the need for a lessee to satisfy itself, as far as possible, with the condition of the aircraft at delivery, in particular Lessee’s need to ensure they have sufficient occasion
to inspect the aircraft, its records and carry out an inspection flight in advance, understanding that it may bear the risk of any defects discovered thereafter.

Whilst the case must be viewed against the particular wording of the Lease, it does, highlight the need for careful drafting to achieve commercial certainty when allocating risk. Having regard to the definition of “airworthy” formulated by Justice Teare, any such references in documentation governed by English law must now be construed in light of this definition and parties should exercise caution in giving an undertaking that an aircraft is airworthy.
Should you have any queries arising out of the foregoing please contact either of the undersigned who will be happy to assist.

Patrick G Flynn  
Managing and Founding Partner  
E: patflynn@fod.ie  
P: 01 6424250

James D Duggan  
Partner  
E: jamesduggan@fod.ie  
P: 01 6424252

Dublin:  
1 Grants Row, Lower Mount Street, Dublin 2, Ireland  
Phone: +353 1 6424220  
Fax: +353 1 6618918

Galway:  
Unit 23, Galway Technology Centre, Mervue Business Park, Galway, Ireland  
Phone: +353 91 396540  
Fax: +353 91 792649