
FORCE MAJEURE AND AIRCRAFT ACQUISITION CONTRACTS: WHAT SHOULD AIRLINES DO?†

by

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SYNOPSIS

SYNOPSIS	505
ABSTRACT	505
RÉSUMÉ.....	506
I. INTRODUCTION	507
II. AIRCRAFT LEASING	507
III. THE EFFECTS OF COVID-19.....	508
IV. LEGAL ANALYSIS.....	509
A. THE DOCTRINE OF FORCE MAJEURE	509
B. DOCTRINE OF FRUSTRATION.....	510
C. HELL OR HIGH-WATER CLAUSE.....	511
V. CONCLUSION AND RECOMMENDATIONS.....	511
A. THE VIGILANCE OF MALAFIDE INTENTION	512
B. NOTICE PERIOD	512
C. DEFERRED PAYMENTS.....	513
D. INTEREST ON PAYMENT IF NECESSARY	513

A B S T R A C T

The aviation industry has been suffering due to the ongoing COVID-19 pandemic, commonly called the Coronavirus. The amount of time both international and domestic flights were curtailed or stopped altogether will have a long-term effect on the aviation industry. Even though the operations are being steadily resumed, there remains uncertainty regarding the number of passengers flying because of virus fears and economic impacts. COVID-19 has led to constant drops in airline

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revenues. On the other hand, their expenses continue in the same manner as before the pandemic. This lack of revenue has resulted in airlines laying off employees or having their employees take leave without pay. These social and economic conditions are entirely unprecedented for airlines who rely mostly on leasing aircraft and now face severe challenges in making rental and maintenance reserve payments to lessors. Since the possession of the aircraft remains with the lessee, it is ideal for lessors to be paid under the lease agreement. In this article, the author analyses the legal implications of these issues. The author also attempts to give some plausible and constructive recommendations that benefit the airlines without injuring the lessors' legal rights.

R É S U M É

Le secteur de l'aviation a beaucoup souffert en raison de la pandémie de la COVID-19, communément appelé le Coronavirus. La période pendant laquelle les vols internationaux et nationaux ont été réduits ou complètement suspendus aura sans aucun doute un effet à long terme sur l'industrie aéronautique. Même si les opérations reprennent progressivement, l'incertitude demeure quant au nombre de passagers qui prendront l'avion et ce, en raison des craintes liées au virus et de ses répercussions économiques. La COVID-19 a entraîné une baisse constante des revenus chez les compagnies aériennes. D'autre part, les compagnies aériennes continuent à assumer leurs obligations financières et leurs dépenses de la même manière qu'avant la pandémie. Leur manque de revenus a cependant conduit les compagnies aériennes à congédier leurs employés ou les mettre en congé sans solde. Ces conditions sociales et économiques sont tout à fait inédites pour les compagnies aériennes qui dépendent principalement de la location d'aéronefs et qui auront désormais beaucoup de difficultés à verser aux bailleurs leurs loyers et leurs réserves d'entretien. Étant donné que le locataire reste en possession de l'aéronef, les bailleurs ont avantage à être payés dans le cadre d'un contrat de location. Dans cet article, l'auteur analyse donc les implications légales de ces questions, et tente de fournir quelques recommandations réalistes et constructives qui pourraient bénéficier les compagnies aériennes sans porter atteinte aux droits légaux des bailleurs.

K E Y W O R D S

Aircraft, Agreement, Doctrine Finance, Frustration Force Majeure, Lease, Possession, Pandemic, Payment.

I. INTRODUCTION

The effects of the pandemic on aviation will have longstanding impacts in the industry. In the meantime, our actions should be to minimise the damage to the industry and gradually work towards generating revenue. In the field of aircraft leasing, the currently active contracts might get breached by the lessee's inability to pay the lessor. Some lessees may even try to take advantage of the situation by getting rid of unfavourable contracts. All of this will act as a hindrance in getting the aviation industry back on regular terms.

The author in this article will first explain how leasing works in the aviation industry. The author will then examine if the lessee has an option to avoid payment under any common law doctrine. The author will also be suggesting actions to be taken in the absence of any such defence.

II. AIRCRAFT LEASING

A lease agreement is defined as:

an agreement under which the owner gives up the possession and use of his property for a valuable consideration and for a definite term. At the end of the term, the owner has the absolute right to retake, control and use the property.¹

In the aviation industry, an aircraft lease is an agreement between parties to lease aircraft. An aircraft is an expensive asset; this leasing method therefore allows some airlines to remain operational without buying a single aircraft or having the option of leasing part of its fleet. Most airlines in today's economy use this tool to lessen the financial cost or burden of buying aircraft. The aircraft leasing is generally divided into two categories, which are defined as follows:

Wet lease – "Wet leasing of an aircraft entails the transfer for use of an aircraft along with the cockpit crew, cabin crew, maintenance and hull insurance. A wet lease is similar to an aircraft charter, except that the wet lessee must be an airline holding its own operating licenses and permits, and the aircraft must be operated under the lessee's flight designator codes and route authorities."²

¹ *Transamerica Leasing Corp. v Bureau of Revenue*, 80 NM 48 450 P 2d 934 (Ct App N Mex 1969).

² Donald H. Bunker, "Aircraft Wet Leasing: The Perils and the Benefits" (2000) 25 *Ann Air & Sp L* 67 at 67-68.

Dry lease— “[A] lease of an aircraft where the aircraft is operated under the AOC [air operator’s certificate] of the lessee. It is normally a lease of an aircraft without crew, operated under the commercial control of the lessee and using the lessee’s airline designator code and traffic rights.”³

In both categories, there are no maintenance charges for flight crew or any other expenses, such as insurance.

III. THE EFFECTS OF COVID-19

For airlines to afford those time-bound payments to lessors, they need to generate revenue. To do so, the airline companies rely upon the sale of tickets and further services during travel. This revenue is entirely dependent upon people traveling from one place to another. The COVID-19 pandemic and its subsequent lockdowns worldwide hit the very core of the industry on two levels.

First, the lockdown prevented people from moving forward with their existing travel plans, which led to the cancellation of their tickets and gave rise to refunds in most cases. Secondly, the uncertainty with regards to when this pandemic will end deterred people from making any travel plans and thus had a chilling effect on future air travel bookings. Both these scenarios have led to airlines suffering a colossal loss of revenue. For instance, the International Air Transport Association (IATA) expects net airline industry losses of US\$ 47.7 billion in 2021. This is an improvement on the estimated net industry loss of US\$ 126.4 billion in 2020.⁴

As a result of COVID-19, some airlines were and still are unable to make payments to the lessors and have gone bankrupt.⁵ However, aircraft leasing companies rely upon these payments as their source of revenue. If the airlines fail to pay the agreed amount, it creates the same economic blockade for the leasing companies.

³ ECAC, “ECAC Recommendation on Leasing of Aircraft – Recommendation ECAC/21-1” (July 1997) at 3, online (pdf): ECAC <www.ecac-ceac.org/images/documents/ECAC-Recommendation_21-1_1997.pdf>.

⁴ See IATA, “Reduced Losses but Continued Pain in 2021” (21 April 2021), online: IATA <www.iata.org/en/pressroom/pr/2021-04-21-01/>.

⁵ See Ezra Fieser, “The world’s second-oldest airline has gone bankrupt” (11 May 2020), online: *Fortune* <fortune.com/2020/05/11/avianca-holdings-airline-bankruptcy/>.

IV. LEGAL ANALYSIS

In such circumstances, the lessee will ideally seek to avoid making payment without giving up the possession of the aircraft or terminating the contract. COVID-19, being an unavoidable scenario, is beyond the airlines' direct control. There is nothing on their part that can be done, and this vulnerability (COVID-19) should therefore be considered in their favour.

There are two doctrines in the legal sphere that consider this vulnerability as a defence, hence lessees are likely to rely upon these: (1) the doctrine of force majeure and (2) the doctrine of frustration.⁶ Hereon, the author will analyse if any of the two doctrines is applicable or has any hope for relief towards lessees in the context of the COVID-19 pandemic.

A. THE DOCTRINE OF FORCE MAJEURE

Under common law, force majeure is neither defined in a statute nor any case law. However, Black's Law Dictionary defines it as "[a]n event or effect that can be neither anticipated nor controlled."⁷ It translates from French as a "superior force". In general, contracts of supply and construction have this type of clause to cover events where a contractor is unable to finish the work on time because of reasons beyond his or her control, such as wars, riots, curfews, or specific acts of God (e.g., floods, earthquakes, cyclones, etc.). It has to be kept in mind that the application of force majeure is not by default,⁸ especially in common law jurisdictions. The courts will not consider the defence of force majeure unless and until it is mentioned clearly in the contract.

If a force majeure clause does exist in the lease agreement, the next step will be to prove that COVID-19 can be termed as a force majeure. In March 2020, COVID-19 was declared to be a pandemic by the World Health Organization.⁹ Since then, several central and State governments around the globe have issued notifications with regards to disruptions of

⁶ See *Indian Contract Act*, 1852, s 56.

⁷ Bryan A Garner, *Black's Law Dictionary*, 9th ed (Eagan, Minnesota: West Publishing Co Law Books, 2009) at 718.

⁸ See *Taylor v Caldwell*, [1863] EWHC QB J1 122 ER 309.

⁹ See WHO, "WHO Director-General's opening remarks at the media briefing on COVID-19 - 11 March 2020" (11 March 2020), online: WHO <www.who.int/dg/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---11-march-2020>.

the supply chain,¹⁰ and governments have imposed State-wide lockdowns and complete travel bans. These events leave no room other than to conclude that COVID-19 does constitute force majeure. However, not every breach of contract during the period of COVID-19 can benefit from the defence of force majeure. It is of utmost importance to prove that the breach in the contract or the inability on behalf of one party is caused by that very reason, i.e., the pandemic. To demonstrate force majeure and the lessee's resulting inability to make payments to the lessor, the lessee has to show that such inability has directly or unswervingly been caused by hardships imposed by the COVID-19 pandemic and not otherwise.

B. DOCTRINE OF FRUSTRATION

In the absence of force majeure, the doctrine of frustration can be applied to discharge a party from its contractual duties and performance. This doctrine provides for the discharge of a valid contract on the grounds of frustration due to an event or happening of such circumstance that renders the contract's performance physically or commercially impossible, or transforms the obligation to perform into a radically different obligation than what was initially agreed upon by the parties.¹¹

As such, this may seem like the best defence to argue in favour of the lessee, but if the precedents regarding frustration are evidence of the high threshold of this doctrine,¹² it is highly unlikely that COVID-19 frustrates the performance of any aviation contract. Merely because a contract becomes onerous or becomes economically expensive at one end is not enough to frustrate a contract.¹³ Most airline lease agreements contain a clause of hell or high-water, which if present, nullifies any possibility of frustration.

¹⁰ See Adam Kelly, "Coronavirus COVID-19 and force majeure: How are your contracts being affected? (Europe)" (12 February 2020), online: *DLA Piper* <www.dlapiper.com/en/qatar/insights/publications/2020/02/novel-coronavirus-and-force-majeure-how-are-your-contracts-being-affected/>.

¹¹ William Stewart & Robert Burgess, *Collins Dictionary of Law* (Glasgow, United Kingdom: HarperCollins Publishers, 2001) at 179.

¹² See *Krell v Henry* (1903), [1903] EWCA 2 KB 740; *Davis Contractors Ltd v Fareham* (1956), [1956] UKHL 3 AC 696.

¹³ See *Standard Retail Pvt. Ltd. v M/s G.S. Global Corp & Ors.* (2020), (Bombay High Court, India).

C. HELL OR HIGH-WATER CLAUSE

It is reasonable to assume that every air lease agreement will have a “hell or high-water” clause, which in effect obligates the lessee to pay rent to the lessor for the duration of the lease even in the occurrence of extraordinary circumstances. In other words, this clause creates an absolute liability for the lessee to meet the due payments.

The severity of the clause was further augmented by a court in *Olympic Airlines v ACG*.¹⁴ In this decision, the court stated that in the agreement under review, the lessee had agreed upon the risk associated with the contract, and the hell or high-water clause therefore forbid the defence of force majeure or frustration of contract. Hence, even in an unprecedented scenario such as COVID-19, a hell or high-water clause makes it impossible for the lessee to avoid payments. Even though COVID-19 was unprecedented, its effects generated economic hardships, particularly in the aviation industry. The losses suffered are significant but economic in nature, hence, it only makes the contract burdensome at one end. The liability under the hell or high-water clause is absolute and therefore, economic hardship would not be enough to avoid it.

V. CONCLUSION AND RECOMMENDATIONS

The COVID-19 pandemic has caused restrictions and threats for people travelling from one place to another. It has also led to the imposition of travel bans and the airline industry has been suffering ever since the start of the pandemic. Airlines who generally lease aircraft from other companies are struggling to meet their due payments in the absence of revenue and are looking for ways to avoid making payments. There is nothing which can preclude the lessor from demanding the payments owed to them while the aircraft is in possession of the lessee.

This situation seems unfavourable towards the lessee as there is minimal scope to avoid payments to the lessor even after the source of revenue has been eliminated. The only proper avenue is the existence of a force majeure clause in the agreement, which in general practice is absent from aircraft lease agreements. Conversely, the threshold for frustration is much higher, and economic hardship cannot fulfil it. Therefore, the lessee has to think of new and innovative ways to avoid legal consequences.

¹⁴ *Olympic Airlines SA v ACG Acquisition XX LLC*, [2012] EWCA Civ 1659.

The formation of new contracts reflecting the realities of COVID-19, as well as its long-lasting effects, will take time. This time-lapse is favourable towards none. If we view COVID-19 as a short-term hindrance, then our goal should be to resume air travel operations as soon as possible. Consequently, in the interest of the entire aviation industry, the lessee should be allowed to make deferred payments. This will provide the lessee with enough time to recover the losses suffered through the COVID-19 period. Over time, the lessor will be paid in full along with additional interest to avoid any legal injury.

Given that the issue we are dealing with is unprecedented, the potential damage could be far more significant. As such, our efforts should be aimed towards mending or limiting the damage for all stakeholders. To do so, we might have to take unprecedented steps in the interest of all. Based on the foregoing, the author wishes to propose the following four recommendations to address the issues outlined in this article.

A. THE VIGILANCE OF MALAFIDE INTENTION

It is a matter of no surprise that if a clause of force majeure is in a contract, the lessee will likely use it as a defence for defaulting payments. In that scenario, the court has an obligation towards the lessors' to whom the defence is granted if the payments are defaulting directly due to the COVID-19 pandemic. If the lessee has a history of defaulting payment and COVID-19 is only used as an excuse to justify earlier defaults of payment, no relief should be granted to the lessee. There must be proper vigilance in this regard towards the lessee. The lessee could also be looking to terminate the contract, which has become unfavourable at the lessee's end. Invoking COVID-19 to terminate such contracts should not be allowed and airlines should not use COVID-19 as an excuse for defaulting payments.

B. NOTICE PERIOD

There could be a scenario where a force majeure clause contains a notice period, which could be crucial for the contract. In the absence of the notice, the lessee may not be granted the relief associated with the force majeure clause. If such notice is required, the airline company must deliver the notice within the specified time frame.

C. DEFERRED PAYMENTS

It is in the interest of no one that contracts get completely terminated, as this would lead to huge losses in the aviation sector, including a significant number of jobs and additional disruptions such as framing new contracts, searching for new parties, etc. Hence, to continue the contract instead of avoiding payments, the lessee should be allowed to make deferred payments. Considering that airline operations are resuming, the pace will gradually pick up and there will be an increase in the number of people travelling every day. In the long run, aircraft owners will receive their payments, the aviation industry will recover, and airlines may not have to opt for layoffs as there is no immediate financial liability to be fulfilled.

D. INTEREST ON PAYMENT IF NECESSARY

Since avoiding payment is not possible and because the option of deferred payments seems to be utterly dependent on the mercy of the lessor, there might be a scenario where the lessor does not accept the option of deferred payment and concludes that his legal right arising out of the contract has been violated. In such circumstances, the lessee should promise minimal interest on the late payment. Interest ensures that the lessee's legal right is not getting violated as the lessor is compensated for the delay in the payment. It will certainly increase the burden of the lessee, but since no other option of avoiding payment exists, this may be the only way to survive in the market. In sum, economic hardship is better than the complete closure of the economy.

