On 17 April 2013 the Court of Appeal handed down its long awaited judgment in the Olympic Airlines v ACG Acquisition XX LLC case. The case has generated much interest among the aviation community and this recent judgment is likely to be welcomed by lessors and financiers seeking to rely on contractual mechanisms in order to manage risk and responsibility.

Background

In August 2008, ACG Acquisition XX LLC (‘ACG’), the aircraft lessor, agreed to lease a 17-year-old Boeing 737-300 aircraft to Greek flag-carrying airline, Olympic Airlines (‘Olympic’), the lessee. The lease was a five year ‘dry’ operating lease in which Olympic agreed to accept the aircraft on an ‘as is, where is’ basis. ACG undertook to deliver the aircraft in an airworthy condition, suitable for commercial service and in compliance with various other requirements. On 19 August 2008, Olympic duly executed a Certificate of Acceptance which, in accordance with the lease, constituted conclusive proof that it had accepted delivery of the aircraft. On the same day, ACG accepted redelivery of the aircraft from its previous operator, AirAsia.

Following delivery the aircraft commenced commercial service almost immediately. However, shortly after, problems began to appear: in a pre-flight inspection in Athens on 6 September 2008, inspectors uncovered corrosion and various other defects with the aircraft, including a broken spoiler cable on the left wing. The Greek Civil Aviation Authority (the ‘CAA’) promptly suspended the aircraft’s airworthiness certificate. The aircraft was grounded and Olympic refused to pay rent.

Olympic sent the aircraft to Europe Aviation, a facility selected by the lessor for repair. However, the aircraft was not repaired to the standard required by the CAA and in October, Olympic ceased trading. In March 2010, ACG terminated the lease and sought redelivery of the aircraft and damages.

The High Court decision

ACG claimed that Olympic was liable for payment of rent and maintenance reserves totalling US$4.6m for the period up until redelivery, and US$6.9m in damages for loss of rent from return until the expiry date of the lease. Olympic counterclaimed damages for breach of contract, claiming that the aircraft was not, in fact, in the delivery condition required by the lease. In particular, Olympic argued that the aircraft was not ‘airworthy’. They claimed €6.8m to cover the cost of hiring a replacement aircraft and the cost associated with attempting to return the aircraft to an airworthy condition. In the alternative, Olympic claimed:
firstly, that it was entitled to reclaim rent and maintenance reserves on the basis that there was a total failure of consideration and, secondly, that the lease was frustrated on termination of the aircraft’s airworthiness certificate by the CAA.

ACG further claimed that, in the event that the Court found that the aircraft was not airworthy or in the delivery condition required, Olympic had signed the Certificate of Acceptance, which constituted conclusive proof that the aircraft complied with the conditions required under the lease at the time of delivery. Hence, Olympic’s acceptance meant that it should be prevented from succeeding in its claim, either on the basis of contractual agreement or under the principle of estoppel by representation.

The Court did not agree with ACG’s contractual argument, namely that execution of the Certificate of Acceptance constituted conclusive proof that the aircraft was in the required condition at delivery. It said that the Conclusive Proof Clause made no direct reference to the required delivery conditions of the aircraft, as detailed in Clause 4.2 and Schedule 2 of the lease. Instead, the effect of the Clause was to waive any rights that Olympic might have had to refuse to accept the aircraft. It did not preclude Olympic from claiming damages for ACG’s failure to deliver the aircraft in accordance with the required delivery conditions.

However, the Court did accept ACG’s alternative argument in relation to estoppel by representation. It held that representations made by Olympic in the Certificate of Acceptance were such that it would be inequitable for Olympic to subsequently be allowed to allege that the aircraft did not comply with the lease conditions. It emphasised that Olympic had ample opportunity to inspect and test the aircraft before it accepted delivery. Further, Olympic was aware that upon signing the Certificate of Acceptance, ACG would rely upon representations made in the Certificate in order to accept redelivery from AirAsia. ACG, in relying on such representations, was acting to its detriment, since it would no longer have the right to refuse redelivery on grounds of the aircraft not being in the required condition. The Court also found against Olympic’s alternative arguments in relation to failure of consideration and frustration.

The Court of Appeal decision
Olympic appealed the decision of the High Court. It claimed that the Judge was wrong to find that the provisions of the lease agreement and Certificate of Acceptance, whilst ineffective at amounting to contractual estoppel, nevertheless amounted to estoppel by representation. ACG reiterated its argument from the earlier hearing, namely, that of contractual estoppel.

In handing down its judgment, the Court of Appeal found that the lower Court had come to the correct conclusion but had done so using incorrect reasoning.

Allocation of risk and responsibility
The Judge began by explaining the dangers of drawing parallels between aircraft operating ‘dry’ leases and similar maritime documents, such as time charters of ships. He referenced the case of 

Pindell v AirAsia, in which he emphasised such dangers.

He went on to give a detailed analysis of the position of the lessor in aircraft transactions. He noted that a lessor’s role was essentially a financial one. It does not, except for the brief interim between
leases, get involved with the operation of the aircraft. Lessees, however, are responsible for the day-to-day operation of the aircraft.

The Judge then discussed the complexities associated with risk allocation in aviation transactions. He stated that:

‘the complexity of a modern passenger aircraft is such that, in the absence of some contractual mechanism whereby compliance with the contractually required delivery condition can be conclusively determined, parties to leases such as this could face years of uncertainty as to the allocation of responsibility for defects of which neither of them were aware on delivery.’

The Judge noted that because of such complexities, industry practice is such that the lessee elects whether or not to accept lease of an aircraft, notwithstanding the fact that it may later transpire that the aircraft did not comply with the required delivery conditions. He went on to note that, in this situation both parties acknowledged that a full inspection of the aircraft was impossible. It would take a complete disassembly in order to be sure that the aircraft was free from any undiscovered defects.

Therefore, the Judge acknowledged that parties to aviation transactions must agree upon allocation of risk and responsibility in the contractual documentation. The question before the Court in this instance was whether the contractual mechanisms put in place by ACG were enough to achieve such end?

The contractual estoppel argument

The Court of Appeal agreed with ACG’s contractual estoppel argument and, in doing so, confirmed that ACG’s contractual mechanisms for allocating risk and responsibility were effective. Consequently, Olympic’s execution of the Certificate of Acceptance was conclusive proof that it had accepted the aircraft and it was precluded from subsequently alleging that it was not satisfactory.

The Judge felt that there was no ambiguity surrounding the wording of the Certificate of Acceptance or the lease. Despite this, the lower Court had failed to give such wording its clear meaning and effect. The Judge noted that the wording of the Certificate of Acceptance was not entirely consistent with the Conclusive Proof Clause in relation to examination of the aircraft. However, he said that this was irrelevant, stating:

‘it is implicit in the Certificate of Acceptance, read with the lease, that the lessee has indeed examined and investigated the aircraft or that it is content to confirm the aircraft’s condition without such an examination.’

As discussed above, the High Court found that the Conclusive Proof Clause did not make express reference to Clause 4.2 or Schedule 2 to the lease. This led it to conclude that the Clause did not preclude Olympic from claiming damages for breach of ACG’s obligations as to the required condition of the aircraft. However, the Court of Appeal felt that such express reference did not matter:

‘Clause 7.9 refers to Clause 4.2 and to Schedule 2 by clear implication. That the reference is not express does not, I think, mean that the reference is insufficiently clear nor does it prevent the words being given their natural meaning. Their
natural meaning is that the aircraft has been examined and investigated, that it has been found in the condition required for delivery, and that it has accordingly been accepted on (or for) lease.’

Thus, the Court of Appeal agreed with the High Court in relation to the Conclusive Proof Clause, specifically that it confirmed Olympic’s acceptance of the aircraft and the obligation to begin to pay rent, but, crucially, the Court of Appeal found that the Clause went further still. It took a more commercial stance and said that it also had the effect of precluding Olympic from alleging that the aircraft was not in compliance with the conditions required under the lease, preventing Olympic from claiming damages. The Court said that:

‘Clause 7.9 and the associated Certificate of Acceptance is a very elaborate mechanism if all it achieves is conclusive proof that the lessee has accepted delivery and thus the obligation to begin to pay rent, but has not accepted that the aircraft was in fact in the condition required to trigger an obligation to accept delivery.’

Conclusion and impact

The Court of Appeal decision has been welcomed by members of the aviation community and, in particular, by financiers and lessors seeking to rely on contractual provisions for risk allocation, including ‘as is, where is’ and conclusive proof clauses. In arriving at its judgment, The Court of Appeal has demonstrated that it has a sound commercial understanding of the realities facing aircraft lessors. It acknowledged the distinction between aircraft and shipping transactions and identified the complexities facing parties to aircraft lease agreements. In particular it noted that dismantling an aircraft for full investigation before acceptance is commercially unrealistic. Thus, it has given credence to the contractual mechanisms relied upon to establish certainty by aviation lessors and financiers.

Notes

1. Olympic Airlines SA (in special liquidation) v ACG Acquisition XX LLC (2013) EWCA Civ 369
2. ACG Acquisition XX LLC v Olympic Airlines (in special liquidation) (2012) EWHC 1070 (Comm)
3. Pindell v AirAsia (2011) 2 ALL ER (Comm) 396